IN THE TAX COURT
(WESTERN CAPE HIGH COURT, CAPE TOWN)

Case Nos: 12760, 12828 &12756

In the matter between:

ABC	**First Appellant**
DEF	**Second Appellant**
GHI	**Third Appellant**
and	
THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE	**Respondent**

JUDGMENT DELIVERED ON 14 SEPTEMBER 2011

ALLIE, J

[1] The appeals in these matters deal with four primary aspects:

1.1. Should the gains made on the difference between the value of the shares purchased by the appellants and the price paid, be taxable and if so, should it be in terms of section 8A, section 8C or paragraph 2(a) of the 7th Schedule to the Income Tax Act No. 58 of 1962 (the Act);

1.2. Should the appellants be exempt from paying tax because the period in which additional assessments could be raised had expired without the first proviso to Section 79(1) applying, namely, that the appellants failed to disclose material facts and that such non disclosure

was the cause of the commissioner not so assessing the appellants to tax within the requisite period and that the commissioner is satisfied that that was the reason for the failure to assess timeously;

1.3. Should the appellants be exempt from paying tax because deferred delivery share option schemes such as the one in which the appellants participated were not hitherto assessed on the bases which the respondent now seeks to assess and that the practice generally prevailing as contemplated in the third proviso to section 79(1) as at the date of the relevant assessments precluded the respondent from doing so now.

1.4. Did the appellants have a substantive, as opposed to a procedural, legitimate expectation that they would not be assessed in the manner proposed by the respondent in these matters.

I THE FACTUAL BACKGROUND:

(i) <u>The 1990 Scheme</u>

[2] In 1990, the XYZ group introduced an employee share incentive scheme. Then the XYZ group was made up of the L XYZ Investment Company Ltd (LXYZ) and its subsidiary, XYZ Ltd, both listed on the Johannesburg Stock Exchange, and XYZ Ltd's wholly owned subsidiaries including The XYZ Group (Pty) Ltd (TXYZG), the main trading company. Mr L and his family trusts were the controlling shareholders in LXYZ.

[3] It is evident from the XYZ group's correspondence with participants at the time and the circular to XYZ Ltd shareholders dated 10 January 1991, that the stated objective of the 1990 scheme was to provide employees and executive directors with incentives to work toward the growth of the companies in the XYZ group.

[4] On 25 January 1991, the 1990 scheme was approved at a general meeting of shareholders of XYZ Ltd.

[5] The following is clear from the circular to XYZ Ltd shareholders and the 1990 scheme document:

5.1 1 000 000 LXYZ ordinary shares were initially set aside for the 1990 scheme, consisting of 10% of LXYZ's issued share capital.

5.2 The 1990 scheme provided for two alternative incentives, namely a share purchase scheme and a share option scheme.

5.3 The terms of the share purchase scheme were not implemented.

5.4 The terms of the option scheme allowed the employee the right to exercise the option for a third of the shares each on the third, sixth and ninth anniversaries of the date on which the option was granted, at which times, the shares would be transferred from XYZ Ltd to the employee. After the last anniversary date, the option would lapse if it had not been

exercised. If a participant left the employ of the XYZ group, all options not exercised would lapse.

5.5 During 1995 and 1996 the XYZ group considered proposed amendments to the 1990 scheme to address problems which were identified. From the correspondence with the XYZ group's attorneys and their auditors and from the minutes of meetings of a committee formed by TXYZG to deal with its "Share Options Strategy" and related internal communications, the main problems which the proposed amendments were meant to resolve were the following:

5.5.1 TXYZG, the main employer, was not the grantor of the options and therefore the cost of the option shares would not be tax deductible in the XYZ group and TXYZG would replace XYZ Ltd as the grantor;

5.5.2 To reinforce control by the L Family, LXYZ introduced low-voting shares, namely LXYZ "N" shares with 1/250th of the voting rights of LXYZ ordinary shares;

5.6 Those amendments were however not effected.

[6] In January 1997 The XYZ Group Ltd. prepared a brief for its auditors and attorneys, about the preparation of a new share incentive scheme. The brief

dealt with the problems with the 1990 scheme and the proposed features of the new scheme. These included the following:

6.1 To "*provide the essential benefits of a Share Option Scheme in terms of rewarding and motivating the achievement of superior financial performance and retaining the Group Two of key employees*";

6.2 To be "*market competitive*, "because the 1990 scheme "*may not be competitive from an employee market point of view";*

6.3 To be "*easily administered*", because the 1990 scheme was "*cumbersome and confusing from an administrative viewpoint*";

6.4 To use "*a vehicle that will be directly affected by the financial results of the company (TXYZG)*", because the shares used by the 1990 scheme i.e. LXYZ shares, were "*not necessarily the ideal vehicle*"; and

6.5 To be "*tax efficient to the greatest degree possible for both employer and employee*", because the 1990 scheme "*is not tax efficient either to the employee or employer."*

[7] In December 1997 a memorandum was prepared for Mr L, who was then the chairman of XYZ Ltd, to use at the general meeting of shareholders at which authority for the introduction of the new scheme was sought. The memorandum contained the following about the reasons for the new scheme:

7.1 The scheme is necessary to motivate and maintain "*the focus and commitment of the senior management team";*

7.2 In the period since XYZ had introduced the 1990 scheme, "*new and improved incentive schemes have been devised";*

7.3 Whereas under the 1990 scheme options could be exercised in tranches after 3,6 and 9 years, under the new scheme options were to be granted for a short period only and would be exercised in that period i.e. 21 days, which would have the effect that the participant was bound to purchasing shares from inception and this caused "*more focus and commitment to the business of the company and significant behavioural changes in senior management*";

7.4 In keeping with the trend towards shorter periods, the new scheme would allow executives to enjoy the benefits of share ownership earlier than under the current scheme, namely after 2,4 and 6 years;

7.5 A necessary advantage for the XYZ group was that the new scheme would be operated by TXYZG which earned taxable income and would be able to deduct the costs of the scheme for tax purposes, whereas the existing scheme was operated by XYZ Ltd.

7.6 A further benefit for the participants "*is the fact that in terms of the New Scheme, the tax burden upon the executives is substantially reduced*

and accordingly the benefits accruing to them are correspondingly enhanced. The reciprocal benefit for the group is that less shares have to be made available in order to achieve desired benefit levels."

[8] Mr GHI, the third appellant, obtained his CA. SA in 1971. He was initially employed by the XYZ Group One Limited in 1975 as a divisional director and eventually he headed up the treasury department. The treasury department consists of two parts, namely, financing and commercial and tax issues. The tax executive, Mr E, reported to him. He had been involved with tax at XYZ for a while. He was involved with the 1997 share option scheme from the time of its inception. He also participated in the share option scheme. GHI's evidence about the reasons for adopting a new scheme, was as follows: There were numerous difficulties with the 1990 scheme, including the following:

8.1 "From the company's point of view there was multiple delivery dates, which could be very numerous, which were difficult for administration. There was a significant disturbance concerning the "N" shares, there was a lot of concern about the fact that the option scheme was not in the employer company, giving rise to tax leakage. There was a discussion about the fact that if we put it into a new scheme we could offload unnecessary shares; if you were not using the "N" shares, you could sell them off. There were probably others as well."

8.2 GHI agreed with the proposition put to him during cross examination that "*the new scheme or share incentive schemes in general are offered to employees to retain skilled and valuable staff, and the essential benefits of the share option scheme were … they provided an incentive to enjoy the enhanced value from the grant price to the price on the date of exercise*".

8.3 GHI testified that a very attractive feature of the 1997 scheme was that gains of commercially the same nature which he could have made under the 1990 scheme were "*free of tax*" under the new scheme.

8.4 GHI also said that the shorter vesting periods of two, four and six years, as opposed to three, six and nine years under the 1990 scheme, was a further advantage.

(ii) <u>The Establishment of the 1997 Scheme</u>

[9] On 1 August 1997 Mr D Meyerowitz SC provided TXYZG with an opinion on the tax consequences of the scheme. It was framed in a questions and answer format.

[10] On 4 November 1997 the boards of directors of XYZ Ltd and TXYZG resolved that the Scheme Agreement be signed and approved a circular to shareholders of LXYZ and XYZ Ltd, which was issued on 25 November 1997.

[11] On 10 December 1997 in general meetings, the shareholders of LXYZ and XYZ Ltd approved the scheme and TXYZG, LXYZ and XYZ Ltd signed the Scheme Agreement.

(iii) <u>The Relevant Terms of the 1997 Scheme</u>

[12] The relevant terms of the scheme, which applied to the options exercised by the appellants, are as follows:

12.1 The purpose of the scheme was to give employees an incentive to increase the growth of the company (Clause 2).

12.2 The scheme operated on the basis that options would first be granted before shares could be bought (Clause 5).

12.3 Options granted by TXYZG were exercisable within 21 days of the Notice Date (Clause 5.1

12.3.1 Once the option was exercised those shares became known as "sale shares" (Clause 1.1.18).

12.4 Shares that had been delivered were known as "scheme shares" (Clause 1.1.20).

12.5 A participant did not have to pay the purchase price upon the exercise of the option, but only on delivery to the participant of the scheme shares (Clause 7.1).

12.6 The participants could only take delivery against payment of the scheme shares in three equal tranches on the second, fourth and sixth anniversaries of the Notice Date or on such later date to which delivery was further deferred (Clauses 7.1 to 7.1.3).

12.7 Each of the second, fourth and sixth anniversaries of the relevant Notice Date, was known as an "Implementation Date" (Clause 1.1.8).

[13] Prior to delivery of the scheme shares to a participant:

13.1 the participant could not alienate, transfer, cede, pledge or encumber his or her rights in terms of the scheme, including the right to delivery of the shares (Clause 5.4.1);

13.2 the risks and benefits of the shares did not pass to the participant until they were registered in the name of the participant. (Clause 7.2);

13.3 the participant could not acquire or have accrue to him/her any cash dividends declared in respect of the shares (Clause 5.4.3);

13.4 the participant could not exercise or dispose of any voting rights in respect of the shares (Clause 5.4.3).

[14] If on the implementation date the middle market price per share of the scheme shares due for delivery was less than the consideration payable in respect of such shares and if the participant wished to dispose of such shares, the participant could re-sell them to TXYZG for the same amount for which they were purchased. TXYZG was obliged to purchase them for that amount on the Implementation Date and the amount owing by the participant to TXYZG would be set off against the amount owing by TXYZG to the participant. This is called the "stop loss" provision.(Clause 7.4).

[15] If on the implementation date a participant did not pay the portion of the consideration attributable to the tranche of the shares tendered by TXYZG, TXYZG was entitled to enforce payment against delivery or to cancel the sale without prejudice to its right to claim damages (Clause 7.5).

[16] If on the implementation date, the tranche of shares was delivered and paid for, the risks and benefits of the shares passed to the participant (Clause 7.2).

[17] If at any time prior to the implementation date in respect of a tranche of shares a participant's service with TXYZG was terminated (for reasons other than the sequestration, death, superannuation or ill-health of the participant), the participant was obliged to sell the shares to TXYZG, which was obliged to buy

them at a purchase price equal to the consideration due by the participant (Clause7.3).

[18] TXYZG was entitled to repurchase sale shares in certain specified circumstances (Clause 10).

[19] TXYZG had a pre-emptive right in the event of a participant wanting to sell any scheme shares (Clause 11.1 and 11.6).

(iv) Subsequent Relevant Amendments to the Scheme

[20] On 27 July 1999 the XYZ Share Incentive Trust ("the Trust") was established.

[21] On about 7 September 1999, by means of an addendum to the scheme agreement, TXYZG assigned its rights and obligations in terms of the scheme to the trustees of the trust.

[22] Shortly thereafter LXYZ was unbundled by distributing all its shares in XYZ Ltd as a dividend *in specie* to its shareholders and a reduction of share capital in terms of Section 60 of the Companies Act.

[23] The shares available for the scheme were initially "N" ordinary shares of 0,1 cent each and ordinary shares of 25 cents each in the capital of LXYZ. After the unbundling of LXYZ, the subject matter of the scheme has been ordinary

shares of 0,5 cents each in the capital of LXYZ and ordinary shares of 1,25 cents each in the capital of XYZ Limited.

[24] On 1 April 2000, through the sale of business agreements, TXYZG's business was divided as a going concern between three new operating companies, namely XYZ Group One (Pty) Ltd (XYZ G1), XYZ Group Two (Pty) Ltd and XYZ Group Three (Pty) Ltd, and TXYZG's employees were transferred to the three new operating companies. The appellants became employees of XYZ Group One.

(v) <u>The Implementation of the Scheme</u>

[25] From time to time TXYZG and later the Trust, acting in terms of the scheme, granted options to certain employees to acquire scheme shares at stipulated prices, being either the middle market price of the scheme shares on the relevant Notice Date or such price less a discount of up to 10%.

[26] The Notice Dates in respect of options granted by TXYZG relevant to ABC's appeals were 14 August 1998 and 2 December 1998. The Notice Dates in respect of options granted by the Trust relevant to the ABC's appeals were 19 March 2001 and 1 April 2003. She exercised all of the options.

(vi) **The Additional Assessments**

[27] It is common cause that when the respondent initially assessed ABC to tax on income under the Act in respect of the 2001, 2003, 2005 and 2006 years, he did not include in her taxable income the difference between the cost of shares to her when she exercised options under the Scheme and their market value on the delivery dates.

[28] In June 2008, however, the respondent issued additional income tax assessments to ABC for the 2001, 2003, 2005 and 2006 years of assessment, in which the respondent assessed ABC for tax on income of R18 806 (for the 2001 year), R45 208 (for the 2003 year), R120 163 (for the 2005 year) and R212 488 (for the 2006 year) on certain specified grounds ("the first additional assessments").

[29] On 16 March 2010, in response to amendments to ABC 's grounds of appeal, when she denied that the shares had been delivered to her because instead of being transferred into her name the shares were sold and the net proceeds were paid to her, the respondent issued further additional assessments to the appellant in which, in the alternative to the first additional assessments and in the event that the shares were not delivered to the appellant, the respondent assessed the appellant for tax on income of R18 585 (for the 2001 year), R44 158

(for the 2003 year) and R61 099 and R58 400 (for the 2005 year) and R208 528 (for the 2006 year), on alternative grounds ("the second additional assessments").

[30] Mrs ABC has objected to the first additional assessments on a number of grounds and, by agreement, is deemed to have objected to the second additional assessments.

[31] The respondent has delivered an amended statement of grounds of assessment in terms of Rule 10 of the Tax Court Rules (**"the grounds of assessment"**) in which he has stated the grounds upon which the appellant's objections are disallowed and the material facts and legal grounds upon which the respondent relies for such disallowance. Mrs ABC has delivered an amended statement of grounds of appeal in terms of Rule 11 (**"the grounds of appeal"**) in which she has stated the grounds upon which she appeals, the material facts and legal grounds upon which she relies for such appeal and the facts and legal grounds alleged in the grounds of assessment which are admitted or denied, as the case may be.

[32] The issues in the appeal to this court are those defined in those two sets of statements and as qualified by counsel. The appellants accepted that shares were delivered to them on the Implementation Date by means of constructive delivery, despite the fact that, instead of being transferred into their names, the shares were sold and the net proceeds were paid to those who elected to have the shares sold.

II THE 2001 & 2003 YEAR OF ASSESSMENT

(i) <u>The facts which are Common Cause</u>

The following facts are common cause:

[33] In terms of the scheme the appellant, ABC, entered into the following agreements in terms of which she purchased specified shares at stipulated prices:

33.1 In August 1998 the appellant, ABC, purchased scheme shares from TXYZG. TXYZG's rights and obligations in terms of this agreement were later assigned to the trust.

33.2 In December 1998 the appellant, ABC, purchased scheme shares from TXYZG. TXYZG's rights and obligations in terms of this agreement were later assigned to the trust.

33.3 In March 2001 the appellant, ABC, purchased scheme shares from the trust.

[34] The following were the implementation dates in terms of the sale agreements:

34.1 The August 1998 sale agreement:

34.1.1 first implementation date: 14 August 2000;

34.1.2 second implementation date: 14 August 2002;

34.1.3 third implementation date: 14 August 2004.

34.2 The August 1998 sale agreement:

34.2.1 delayed first implementation date: 2 December 2002;

34.2.2 delayed second implementation date: 7 June 2003;

34.2.3 third implementation date: 2 December 2001.

34.3 The March 2001 sale agreement:

34.3.1 Anticipated first implementation date: 28 February 2003.

34.3.2 second implementation date: 2 March 2005;

34.3.3 third implementation date: 2 March 2007.

[35] Between 2000 and 2002 the Implementation Dates were postponed, by agreement between the Trust and the appellant, mainly because at the time the market price of the shares was low.

[36] Shortly before each of the Implementation Dates, the Trust offered the appellant the choice of having the shares transferred into her name against payment of the consideration or selling them on her behalf and paying to her the net proceeds. In each instance, she asked the Trust to sell the shares on her behalf. The parties reached a formal agreement as to the manner in which such sales were effected.

[37] The important terms of the agreement are as follows:

> *"[1] The scheme shares were purchased by the trust from time to time and were held by the trust's brokers on behalf of the trust. The trust's brokers at the relevant times were Merill Lynch and, thereafter, Investec Securities.*
>
> *[2] At or about the time when the appellant became entitled to delivery of the relevant scheme shares pursuant to the sale agreements, the appellant was given an election by the trust whether to have the relevant scheme shares transferred into her name by the trust or to have all or some of the relevant shares sold by the trust and the net proceeds from such sale(s) paid to her (after deduction of the cost to the appellant of the shares and the selling costs).*
>
> *[3] The appellant notified the trust that she elected that the relevant shares be sold by the trust and the net proceeds from such sale(s) be paid to her.*

[4] Pursuant to such elections (and the same elections made by other employees) the trust instructed its brokers to sell specified numbers of the scheme shares held by the trust's brokers without reference to the identity of the employees. The brokers executed such instructions, and notified the trust of the sales of such scheme shares, the associated costs and the net proceeds resulting from such sales. The brokers paid the net proceeds to the trust.

[5] The trust calculated the net amounts payable to the appellant, based upon the number of scheme shares to which the appellant had been entitled pursuant to the sale agreements, as a proportion of the net proceeds of the sale of shares referred to in paragraph 4 above, and paid such amounts to the appellant.

[6] The relevant scheme shares were never registered in the appellant's name.

[7] The aforegoing applies in respect of all the sale agreements which are the subject of this appeal.

[8] The above agreement does not constitute an admission by the respondent that the sales of the shares were not made on behalf of the appellant nor does it constitute an admission by the appellant that the sales of shares were made on her behalf."

[38] The appellants now accept that the shares were delivered by means of constructive delivery. Therefore, the alternative grounds of assessment raised by the respondent in the second additional assessments and the relevant paragraphs of the grounds of objection and grounds of appeal, which are based upon the shares not having been delivered to the appellants, do not fall to be considered.

[39] On the implementation dates the market values of the relevant shares and the prices payable were as follows:

Date	Market Value	Price Paid	Gain
14/08/2000	R38 806	R20 000	R18 806
14/08/2002	R34 742	R20 013	R14 729
02/12/2002	R19 739	R10 590	R9 148
R28/02/2003	R38 662	R17 331	R21 331

[40] Consequent upon the sale of the relevant shares by the trust, ABC received the following cash payments from the trust:

Date	**Net Proceeds**
19/09/2002	R14 193
09/12/2002	R9 010
28/02/2003	R20 955

(ii) <u>The Issues</u>

[41] The following are the issues in dispute:

41.1 Whether the respondent was precluded from issuing the first additional assessments for the 2001 and 2003 years of assessment by the first proviso to Section 79(1) of the Act.

41.2 Whether the respondent was precluded from issuing the first additional assessments for the 2001 and 2003 years of assessment by the third proviso to Section 79(1).

41.3 Whether the respondent is precluded from issuing the first additional assessment for the 2001 and 2003 years of assessment by virtue of the appellant's legitimate expectation that she would be taxed solely on the

basis that the exercise of an option or acceptance of an offer to sell shares is the only relevant event for the purposes of Section 8A and that the gain in terms of that section was the difference between the consideration payable and the value of the shares at the date of such exercise or acceptance.

41.4 Whether the appellant became liable for tax in terms of Section 8A, upon delivery of the scheme shares.

41.5 Whether the appellant became liable for tax in terms of paragraph 2(a) of the 7th schedule of the Act, upon delivery of the scheme shares.

41.6 In the second additional assessments and in paragraph 43D of the grounds of assessment the respondent relied upon paragraph (c) of the definition of "gross income" in Section 1 of the Act. However, this ground of assessment was raised in the event that the scheme shares were not delivered to the appellant. Since the appellant now accepts that the shares were delivered, this ground of assessment falls away.

(ii) Whether the respondent was precluded from issuing the first and second additional assessments for the 2001 and 2003 years of assessment by proviso (i) of Section 79(1)

[42] The relevant provisions of Section 79(1) reads as follows:

"If at any time the Commissioner is satisfied:

a. that any amount which was subject to tax and should have been assessed to tax under this Act has not been assessed to tax; or

b. that any amount of tax which was chargeable and should have been assessed under this Act has not been assessed; or

c. …

he shall raise an assessment or assessments in respect of the said amount or amounts, notwithstanding that an assessment or assessments may have been made upon the person concerned in respect of the year or years of assessment in respect of which the amount or amounts in question is or are assessable …: Provided that the Commissioner shall not raise an assessment under this sub-section:

(i) after the expiration of three years from the date of the assessment (if any) in terms of which any amount which should have been assessed to tax under such assessment was not so assessed or in terms of which the amount of tax assessed was less than the amount of such tax which was properly chargeable, unless:

(aa) the Commissioner is satisfied that the fact that the amount which should have been assessed to tax was not so assessed or the fact

*that the full amount of tax chargeable was not assessed, <u>was due to</u> fraud or misrepresentation or non-disclosure of material facts".(*my emphasis)

[43] The three year period mentioned in this provision ran from the due dates of the original assessments for the 2001 and 2003 years of assessment. The original assessment in respect of the appellant, ABC, for the 2001 year was issued with a due date of 1 December 2001. The original assessment in respect of the appellant, ABC, for the 2003 year was issued with due date of 1 January 2004.

[44] The first additional assessments were issued in June 2008. The three year period referred to in Section 79(1) had accordingly expired by then.

[45] In terms of the proviso to Section 79(1) the Commissioner was precluded from raising the additional assessments outside the 3 year period, unless he was satisfied:

45.1 that there was fraud or misrepresentation or non-disclosure of material facts; and

45.2 It was not sufficient that the Commissioner was satisfied that there was fraud, misrepresentation or non-disclosure of material facts. He must have been satisfied that *"the fact that the amount which should have been assessed to tax was not so assessed … was due to such fraud, misrepresentation or non-disclosure of material facts"*.

[46] The onus of proving that he was so satisfied before issuing the additional assessments rests upon the respondent. [see **Natal Estates v SIR 1975 (4) SA 177 (A) at 206-8; ITC 1454 (1988) 51 SATC 107 at 108-110 and ITC 1685; 62 SATC 424 at 431-2**.]

[47] In **ITC 1776 (2003); 66 SATC 296,** Squires J held as follows at 300:

> *"The thrust of the appellant's case is based on the perceived requirement in the legislative intention in enacting s79(1) to the effect that, before the respondent can disregard the immunity provided to a taxpayer after three years from an assessment, the Commissioner must be satisfied that the dividend in question escaped assessment because of one or other of the causative factors there listed. Not only must he be so satisfied, but there must be some evidence to show this and particularly which wrongdoing of the appellant of the identified categories caused the respondent not to issue the assessment."*

[48] The question of whether the respondent proved the presence of fraud, misrepresentation or non-disclosure of material facts has to be determined with reference to the following:

48.1 The respondent submits that there was misrepresentation or non-disclosure of material facts by ABC. The respondent points out that the appellant failed to disclose to the respondent, in the relevant years of

assessment, that she had taken delivery of the shares in that year and/or had made or realised any gain of an income nature.

48.2 ABC concedes that she did not make the disclosure in the 2001 year of assessment.

48.3 ABC alleges that she made sufficient disclosure in the 2003 year of assessment. She alleges that she informed the respondent that she received the proceeds of the sale of the scheme's shares earmarked for delivery in terms of the scheme, during the 2003 year of assessment, in schedule 5 of her income tax return and by attaching copies of letters from the trust setting out the determined delivery dates, the market prices of the shares, the proceeds of the sale of the shares less the cost of the sales, the cost of the shares and the actual amount that she received from the trust.

48.4 ABC alleges that in regard to the 2003 year of assessment, sufficient disclosure was made by her employer, the trust and other companies in the XYZ group, prior to the dates of the respondent's original assessments and that such corporate disclosures should be considered to be sufficient disclosures for the purposes of Section 79(1).

48.5 The respondent submits that any disclosure by the appellant's employer, or by other companies in the same group, to the respondent,

was not attributable to the appellant for the purposes of the proviso to Section 79(1) and, therefore, did not cure the alleged non-disclosure.

[49] The evidence relating to the personal disclosure by the appellant, ABC, was as follows:

49.1 The respondent's witness, Ms M, alleged that ABC's 2003 income tax return contained a misrepresentation, namely that in the return, ABC stated that she had made a capital gain on the sale of the shares, instead of stating that an amount should be included in her taxable income due to the deferred delivery of the shares which had at that stage been delivered.

49.2 ABC testified that her husband completed her tax returns.

49.3 ABC stated that her husband did not complete the capital gains tax part of the 2003 return, Schedule 3, which, like the section for office use, seems to have been completed by someone at the SARS. During the cross-examination of ABC, respondent's counsel did not dispute this.

49.4 ABC testified that she received the proceeds of three tranches of scheme shares in the 2003 tax year, namely in September and December 2002 and February 2003, and that she disclosed the proceeds in her 2003 tax return in Schedule 5 under "Other income not disclosed elsewhere" and in the three XYZ letters attached to her tax return.

49.5 Specifically in relation to Schedule 5 of her tax return, she said the following:

49.5.1 In Schedule 5, she noted that she had received from the XYZ Share Incentive Trust the proceeds of share options on three occasions in the 2003 year which she referred to as: "*Opbrengs van Aandele Opsies (x3)*" in a total amount of R44 160.

49.5.2 ABC gave a breakdown in Schedule 5 of each of the amounts she received and the dates on which she received them.

[50] I cannot find that the statements of relevant facts in the appellant's 2003 income tax return is a misrepresentation. Those returns do not misrepresent that the amounts received were capital gains instead of other income not disclosed elsewhere.

[51] At the time of the 2003 assessment, the respondent had all the information that he needed to assess the appellant to income tax under Section 8A, on his view of the basis of taxation, namely that a gain made on the date of delivery of option shares is taxable under that section. This is clear from the additional assessment issued on 2 June 2008. It sets out three additional amounts included in appellant's income under the code 4214, namely, R14 729, R9 148 and R21 331.

[52] Ms M confirmed that each amount was calculated by adding back to the net amount stated to have been received by ABC, the costs of the sales stated in the XYZ letters attached to her 2003 income tax return. Ms M also confirmed that each of the additional amounts was the difference between the cost of the shares to the appellant and the market value of the shares which were delivered to the appellant. Ms M eventually conceded that every fact SARS used for the additional assessments could be established from the appellant's 2003 income tax return.

[53] In support of the argument that in respect of the 2003 year of assessment, there was sufficient disclosure made by ABC's employer, the Trust and related companies, much evidence was adduced on appellants' behalf about various documents and correspondence delivered by her employer to SARS. This occurred firstly in response to requests by SARS for the purpose of conducting a PAYE audit and secondly in the course of obtaining a tax directive concerning that audit.

[54] The proviso to Section 79(1) does not expressly say that the disclosure must be made by the taxpayer personally. The rationale for the proviso is that, if the Commissioner was aware of the material facts at the time when he issued the original assessment, but did not assess the taxpayer on the correct basis, then he should be precluded from issuing a revised assessment. Section 79(1) and its provisos must however be read with section 8A in this case. Section 8A clearly places the onus of disclosure on the taxpayer who should include such gains in

his/her **income** for the year of assessment. As such, reliance cannot be placed on the corporate disclosure referred to.

[55] While I have found that there has been sufficient disclosure by ABC in the 2003 tax return, had this not been the case, the Commissioner would still have to show that he is satisfied that the non disclosure or misrepresentation was the cause of him failing to so assess to tax within 3 years from the due date of each original assessment.

[56] The letter containing the revised assessments in respect of, *inter alia*, the 2001 and 2003 years was issued on 30 May 2008. In this letter Ms M said the following:

> *"[t]he assessments in respect to of the 2001 and 2003 years have expired however (sic) have been raised in terms of proviso (i)(aa) to the Section 79(1) of the Act. These assessments have been raised due to the fact that the Commissioner is satisfied that there was non-disclosure and misrepresentation of material facts in respect of 2001 and 2003 tax returns respectively regarding the gains made in terms of Section 8A of the Act".*

[57] The letter fails to state that Ms M was satisfied that the non-disclosure (2001) and alleged misrepresentation (2003) were the cause of ABC not originally being assessed to tax on those gains.

[58] In the letter setting out the reasons for the revised assessments dated 10 October 2008, the respondent states that there was a non-disclosure of material facts in ABC's income tax return for both the 2001 and 2003 years *"as the taxable gain in terms of Section 8A of the Act was not disclosed"* therefore the alleged reason for the revised assessment of the 2003 return was altered from misrepresentation to non-disclosure. The letter states pertinently: *"It is the Commissioner's view that had the taxable gain in terms of Section 8A of the Act been disclosed, it would have been assessed."*

[59] Ms M made concessions during her cross-examination that do not accord with the above quoted part of the letter that the reason for the gain not being assessed to tax was due to appellant's non- disclosure. The evidence shows that, until the respondent decided during February 2004 to assess XYZ for PAYE on the difference between the purchase price of the scheme shares and their market price on the delivery dates, no assessor had done so before.

[60] In his correspondence, the respondent raised contradictory potential grounds for liability which are as follows:

> 60.1 Bearing in mind that the on-site phase of the PAYE audit started on 17 November 2003 and continued until mid-January 2004, in the period since the respondent first told XYZ in a letter dated 23 February 2004 concerning the PAYE audit, that the difference between the cost of the shares to the participants and their market value on the dates they were

delivered was taxable, the respondent's officials involved in the process changed their minds several times about the legal basis for the tax liability.

60.2 Only on 23 February 2004 and on 31 March 2004 in letters concerning the PAYE audit, did the respondent say that acquisition for purposes of Section 8A occurred upon the exercise of the option and that the extended term for payment gave rise to an interest free loan taxable under paragraph 2(f) of the Seventh Schedule to the Act.

60.3 In the letter of 31 March 2004, the respondent for the first time raised the possibility that the exercise of the right to acquire the shares, for purposes of Section 8A, occurred upon payment for and delivery of the scheme shares. This was only raised as an alternative basis for assessment. In a letter dated 19 August 2004, the respondent repeated this alternative basis for assessment.

60.4 In the letter of 19 August 2004 the primary basis for tax liability was the allegation that if the scheme shares were delivered against payment of a price lower than the then prevailing market price, the difference was taxable under paragraph 2(a) of the 7th Schedule of the Act.

60.5 In his letter dated 28 December 2004 the respondent said that after the exercise of the option *"[a] binding agreement exists, but it has yet to be concluded"* and *"I do not agree with the idea that there has been an*

exercise of a right to acquire as envisaged in Section 8A of the Income Tax Act, because nothing is acquired until the 'implementation date'."

[61] Ms M testified that the Woodmead project, which was conducting the PAYE audit of XYZ, was a high level SARS initiative and that its members, including herself, were specialists.

[62] Ms M could not have been satisfied, as is required in terms of proviso (i) to section 79(1), that in May or June 2008 the SARS' assessors who had issued the original assessments for the 2001 and 2003 years would have assessed those gains to tax had the relevant facts been known to them and Ms M conceded as much during cross-examination.

[63] Ms M testified that she had made enquiries and it did not appear that SARS had really investigated cases involving a similar scheme and a different company.

[64] Ms M testified that in November 2005 her inquiries within the SARS revealed that before she and Mr P at the Woodmead project decided to do so in relation to the XYZ scheme in early 2004, no SARS office had approached the taxation of share incentive schemes like the XYZ scheme on the basis that the participants were liable for income tax on the difference between the cost of the shares to the participants and their market value on the dates they were delivered.

[65] During her cross-examination Ms M agreed with the following further propositions:

> *"no assessor at SARS during 2003 would have assessed Ms ABC to tax on the difference between the cost of the shares to the participants and their market value on the dates they were delivered, because you and Mr P were the first SARS officials to decide to do so and you only reached that decision in 2004".*

[66] It is clear from the evidence that the reason why the appellant was not assessed for the tax in the original assessments, on the grounds currently raised by the respondent, was that the respondent, at the time, was of the view that, in the case of this type of share incentive scheme, the event giving rise to a liability for tax took place upon the exercise of the option or the conclusion of the agreement for the purchase of the shares, as the case may be, and not upon the subsequent delivery of the shares. It was only much later, in 2004 long after the original assessments for the 2001 and 2003 years had been issued, that the respondent held the opinion that a right to acquire shares for the purpose of Section 8A, or the acquisition of a share for the purposes of paragraph 2(a) of the 7th Schedule, occurred on delivery of the share.

[67] Clearly ABC had disclosed the sale shares in Schedule 5 of the return and could not have been found to have fallen foul of proviso (i) of section 79(1) due to non disclosure. Furthermore, the respondent has failed to discharge the onus of

proving that he could have been satisfied that , if one were to assume that there was indeed non-disclosure, that such non-disclosure caused the respondent's failure to assess the gains made upon delivery of the scheme shares. The respondent's changing versions as to the reasons for its failure to assess the gains, as evidenced by its correspondence with the appellant, strengthens this view.

(iii) <u>The issue of whether the respondent was precluded from issuing the additional assessments for the 2001 and 2003 years of assessment by proviso (iii) to Section 79(1) is dealt with below</u>

[68] Proviso (iii) to Section 79(1) reads as follows:

> *"Provided that the Commissioner shall not raise an assessment under this sub-section:*
>
> *(i)....*
>
> *(ii)....*
>
> *(iii) if the amount which should have been assessed to tax under the assessment referred to in paragraph (i) of this proviso was, in accordance with the practice generally prevailing at the date of the assessment, not assessed to tax, or the full amount of tax which should have been assessed under such assessment was, in accordance with such practice, not assessed or …"*

[69] The question is whether at 1 December 2001 and 1 January 2004 it was the practice generally prevailing to assess taxpayers, who purchased shares in terms of share incentive schemes on the terms on which the appellants purchased the relevant scheme shares, on the grounds relied upon by the respondent in the first additional assessments.

[70] In **CIR v SA Mutual Unit Trust Management Co Ltd 1990 (4) SA 529 (A) at 536G-I** Corbett CJ said the following:

> *"At all events, a practice "generally prevailing" is one which is applied generally in the different offices of the Department in the assessment of taxpayers and in seeking to establish such a practice in regard to a particular aspect of tax assessment it would not be sufficient to show that the practice was applied in merely one or two offices. Moreover, the word "practice', in this context, means 'a habitual way or mode of acting' (see The Oxford English Dictionary meaning 2.c); and consequently, in general, it would also not be sufficient to show that, in regard to an aspect of assessment, a certain attitude had been adopted by assessors concerned only in some instances."*

[71] **The evidence concerning the practice generally prevailing is as follows**:

71.1 Mr N, chairman of the board of directors of XYZ Group Limited, testified that deferred delivery schemes were very common from the mid 1990's to the early 2000's, and that stop loss provisions were common.

None of the other public companies with which he had been involved had been assessed to tax on the basis now in issue.

71.2 Mr B, a remuneration consultant, said that although many of the circulars and other publicly available documents concerning deferred delivery schemes, which he had accessed through the McGregor BFA database, did not mention "stop loss" provisions, most of such schemes had a provision designed to ensure that employees did not suffer a loss if, on the delivery date, the shares were worth less than the agreed purchase price. He was not aware of any deferred delivery schemes that had been assessed to employees' tax on the basis that a gain was made on delivery of the shares.

71.3 During his cross-examination, Mr A, an employees of the SARS, said he could not dispute the evidence of Mr N and Mr B that deferred delivery schemes were very common from the mid 1990's to the early 2000's. Mr A also said he could not dispute the evidence of Mr B that most deferred delivery schemes included stop loss provisions.

71.4 Mr A said he had not found any documentary evidence of any of the respondent's offices assessing to tax a company or trust administering a deferred delivery scheme, or the participants in a deferred delivery scheme, on the difference between the price paid for the shares by the participants and the market value on the date of delivery of the shares,

before the decision was taken in 2004 to assess the XYZ scheme to tax on this basis.

71.5 Mr A was only involved in the taxation of deferred delivery schemes between 1994 and 1996.

71.6 Mr A testified that in 1994 Mr T, the acting Commissioner for the SARS, instructed the division in which he worked to look into the share incentive schemes of approximately four companies. The instruction was passed on to him and he wrote letters to each of them along the lines of Exhibit "J". He did not receive any response and did not follow up the letters. As far as he knew, nothing came of Mr T's instruction.

71.7 Mr A testified that in 1996, in response to the request from another company about the taxation of its scheme, he advised his superiors that, for the reasons given by that company, he agreed that the scheme avoided tax under Section 8A on the difference between the price paid for the shares by the participants and the market value on the date of delivery of the shares.

71.8 Mr A wrote two memoranda to the SARS legislative committee about that particular scheme, in March 1996 and a revised one in November 1996. In both, he said deferred delivery schemes had been perfected and were successful in avoiding tax under Section 8A, and he

recommended that the law be changed to tax the total value of the benefit received by participants on the dates when they received the shares.

71.9 Mr A' evidence on the respondent's practice generally prevailing before 2004 supports the evidence of Ms M on what the position was prior to the additional assessments *in casu.*

[72] The respondent has not successfully challenged the evidence with reference to any situation in which the participants in a deferred delivery scheme were or are being assessed to tax on the difference between the price paid for the shares and the market value on the date of delivery of the shares, prior to the decision taken in 2004 to assess the XYZ scheme to tax. During his cross-examination Mr A said that, if this had occurred, he would have been aware of it. This should be viewed in the light of the evidence of Mr A that the respondent was well aware of the existence of such deferred delivery schemes.

[73] The appellants rely on s79(1)(iii) which precludes the Commissioner from raising an additional assessment if the amount which is sought to be taxed was *"in accordance with the practice generally prevailing at the date of the assessment, not assessed to tax".* The date at which the practice is ascertained is the due date of the original assessment, and the taxpayer bears the onus of establishing a practice generally prevailing.

[74] It has been held in **CIR v SA Mutual Unit Trust Management Co Ltd 1990 (4) SA 529 (A) at 536 E – I** that a *"practice generally prevailing"* is one known to the Commissioner and authorised by him for application, and duly

applied, by the various assessment offices throughout the country. [See: **Silke on South African Income Taxed and CIR v Nemojim (Pty) Ltd 1983 (4) SA 935 (A) at 148**]. It has also been held that the taxpayer must show that the failure originally to assess in a particular manner was *attributable to* the practice generally prevailing.

[75] The appellants have shown, by virtue of the concession made by Ms M and Mr A that the practice generally prevailing was authorised by the Commissioner and that it was a widely applied practice. The evidence of Mr B was that at least 60 companies had deferred delivery share options schemes and that none of their employees had hitherto been assessed to tax on the gains made on the deferred date of delivery. Although the respondent challenged Mr B's evidence, it was primarily on the basis that terms of the schemes of a majority of the companies who had those schemes did not have stop loss provisions i.e. provisions whereby the employee did not have to bear the risk of paying for shares where its value had become substantially lower than the price . Even if that was the prevailing situation, the respondent failed to disprove Mr B's research by explaining why it had not sought to assess to tax the employees in the minority of companies mentioned by Mr B, on the basis that it now seeks to assess the appellants.

[76] There was also evidence of the positive or conscious existence of such a practice by the Commissioner. The 1996 positive directive to a specific employer of another company who had a deferred delivery share option scheme is relevant

because the Commissioner's representatives believed that, that scheme provided unconditional rights on acceptance of the option, yet they accepted the interpretation now argued for by the appellants *in casu*.

[77] On respondent's behalf, it was argued that insufficient disclosure made on a return would not necessarily have alerted the assessor to the fact that the practice should be placed in issue. The respondent's attempt to conflate the issue of non-disclosure with practice prevailing must fail because they are separate and distinct provisions covered by different provisos to section 79 (1).

[78] The concessions made by the respondent's employees support the argument of appellant that it was a practice prevailing until August 2004, that tax would not be levied against a gain made at the time when delivery against payment occurred in a deferred delivery share option scheme or agreement.

[79] By 19 August 2004 the Commissioner had expressed an intention to depart from any practice that prevailed before in the assessment of deferred delivery schemes of this kind, although initially varying legal bases were given in the correspondence and the grounds of assessment as discussed earlier.

[80] Until the Respondent took the XYZ decision in February 2004 and at the time of the due dates of the 2001 and 2003 original assessments, the practice of the respondent generally prevailing was not to tax the participants on the difference between the price paid for the shares by the participants and the market value on the date of delivery of the shares.

(iv) <u>Whether the respondent is precluded from issuing the additional assessments for the 2001 and 2003 years of assessment by virtue of the appellants' legitimate expectation that they would be taxed on the basis set out in paragraph 38 of the grounds of appeal</u>

[81] For an expectation to be legitimate the aggrieved person must have held the expectation subjectively. ABC did not allege she held any expectation regarding the taxation of the gains. She simply followed the advice of the accountants of her employer.

[82] There is no evidence that an expectation was created by any representation of the Commissioner. If the appellants wish to rely on the doctrine of legitimate expectation, they surprisingly did not seek to prove an undertaking or promise on the part of the respondent [see: **R v Secretary for the Home Department, ex parte Khan [1985] ALL ER 40 (CA) and R v Ministry of Agriculture, Fisheries and Food, ex parte Humble (Offshore) Fisheries Ltd [1995] 2 ALL ER 714 (QB) at 731g.**]

[83] The application of the doctrine of legitimate expectation under South African law has been recognised by the courts. To date however, the doctrine has only been applied to the determination of procedural fairness. [see: **Duncan v Minister of Environmental Affairs & Tourism and Another 2010 (6) SA 374 (SCA) at paragraphs 13 – 14**]

[84] Although appellants have shown a practice generally prevailing, I am not persuaded that they have shown a legal right to expect that practice to continue without a change in the tax treatment of deferred delivery schemes. Our courts have held that it is insufficient to prove an expectation. What must be shown is the legitimacy of that expectation which led the person whose expectation was so raised to believe that it would receive a procedural benefit.

(v) <u>The applicability of Section 8A</u>

[85] I have found that, the respondent, in reassessing to tax the gains made by the appellants on delivery of the scheme shares, has failed to comply, in respect of the 2001 and 2003 years of assessment, with the provisos to section 79(1). As such ABC and DEF are not liable to pay the reassessed amounts relating to the 2001 and 2003 years of assessment. However, for the purpose of providing guidance to the parties, I will continue to decide whether Sections 8A, 8C or paragraph 2(a) of the 7th Schedule apply to the gains made by the appellants in participating in the share option scheme under consideration.

[86] The salient parts of Section 8A reads as follows:

> *"(1)(a) There shall be included in the taxpayer's income for the year of assessment the amount of any gain made by the taxpayer … by the exercise … during such year of any right to acquire any marketable security … if such right*

was obtained by the taxpayer before 26 October 2004 … in respect of Group Two rendered or to be rendered by him as an employee to an employer."

Did the appellant exercise a right to acquire the scheme shares at the delivery dates?

[87] The respondent submits as follows:

"18 … that the exercise by an employee of an option under the incentive scheme did not give rise to an unconditional sale, and that the employee's purchase of the shares was conditional at least upon the following:

18.1 the employee's employment having been not terminated prior to the relevant anniversary date on grounds other than those specified in clauses 10.1 and 8.2 (of the incentive scheme);

18.2 the middle market price of the shares at the anniversary date being higher than the specified consideration or, if it was lower, upon the employee having elected in terms of Clause 7.4 not to proceed with the sale,

and that although as a matter of formulation Clauses 7.3 and 7.4 (of the incentive scheme) speak of a 'sale of the shares back to the company' the true substance of the said arrangements was that the original sale to the employee would simply not have become unconditional and for that reason would not have been implemented.

19. The respondent contends, further, that the true substance of the said arrangements, and the common intention of the parties to the incentive scheme (as amended) and the employees concerned, were that the sale envisaged by the exercise of the option would (save in the exceptional circumstances contemplated in Clauses 10.1 and 8.2 [of the incentive scheme]) take place only if the employee remained in the employer's employ until the relevant anniversary date and only if (by virtue of the current value of the shares being higher than the specified consideration) it was to the employee's financial advantage to take delivery of the shares and to pay the specified consideration.

20. In any event, and even if the employee's purchase of the shares was not as a matter of contract conditional as aforesaid, the terms referred to in paragraph 17 above were such as to create, for fiscal purposes, material uncertainty as to whether the purchase would be implemented, and thus to cause the fiscal consequences of the purchase to be the same as if the purchase had been contractually conditional as aforesaid.

21. The terms of the incentive scheme were, moreover, intentionally designed to ensure that there was no gain (or an insignificant gain) at the time of the exercise of the option and that the employee's material financial benefit would accrue (if at all) only when delivery of the shares occurred on the respective anniversary dates.

21. A In the circumstances, the employee only acquired an unconditional right to delivery of the relevant shares upon the arrival of the defined

implementation date and if at such date the sale had become unconditional as set out in 18 above.

....

24. The respondent contends that a gain is only 'made' as contemplated in s8A(1)(a) is such gain has unconditionally accrued to the taxpayer.

25. By virtue of the conditional nature of the appellant's rights upon the exercise of the option, no gain was made until the anniversary dates in question arrived and delivery of the shares took place.

26. It was thus upon delivery (and not earlier) that a gain under s8A(1)(a) was made by the appellant.

27. In any event, the proper meaning of the words 'the exercise … of any right to acquire any marketable security' in s8A(1)(a) is the exercise of a right to become the owner of the shares in question, i.e. to claim delivery thereof. The exercise of an option to acquire shares two or more years thereafter is not such an act as is contemplated in s8A(1)(a).

28. Accordingly, the gain made upon the exercise by the appellant of the right to take delivery of the shares on the relevant anniversary date is taxable under s8A.

29. <u>Alternatively to the foregoing</u>, and even if it is found that s8A became operative when the appellant exercised the option (by virtue of the appellant having thereby 'exercised' a 'right to acquire' the shares in question within the

meaning of s8A(1)(a)), the respondent contends that s8A(1)(a) is also applicable upon the actual delivery of shares on an anniversary date.

30. On the premise that the appellant, when exercising the option, 'exercised' a 'right to acquire' the shares, there would be not one but two 'rights' which would fall for consideration, namely:

30.1 the right to exercise the option within 21 days of the notice date ('the first right');

30.2 the further right (assuming the first right to have been exercised) to require the shares to be delivered in tranches on the second, fourth and sixth anniversaries ('the second right').

31. Even if, as the appellant contends, the exercise of the first right triggered the operation of s8A(1)(a), there is nothing in that section which would preclude its operation when the second right (a different right) was exercised.

32. Accordingly, and subject to deduction of any gains already taxed upon the exercise of the first right (a deduction which would flow from the implied statutory prohibition against double taxation), the gains made upon the exercise by the appellant of the right to take delivery of shares on the various anniversary dates were fully taxable under s8A.

33. On the facts of the present appeal no question of double tax arises. The only gains which the respondent has sought to tax are those made on the exercise by the appellant of the right to take delivery of the shares on the relevant anniversary date."

[88] On behalf of respondent it was argued that ABC's right to delivery of the shares under her deferred purchase agreements was a *"right to acquire"* shares obtained in respect of Group Two for purposes of section 8A, which she exercised when asking for delivery and tendering the price and that the ordinary meaning of the words *"right to acquire"* connotes the right of a purchaser to demand delivery.

[89] Respondent's counsel contends that this meaning accords with the purpose of section 8A, which is to tax the real and intended employment gain made by the employee by reference to the value of the shares when actually acquired.

[90] The respondent's further argument is that even if a *"right to acquire"* covers the exercise of an option without the immediate acquisition of shares, and even if, in such an event, the later exercise of the right to delivery of the shares is not covered by s8A, this can only be the case if the exercise of the option vests in the employee an unconditional right to obtain the shares. Since the exercise of the 21 day option in XYZ's case did not vest such an unconditional entitlement in the employees, the position is either that the later exercise of the right to claim delivery is the relevant s8A event in this instance or alternatively that s8A is inapplicable altogether, in which case the acquisition of the shares on the implementation dates at less than their market value would be a taxable benefit under paragraph 2(a) of the seventh schedule.

[91] The right of a purchaser to obtain delivery of shares under a purchase agreement could be conditional in two ways: the right may be subject to a suspensive or resolutive condition and/or the right may be enforceable only if the purchaser provides reciprocal counter-performance. Both these conditions create conditionality which prevents an out and out right to acquire.

[92] The gain is taxable on the implementation date, either because it is at this date that for the first time the exercise of an unconditional right to acquire shares comes into existence or because paragraph 2(a) of the seventh schedule applies. On the implementation date the participant would have acquired the shares for a price less than their market value as at the date of acquisition.

[93] The appellants deny that, upon exercise of the options, their rights to acquire the shares were conditional.

[94] The appellants contend that a right to acquire shares was exercised, for the purposes of Section 8A, when the relevant option to purchase the shares was exercised.

[95] The appellants deny that a right to acquire shares was exercised for the purposes of Section 8A when the shares were delivered.

[96] The appellants contend that, the issues in this regard are the following:

96.1 whether the exercise by the appellant of the options gave rise to unconditional sales of the relevant scheme shares or whether the purchase of the shares resulting from the exercise of the options were subject to the conditions alleged by the respondent;

96.2 whether the rights to acquire the scheme shares were exercised, for the purposes of Section 8A, when the relevant options to purchase the shares were exercised by the appellant;

96.3 whether the rights to acquire the scheme shares were exercised for purposes of Section 8A when the shares were delivered to the appellants.

[97] To decide whether the exercise by the appellants of the options resulted in unconditional sales of the said scheme shares, it is necessary to identify what the terms of the sale agreements were and, whether the sale agreements were subject to conditions alleged by the respondent.

[98] Clause 7.1 of the 1997scheme agreement specified that on the exercise of an option, *"the participant shall become entitled to delivery thereof against payment of the portion of the consideration attributable thereto, on the following dates"* and then specified the second, fourth and sixth anniversaries of the notice date.

[99] Clause 7.1.4 of the scheme agreement stated that in the case of a participant whose service with TXYZG was terminated for specified reasons, TXYZG would be entitled to effect earlier delivery of the sale shares to the participant against payment of the consideration by the participant who was obliged to effect payment, on a date earlier than the specified anniversaries as may be determined by the board.

[100] Clause 7.3 of the scheme agreement provided that if at any time prior to the implementation date in respect of any sale shares a participant's service with TXYZG was terminated for any other reasons, the participant would be obliged to sell his sale shares to TXYZG and TXYZG would be obliged to purchase such shares at a purchase price equal to the consideration which would have been payable by the participant on the implementation date in respect of such sale shares.

[101] Clause 7.4 of the scheme agreement stated that if the middle market price per share of a participant's sale shares on the implementation date was less than the consideration payable in respect of such sale shares by the participant, and if the participant wished to dispose of such shares, TXYZG would be obliged to repurchase such sale shares at an amount equal to such consideration.

[102] Clause 7.5 of the scheme agreement provided that, failing payment of the consideration in respect of the sale shares against tender of delivery of such shares by TXYZG, in terms of Clause 7.1, TXYZG would be entitled to enforce

payment against delivery of the sale shares or to cancel the sale without prejudice to its rights to claim damages.

[103] Clause 10.2 provided that in the agreement whenever TXYZG was entitled or obliged to repurchase sale shares prior to delivery to a participant, TXYZG would be entitled to elect to cancel the sale provided that, subject to Clause 7.4, the amount which would have been payable by the participant and TXYZG respectively would be taken into account in determining the amount if any payable to the participant pursuant to such cancellation.

[104] In determining whether the above stated terms constitute a conditional purchase of shares, regard must be had to the authorities in which guidelines are set out to establish the true substance of a transaction.

[105] In the case of **South African Revenue Service v NWK Limited**, Case No. 27/10 of the Supreme Court of Appeal, at paragraph [55] Lewis JA said the following:

> *"In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that*

allows the evasion of tax, or of a peremptory law, then it will be regarded as simulated.

[106] After considering certain of the evidence in the matter, Lewis JA said the following in paragraph [80]:

> *"The intention to perform in accordance with the terms of the contract is accordingly questionable, and the Tax Court should have considered this. It should have asked whether there was actually any purpose in the contract other than tax evasion. This is not to suggest that a taxpayer should not take advantage of a tax-effective structure. But as I have said, there must be some substance – commercial reason - in the arrangement, not just an intention to achieve a tax benefit or to avoid the application of a law. A court should not look only to the outward trappings of a contract: it must consider, when simulation is in issue, what the parties really sought to achieve."*

[107] After considering the evidence of the taxpayer's principal witness and rejecting his credibility with regard to what was intended in the transaction in question, Lewis JA said the following in paragraph [86]:

> *"As I have said, the appropriate question to be asked, in order to determine whether the loan and other transactions were simulated, is whether there was a real and sensible commercial purpose in the transaction other than the opportunity to claim deductions of interest from income tax on a capital amount greater than R50m. None is to be found. What NWK really wished to achieve*

was a tax advantage. What else could it, or did it, achieve through the transactions in respect of the maize? Barnard did not explain any, other than the creation of a hedge which had no effect. He could thus not honestly have believed that the contract was to be performed in accordance with its tenor.“

[108] While accepting the principle that a taxpayer may organise his financial affairs in such a way as to pay the least tax permissible, I cannot find on the terms of the scheme agreement, and in particular paragraph 7.3 viewed against the undisputed evidence of Mr N and GHI that the purpose of the scheme was to attract and incentivise existing employees, that the sale of shares agreements were unconditional. They were clearly conditional upon the participant remaining an employee until the implementation dates. Clause 7.4 was inserted to ensure that the employee would only proceed with the transaction if, on the implementation date, the shares were worth more than the price.

[109] The conditionality is clear from the way the parties referred to the rights exercisable on the implementation dates and from the uncertainty created by the issuing of bonus shares and the effect this would have on the number and price of each share to be acquired by the participant. This uncertainty belies the evidence of Mr N that a complete sale occurred on exercise of the option as the exact number of shares and their purchase price was subject to change albeit minimal change.

[110] The participant's right to obtain delivery was subject to a reciprocal performance of a tender of the price. This rights that accrued at the time the 21 day option was exercised were conditional.

[111] There was no evidence advanced on behalf of the appellants, that the scheme was designed to provide a benefit to former employees. The sale of shares was clearly an incentive for current employees who remained so employed with the company. To find otherwise would be to completely ignore paragraph 7.3 and the evidence stated above.

[112] A *"right to acquire"* shares is exercised, for the purposes of Section 8A, when an offer to sell the shares is accepted by the relevant taxpayer or, in the case of an option, when the option to acquire the shares is exercised. In **SIR v Kirsch 1978(3) SA 93 (T),** the Full Bench of the Transvaal Provincial Division dealt with what constitutes a "right to acquire" shares, for the purposes of Section 8A. The issue was whether the exercise of a "right to acquire" shares was limited to the exercise of an option or also included the acceptance of an offer. Coetzee J held that it included both concepts. Accordingly, whether an employee accepts an offer for the sale of shares or exercises an option to purchase the shares, both would be the exercise of a right to acquire shares.

[113] In **ITC 1493**, 53 SATC 187 at 201 Melamet J said the following:

> *"It matters not for purposes of the decision in the appeal whether the right is a simple offer, which, upon acceptance by the offeree will bring into existence a contract for the acquisition of shares, or whether the right is an option to acquire shares and upon exercise of which a contract for the acquisition of the shares is perfected. The right contemplated in the sub-section is the right enjoyed by a taxpayer to bring into existence by his voluntary and unilateral act of exercise or acceptance a contract which entitles him to claim the shares."*

[114] Both parties accepted that, for there to be an exercise of a right to acquire shares for the purpose of Section 8A, the acceptance of the offer or exercise of the option must result in an unconditional contract for the sale of the shares.

[115] Appellants submit that a party taking delivery of shares pursuant to the conclusion of an agreement for the purchase of the shares does not thereby exercise a right to acquire the shares for the purposes of Section 8A, for the following reasons:

> 115.1 On behalf of the appellant it was argued that the general policy of the Act is that it is the act of creating a right which triggers the liability for tax and not the act of receiving performance of that right. The delivery of shares pursuant to an agreement of sale is simply the performance of the agreement. A party to an agreement for the sale of shares which defers delivery of the shares and payment of the purchase price to a future date

cannot be said to exercise a right to acquire the shares when the date for performance arrives. That party is as much entitled as he or she is obliged to take delivery and pay the purchase price

115.2 That it is more likely that the legislature intended Section 8A to apply to the exercise of an option or acceptance of an offer to sell the shares, as was confirmed by the courts in Kirsch and ITC 1493. The word "acquire" in Section 8A just as the word "acquired" in the Transfer Duty Act, 1949, was intended to refer to *"not the acquisition of actual ownership of … property, but the acquisition of a right to acquire ownership of … property at such time as may be designated in the relevant contract"*.

[116] I disagree with the contention made on behalf of Appellants that the performance of the right can be separated from the right itself because a right's efficacy is determined by the holder of that right's ability to exact performance.

[117] Furthermore, in the context of section 8A, it is not the mere right but the acquisition pursuant to the grant of that right which brings with it the possibility of financial gain. Having regard to the environment in which Section8A was introduced, the clear purpose of Section 8A was to tax employees who bought shares at less than their market value by either accepting offers for the sale of the shares, or by accepting options to purchase the shares. It is the intended result of the exercise of the right to acquire which section 8A, and failing that section,

paragraph 2(a) of the seventh schedule, seeks to regulate for income tax purposes.

[118] Section 8A is triggered when a gain is made. In the case of deferred delivery schemes, the gain can only be finally quantified once delivery occurs as that is when acquisition of the shares is complete.

[119] Accordingly, it must be that Section 8A can be triggered on delivery. In any event, the prohibition against double taxation will ensure that an appropriate deduction or set off is made in instances where a participant makes a gain twice i.e. within the 21 day period in which the option is exercised and on delivery against payment where delivery has been deferred.

[120] It is clear from the scheme and the way appellants understood its purpose, that it is the right to take delivery against payment at a later date at a price less than the market value of the shares at that later date that created the substantial financial gain which serves as an incentive to employees.

Whether the rights to acquire the shares were in respect of services rendered or to be rendered by her as an employee to an employer.

[121] The words "in respect of" mean that there must a sufficient causal connection between the acquisition of the right and the services rendered or to be rendered by the appellant to his/her employer. As it was stated in **ITC 1493; 53 SATC 187 at 201**:

> *"There must be a causal link between the obtaining of the right and the services rendered or to be rendered by the taxpayer as an employee to an employer …"*

[122] In **Stevens v CSARS 2007 (2) SA 554 (A)** the court considered the meaning of the words "*in respect of or by virtue of any employment or the holding of any office*" in paragraph (c) of the definition of "gross income" in Section 1 of the Income Tax Act. At 559 in paragraph [20] it said the following:

> *"… There is no material difference between the expressions 'in respect of' and 'by virtue' in paragraph (c). They connote a causal relationship between the amount received and the taxpayer's service or employment."*

[123] At 560 in paragraph [22] the court referred to there being:

> *"an unbroken causal relationship between the employ on the one hand and the receipt on the other".*

[124] In **Stander v CIR 1997 (3) SA 617 (C)** the Full Bench considered the meaning of the words "*in respect of services rendered*" in paragraph (c) of the definition of "gross income". At 622H - 623A the court said the following:

"A further requirement in order to bring the trip within the terms of paragraph (c) of the definition of 'gross income' is that it must be 'in respect of services rendered'.

In De Villiers v Commission of Inland Revenue 1929 AD 227Stratford JA stated at 229:

*'(T)he words "in respect of" received judicial interpretation in the case of Commission for Inland Revenue v Crown Mines Ltd (1923 AD 121**)** in which Innes CJ said that a tax could not be imposed "in respect of a particular subject matter, unless it had direct relationship to that matter", by which is meant, I think, "causal relationship".'*

The fact that Stander's employment with Frank Vos Motors was a sine qua non of the receipt by him of the reward sought to be taxed, is not sufficient."

[125] In **CIR v Shell Southern Africa Pension Fund 1984 (10 SA 627 (A)**the court considered the meaning of the words "*in consequence of*" or "*following upon*" in the context of paragraph 3 (as it then was) of the second schedule to the Income Tax Act. Nicholas JA said the following at 678H – 679H:

"The problem is therefore one of causation: In a case where a lump sum becomes recoverable as a result of the exercise by the committee of its discretion under Rule 37(3), is there the required causal connection between the recoverability and the death of the member?

In the Australian case of McIntosh v Federal Commissioner of Taxes [1979] 25 ALR 557 the court was concerned with a provision in the Income Tax Assessment Act 1936 that the assessable income of a taxpayer should include a lump sum amount paid in consequence of retirement from, or the termination of, an office of employment. It was held that within the ordinary meaning of the words a sum is paid in consequence of the termination of employment when the payment follows as an effect or result of the termination, but that termination need not be the dominant cause of the payment. In my opinion that is the effect of the expression "in consequence of" (and also of the expression "following upon") in paragraph 3: they import no more than that the death of a member should be a cause of the recoverability of a lump sum payment.

It is clear that the death of the member is a condition sine qua non to the recoverability of the lump sum: but for the death, there can be no pension granted to an eligible widow or eligible dependant, and hence nothing which is commutable under Rule 37(3). A conditio sine qua non is not, however, necessarily a causally relevant factor. (See Hart and Honoré Causation in the Law at 107, 121 – 2). As Denning J pointed out in Minister of Pensions v Chennell [1947] 1 KB 250 at 255 in fine, the latest event in a train of physical events is not necessarily "caused by" the first even.

And at 254 *'the test of causation is to be found by recognizing that causes are different from the circumstances in or on which they operate. The line between the two depends on the facts of each case'* and at 256*" that an intervening cause or extraneous event may be so powerful a cause as to reduce what has gone before to part of the circumstances in which the cause operates.*

The paradigm of the present case is an occurrence A (the death of a member) which initiates a chain of events leading to the final result B (the recoverability of the lump sum benefit), one of the intervening events being occurrence C (the exercise by the committee of its discretion).

The question is whether the intervening cause C, which contributes to bring about the result B, is of such a kind that it isolates the original cause A so as to relegate it "to the status of a merely historical antecedent or background feature". (See Iron and Steel Holding and Realisation Agency v Compensation Appeal Tribunal and Another [1966] 1 All ER 769 G (QB) at 775D – G).

In my opinion the answer to the question is in the affirmative. Upon the grant of a pension to the dependant, the death of the member ceases to have any operative effect. The decision of the committee is "the intervention of an independent, unconnected and extraneous causative factor or event" (ibid at 775G) which isolates the death from the final result. That decision is alone the cause of the recoverability of the lump sum benefit."

[126] On appellant's behalf it was submitted that it is not sufficient that the services rendered or to be rendered by the appellant to her employer were a *sine qua non* for the right in question. There had to be a direct and causal relationship between the services rendered or to be rendered and the right.

[127] The services rendered were a *sine qua non* for the coming into existence of the rights to take delivery inasmuch as delivery could only take place if the

participant was still employed with the company. In practice, a set off operated without actual delivery occurring if a participant was no longer employed.

[128] It is not correct, as contended on appellants' behalf, that the participating employee's exercise of the option is an intervening cause between the services rendered and the appellant's right to take delivery of the shares because the exercise of the option does not isolate the original cause, namely being in the employ of the company, nor is it an "*independent, unconnected and extraneous causative factor or event*". It is so closely connected to the scheme agreement and its original cause, namely an incentive for current employees, as stated in clause 2 of the 1997 scheme agreement, that the witnesses who testified on behalf of the appellants described that incentive to current employees as an integral part of the deferred delivery share option scheme in question. Accordingly, in my view there does indeed exist a sufficient causal relationship between the delivery of the shares and the services rendered by the appellants to their employee.

(vi) Whether the appellant was liable for the relevant tax in terms of paragraph 2(a) of the seventh schedule

[129] The salient parts of Paragraph 2(a) of the 7th Schedule, as it was at the time, read as follows:

> *"For the purposes of this Schedule and paragraph (i) of the definition of 'gross income' in Section 1 of this Act, a taxable benefit shall be deemed to have*

been granted by an employer to his employee in respect of the employee's employment with the employer, if as a benefit or advantage of or by virtue of such employment or as a reward for services rendered or to be rendered by the employee to the employer;

> *(a) any asset consisting of any … marketable security or property of any nature (other than money) has been acquired by the employee from the employer or any associated institution in relation to the employer or from any person by arrangement with the employer, either for no consideration or for a consideration given by the employee which is less than the value of such asset, as determined under paragraph 5(2): Provided that the provisions of this paragraph shall not apply … in any respect of any marketable security acquired by the exercise by the employee, as contemplated in Section 8A of this Act, of any right to acquire any marketable security".*

[130] For paragraph 2(a) of the 7th Schedule to apply, the following must be present:

130.1 A marketable security or property must have been acquired by the employee

130.2 The asset must have been acquired as a benefit or advantage of or by virtue of the employee's employment with the employer or as a reward for services rendered or to be rendered by the employee to the employer

130.3 The share must not have been acquired by the exercise by the employee of any right to acquire any marketable security, as provided for in Section 8A

[131] It is necessary to determine what is meant by the word "acquired" within the context of paragraph 2(a).

131.1 The proviso to paragraph 2(a), states that: *"the provisions of this paragraph shall not apply … in respect of any marketable security acquired by the exercise by the employee, as contemplated in Section 8A of this Act, of any right to acquire any marketable security".* In the light of this it is inconceivable that the legislature could have intended different meaning for the word 'acquired' and "acquire", in paragraph 2(a) and Section 8A, respectively.

131.2 In **Transvaal Investment Co Ltd v Springs Municipality 1922 AD 337** the court looked at the meaning of the word "acquire" in the context of Section 2 of Act 37 of 1919. At 341-2 Innes CJ recognised that the word can bear a wider meaning of acquiring a right to obtain ownership or a narrower meaning of acquiring ownership.

131.3 If the word "acquired", in the context of paragraph 2(a), bears the wider meaning i.e. the acquisition of a right to obtain ownership, the appellant acquired this right upon the exercise of the options.

131.4 There is however nothing in the content of paragraph 2(a) which prohibits acquisition in the narrow sense of acquiring ownership from also applying. The primary purpose of paragraph 2(a) is to deem a benefit granted by an employer to be considered as part of gross income.

[132] Appellant's counsel submitted that the appellant acquired the relevant shares by exercising the options and, therefore, the application of paragraph 2(a) is excluded in terms of the proviso to that paragraph.

[133] It could not have been the intention that a taxpayer, who exercised a right to acquire a share, for the purposes of Section 8A, by accepting an offer or exercising an option to purchase the share, would again be subjected to tax in terms of paragraph 2(a) upon delivery of the share.

[134] Having determined that section 8A applies to the transactions *in casu*, clearly paragraph 2 (a) cannot also apply.

III THE 2005 AND 2006 ASSESSMENTS FOR ABC

[135] The third implementation dates in respect of the August 1998 and December 1998 sale agreements were 14 August 2004 and 2 December 2004, respectively, fell within the 2005 year of assessment.

[136] On these implementation dates the market values of the relevant shares and the prices payable for such shares in terms of the sale agreements were as follows:

Date	Market Value	Price Paid	Gain
14/08/2004	R81,106	R20,007	R61,099
02/12/2004	R69,671	R10,607	R59,064

[137] As a result of the sale of those shares by the trust the appellant received the following cash payments from the trust:

Date	Net Amount
26/08/2004	R61,099
09/12/2004	R58,400

[138] The second implementation date in respect of the March 2001 sale agreement was 19 March 2005 and the first implementation date in respect of the April 2003 sale agreement was 1 April 2005. Both fell within the 2006 year of assessment.

[139] On these implementation dates the market values of the relevant shares and the prices payable for such shares in terms of the sale agreements were as follows:

Date	Market Value	Price Paid	Gain
19/03/2005	R118,571	R17,332	R101,239
01/04/2005	R153,279	R42,030	R111,249

[140] After the sale of those shares by the trust the appellant received the following:

Date	Net Amount
31/03/2005	R102,710
19/04/2005	R105,818

[141] The salient parts of Section 8C reads as follows:

> *"…a taxpayer must include in … his or her income for a year of assessment any gain … determined in terms of sub-section (2) in respect of the vesting during that year of any equity instrument, if that equity instrument was acquired by the taxpayer –*
>
> *(i) by virtue of his or her employment …".*

[142] Section 8C was introduced into the Act with effect from 26 October 2004. Section 8(2)(b) of Act 32 of 2004 provided that Section 8C would apply:

> *"in respect of any equity instrument acquired on or after [26 October 2004] otherwise than by way of the exercise of any right granted before that date and in respect of which Section 8A applies."*

[143] For Section 8C to apply, it is necessary that the following relevant requirements are met:

143.1 The scheme shares must not have been acquired by way of the exercise of any right granted before 26 October 2004 and in respect of which Section 8A applied.

143.2 Such acquisition of scheme shares by the appellant must have been by virtue of his/her employment.

[144] In view of my earlier finding that section 8A applies to the transactions relevant to the 2001 and 2003 years of assessment and that those shares were acquired by virtue of the appellants' employment, the only outstanding issue for consideration is whether the relevant shares pertaining to the 2005 and 2006 years of assessment were acquired after 26 October 2004, in which case section 8C would apply. The appellants are not proceeding with the defence relating to paragraph (iii) of the proviso to Section 79(1), namely that they held a legitimate

expectation not to be assessed to tax on the gains in dispute in the 2005 and 2006 year of assessment.

[145] As stated earlier, in my view, in the case of the type of deferred delivery share options incentive schemes in this matter, the process of acquisition is commenced when the option to purchase is exercised and only complete when delivery against payment takes place.

[146] The acquisition can only be complete if the participant is still in the employ of the company. Accordingly, for ABC acquisition in full for the 2005 year of assessment occurred on 14 August 2004 being before 26 October 2004, therefore Section 8A would apply and not Section 8C.

[147] In respect of the third tranche for the December 1998 agreement, delivery and complete acquisition only occurred on 2 December 2004.

[148] The second tranche of the March 2001 agreement was finally implemented only on 19 March 2005.

[149] The first tranche of the April 2003 agreement was fully implemented only on 1 April 2005.

[150] Accordingly, acquisition occurred in full after 26 October 2004 in relation to the 2 December 2004, the 19 March 2005 and 1 April 2005 implementation dates and Section 8C would apply.

[151] The same reasoning relied upon for determining that the gains made in the 2001 and 2003 years of assessment fall to be taxed under section 8A, apply equally to the determination of whether the gains made in the 2005 and 2006 years of assessment fall to be taxed under section 8C.

iv Appellant, DEF

[152] The appeal by DEF is ancillary to the appeal of ABC in respect of the 2003 year of assessment. By agreement between the parties it was ordered that the only issue for decision is the appellant's special defence based on paragraph (i)(aa) to the proviso to Section 79(1) of the Income Tax Act 58 of 1962 (as amended).

[153] Mr DEF has conceded that he did not disclose the delivery of the shares in question in his income tax return for the 2003 year, therefore issues for decision are:

> 153.1 whether, prior to his original assessment for the 2003 year on 1 December 2003 sufficient disclosures were made by his employer, the trust and other companies in the XYZ Group, and whether such disclosures comply with Section 79(1) of the Act;

153.2 if sub-paragraph 1 above is answered in the negative, whether the fact that the relevant amounts were not assessed to tax in the original assessment was due to the non-disclosure.

[154] Mr DEF exercised two sets of options which resulted in deliveries to him of shares in the 2003 year of assessment:

154.1 In August 1998 he purchased scheme shares from TXYZG. In August 2002 the trust delivered to the appellant the second tranche of the shares, when the market value of the shares delivered was R39 208.26 and the difference between the value and the consideration payable was R15 197.26. The costs of selling the shares were R548.55, creating a net difference of R14 648.71.

154.2 In December 1998 he purchased scheme shares from TXYZG. In December 2002 the trust delivered to the appellant the second tranche of the shares, when the market value of the shares delivered was R99 823.50 and the difference between that value and the consideration payable was R46 774.44. The costs of selling the shares were R696.02, creating a net difference of R46 078.42.

[155] On 1 November 2007 the respondent issued an additional assessment for the 2003 year of assessment, in which the respondent assessed DEF for tax on income of R15 197 and R46 774.

[156] On 1 June 2010, following the amendment of the appellant's grounds of appeal to include the allegation that the shares were not in fact delivered to those of the participants who chose to have the shares sold by the trust and receive the proceeds instead of having them transferred into their names, the respondent issued a further additional assessment where, in the alternative to the first additional assessment, the respondent assessed DEF for tax on income of R14 648 and R46 078. DEF now accepts that the shares were delivered to him on the implementation date through constructive delivery. Therefore, the second additional assessment and the need to adjudicate on those alternative grounds of assessment has fallen away.

[157] As the original assessment for the 2003 year of assessment was 1 December 2003 and the date of issue of the first additional assessment was 1 November 2007, the three year period referred to in paragraph (i) of the proviso to Section 79(1) of the Act had expired before the first additional assessment was issued. Therefore, the respondent could only justifiably issue the first additional assessment if the requirements of paragraph (i)(aa) were met, namely he was *"satisfied that the fact that the amount which should have been assessed to tax was not so assessed or the fact that the full amount of tax chargeable was not assessed, was due to fraud or misrepresentation or non-disclosure of material facts".*

[158] Corporate disclosure cannot absolve a taxpayer from the obligation to disclose in his tax return the income he derived in a particular year of assessment

through the acquisition of marketable security as contemplated in section 8A. He could have made the disclosure and stated that he believed that section 8A applied at the stage when the option was exercised and left it in the hands of the SARS to determine, and thereafter he could still have pursued his remedies of appeal, as he does in this instance. As stated earlier, section 79(1) and its provisos must be read with section 8A as a whole.

[159] The letter dated 31 October 2007 from the respondent's Ms M and Mr C explaining the first additional assessment stated:

> *"[a]ssessments in respect of the 2001 and 2003 tax years have been raised in terms of proviso (i)(aa0 to the Section 79(1) of the Act. The assessments that have expired have been raised due to the fact that the Commissioner is satisfied that there was non-disclosure or in the alternative misrepresentation, of material facts in your tax returns regarding the gains made in terms of Section 8A of the Act".*

[160] The letter does not state that the respondent was satisfied that the non-disclosure or the misrepresentation was the cause of him not originally being assessed to tax on those gains.

[161] Only in a later letter dated 1 April 2008 and after the additional assessment was raised, did the respondent explicitly state there was a causal connection between the non-disclosure and his failure to assess to tax on the bases set out

in the additional assessment. The respondent states that there was a non-disclosure of material facts in the appellant's income tax return for the 2003 year *"as the taxable gain in terms of Section 8A of the Act was not disclosed"*. The letter continues: *"It is the Commissioner's view that had the taxable gain in terms of Section 8A of the Act been disclosed, it would have been assessed."*

[162] Ms M testified that letters like these were standard letters based on a template. It appears that the respondent later realised that it was necessary to state that he was satisfied that his failure to initially assess the gain was due to the non-disclosure.

[163] Furthermore, in view of my earlier finding that the practice generally prevailing until 2004 was not to assess to tax the gain made on delivery of the shares, the non-disclosure by this appellant in the 2003 year of assessment could not have been the cause of him not being assessed to tax in the original assessment in the manner in which he was assessed in the additional assessment.

[164] I can accordingly find no basis for the respondent issuing the first additional assessment for DEF in respect of the 2003 year of assessment.

V Appellant, GHI

[165] The result in the appeal by Mr GHI follows the result of the appeal of ABC in respect of the 2005 year of assessment.

[166] Mr GHI exercised two sets of options which resulted in deliveries to him of shares in the 2005 year of assessment:

> 166.1 In August 1998 the appellant bought scheme shares from TXYZG. In August 2004 the trust delivered to the appellant the third tranche of the shares, when the market value of the shares delivered was R40 620.69. The difference between that value and the consideration was R30 600.33.
>
> 166.2 In December 1998 the appellant bought scheme shares from TXYZG. In December 2004 the trust delivered to the appellant the third tranche of the shares, when the market value of the shares delivered was R92 493.96. The difference between that value and the consideration was R78 365.40.

[167] In respect of both the August 2004 and December 2004 tranches, the appellant elected to have the shares transferred into his name rather than sell them.

[168] The respondent issued an additional assessment to the appellant for the 2005 year on 29 February 2008. This was substituted with a lesser assessment on 16 February 2009, and later substituted with a reduced assessment issued on 28 May 2009. The respondent assessed the appellant for tax on income of R30 600 and R78 365 for the 2005 year of assessment.

[169] The gain made in August 2004 falls to be taxed under section 8A as it was made before 26 October 2004, while the gain made in December 2004 falls to be taxed under section 8C.

VI CONCLUSION

[170] In terms of section 82, the appellants must prove that the gains are not taxable. They have to prove that they and not the respondent are correct as to the interpretation and true meaning and effect of the scheme and agreements.

[171] Conventional option schemes were until October 2004 taxable under section 8A. Conventional purchase schemes were taxable under paragraph 2(f) of the seventh schedule. XYZ's 1997 scheme was an attempt to avoid both provisions. There is of course nothing sinister in seeking to avoid tax. Provided that tax avoidance is not the only "*real and sensible commercial purpose*" of the scheme. [see: **NWK case***supra*]

[172] I find that the gains made under the XYZ Share Option incentive Scheme prior to 26 October 2004 are taxable under Section 8A. Those gains made after 26 October 2004 are taxable under Section 8C.

[173] *In casu*, the non-disclosure or alleged misrepresentation by the appellants in the 2001 and 2003 years of assessment do not afford the respondent the right to raise additional assessments once 3 years from the due date of the original assessments had lapsed because:

173.1 the respondent did not state that it's failure to assess the appellants' gains under Section 8A or 8C was due to the appellants' alleged non-disclosure or misrepresentation

173.2 at the stage when the right to additionally assess had expired, respondent had adopted a practice which generally prevailed of not raising assessments on the basis which it now contends it was entitled to.

[174] I find further that the appellants are not exempt from paying tax on the basis of an alleged substantive legitimate expectation as no such expectation has been proved nor has it been established to exist on a substantive basis.

It is ordered that:

1. The appeal fails in proving that neither section 8A, nor section 8C nor paragraph 2(a) of the 7th Schedule of the Income Tax Act applies to the relevant gains made by the appellants by participating in the Share Option Scheme under consideration in this matter.

2. Section 8A applies to the gains made on delivery of the relevant scheme shares during the 2001 and 2003 year of assessment as it constitutes the exercise of the right to acquire marketable security for the purposes of Section 8A.

3. Section 8C applies to the gains made on delivery of the relevant scheme shares after 26 October 2004 during the 2005 and 2006 years of assessment as it constitutes the vesting of equity instruments acquired during the relevant years of assessment as contemplated by the provisions of Section 8C.

4. The appellant ABC's additional assessment for the 2001 year of assessment is set aside because, although the appellant acknowledged her non-disclosure, the practice of the respondent generally prevailing was not to assess to tax the gains made on delivery of the relevant scheme at that stage.

5. The appellant ABC 's additional assessment for the 2003 year of assessment is set aside for the following reasons:

5.1. the respondent has failed to prove that his failure to assess her to tax within 3 years from the due date of her original assessment **was due to** non-disclosure on the part of the appellant;

5.2. in the 2003 tax return, the appellant, ABC completed Schedule 5 of the tax return by stating that she received the proceeds of scheme shares sold in the 2003 tax year and accordingly it cannot be said that she did not disclose the relevant information for that year of assessment in her tax return;

5.3. it was the practice generally prevailing at the time when the original assessment was made not to assess gains of the nature under consideration on the bases now sought to assess.

6. The gain made by appellant, ABC on 26 August 2004 in the amount of R61 099 falls to be taxed under Section 8A.

7. The gains made by appellant, ABC on 9 December 2004 in the amount of R58 400, on 31 March 2005 in the amount of R102 710 and on 19 April 2005 in the amount of R105 818 fall to be taxed under Section 8C.

8. The additional assessments of ABC for the 2005 and 2006 years of assessment are confirmed.

9. Appellant, DEF did not disclose sufficiently, the gains made in his tax return for the 2003 year of assessment and the corporate disclosures do not exonerate him from the duty to so disclose, where section 8A applies.

10. Appellant DEF's additional assessment for the 2003 year of assessment is set aside for the following reasons:

> 10.1. the respondent has failed to prove that its failure to assess him to tax within 3 years from the due date of the original assessment **was due to** non-disclosure on the part of the appellant; and
>
> 10.2. it was the practice generally prevailing at the time when the original assessment was made not to assess gains of the nature under consideration on the bases now sought to assess

11. The gains made by appellant, GHI in the 2005 year of assessment falls to be taxed, in respect of the August 2004 one, under Section 8A and in respect of the December 2004 gain, under Section 8C. Accordingly, the additional assessment of GHI for the 2005 year of assessment is confirmed.

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ALLIE, J
(President of the Tax Court)

Presiding with:

Adv. A B Meiring **And** **Dr H A Coetzee**
(Commercial Member) **(Accountant Member)**