REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA
GAUTENG LOCAL DIVISION, JOHANNESBURG

CASE NO: 13285

(1) REPORTABLE: YES / NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED.

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DATE SIGNATURE

In the matter between:

XYZ CC Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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J U D G M E N T

TSOKA, J:

INTRODUCTION

[1] This appeal concerns the meaning of deemed dividends in terms of s 64(B)(2)(g) of the Income Tax Act 58 of 1962 (the Act) with regard to interest-free loans made by the appellant, XYZ CC ("XYZ") to its sole shareholder or connected person in the 2011 year of assessment ("the disputed assessment").

[2] The amounts assessed in terms of the disputed assessment are the secondary tax on companies ("STC") on the undisputed interest-free loans of R11 424 619 and R114 404 171 made by XYZ during the 2011 year of assessment to JK Property CC ("JK") and to LM CC ("LM") respectively.

[3] Of the total amount lent to JK and LM, only the amounts of R290 650 and R1 140 029 were repaid to XYZ during the year of assessment resulting in the respondent, The Commissioner for the South African Revenue Service ("the Commissioner") exempting these payments from STC in terms of s 64(C)(4)(f) of the Act. On 26 March 2012 the Commissioner issued an assessment and levied STC and interest in terms of s 64K(6) of the Act against XYZ as the former deemed the loans as dividends and failed to pay any dividend tax within the required period.

[5] On 30 May 2012 XYZ objected to the assessment on the basis that the loans should rather be treated as loans made to shareholders forming part of

the same group of companies, and therefore be exempted from dividend tax in terms of s 64(c)4(K) alternatively s 64(C)(4)(l) of the Act.

[6] In this appeal XYZ is represented by Mr. D, a Chartered Accountant, who argued the appeal.

THE ISSUE IN DISPUTE

[7] The crisp issue for determination is whether the loans should be exempted from STC in terms of s 64(c)4(k) alternatively s 64(c)4() of the Act.

THE FACTS

[8] The sole member of XYZ is Mr. B, who is also the sole member of both JK and LM. In this context, the Close Corporations are, undoubtedly, connected persons as defined in the Act. XYZ is the supplier of various products to mining companies while JK is a property holding company. Special Transmission deals in specialised pumps. All the three close corporations appear to be doing business with mining companies, by tending for business. In tendering for business, they are each issued a tendering number. However, the three entities, depending which close corporation has been awarded a tender, finance their separate growth from profits made by the other by means of inter-loan accounts. Once one of them is granted a tender, the necessary funds are transferred from XYZ to the relevant party in order for it to carry out its obligations in terms of the tender.

[9] The transfer of funds from XYZ to the relevant party is treated as cash transactions and the necessary journal entries are made in their books. The entries, however, do not have any effect on income or loss. Any balance due will be used to measure the total growth of the business as consolidated value of the loan accounts. Assets in the individual close corporation concern, equals the total sum of all liabilities and retained income.

THE PARTIES' CONTENTIONS AND APPLICABLE LEGAL PRINCIPLES

[10] In terms of s 102(l) of the Act, the *onus* is on XYZ to rebut the statutory presumption of the validity of the assessment issued by the Commissioner that the disputed assessment is not taxable. In *Inland Revenue v Goodrick* 1942 OPD 1, 12 STC 279 the court pointed out in discharging the *onus*, the taxpayer is required to produce affirmative evidence that satisfied a court, upon a preponderance of probability, that the amount disputed, is not taxable.

[11] The mere say-so of the taxpayer is insufficient to discharge the *onus* of proof. In ITC 1185, 35 SATC 122 Miller J, with regard to a taxpayer's mere say so, said the following –

> '*It is often very difficult, however, to discover what his true intention was. It is necessary to bear in mind that regards that ipse dixit of the taxpayer as to his intent and purpose should not lightly be regarded as decisive. It is the function of the Court to determine on an objective*

review of all the relevant facts and circumstances what the motive, purpose and intention of the taxpayer were.

Not the least important of the facts will be the course of conduct of the taxpayer in relation to the transactions in issue, the nature of his business or occupation and the frequency or otherwise of his past involvement or participation in similar transactions. The facts in regard to those matters will form an important part of material from which the court will draw only inferences against background of the general human and business probabilities. This will not to say the Court will give little or no eight to what the taxpayer says his intention was, as is sometimes contended in argument on behalf of the Secretary in cases of this nature. The taxpayer's evidence under oath and that of his witnesses must necessarily be given full consideration and the credibility of the witnesses must be assessed as in any other case which comes before the Court. But direct evidence of intent and purpose must be weighed and tested against the probabilities and the inferences normally to be drawn from the established facts.'

[12] The common cause facts in this matter reveal the following. The three close corporations, although doing business with mining companies, were incorporated for different purposes. They each have one member as the sole member. They compete with one another in their tendering of services to the mining companies. The mining companies treat the three close corporations as different entities hence they are always given a different tendering number. XYZ quite often advances interest-free loans to the two close corporations. The loans are treated as cash transactions, and do not have any effect on income or loss on the parties involved. Quite often the loans are not repaid. The main aim of the loans is to finance the business activities of the affected party while any profits made are ploughed back into the inter-company loan accounts.

[13] Other than the amounts of R290 650 and R1 140 029 repaid by JK and LM to XYZ within the stipulated period in terms of s 64(c)4(f), no other amounts were repaid to the latter. Consequently, in terms of s 64(c)4(f) of the Act, this once-off concession of exemption is not applicable to the balance of the loans as they were not repaid or extinguished by no later than the end of the succeeding year of assessment of XYZ.

[14] XYZ cannot seek shelter behind the provisions of s 41 of the Act as a close corporation cannot form part of a group of companies. The definition of a juristic person in terms of this section, does not include a close corporation, which *ex lege*, is incapable of being a member in another close corporation. It is only for the purposes of the Act and for tax purposes that a close corporation is regarded as a company for the tax purposes. It is only natural persons who can hold membership interest in a close corporation such as in the present matter. As the facts reveal, Mr. B would move money from one close corporation to himself as interest-free loan without any agreement for repayment and interest. Such loans were, for a period of two years, not repaid. This conduct, in my view, is nothing but an anti-avoidance scheme embarked upon by Mr. B to avoid falling foul to the provisions of s 64(c)2(g).

[15] It is interesting that, in spite of his insistence that the loans should not be regarded as dividends that were distributed to himself, he elected not to testify. Neither did he lead any evidence on his behalf. The inescapable inference is that his version could not stand the rigour of cross-examination.

Realising that the true nature of the loans would be revealed, he elected to present only legal argument.

[16] In ITC 1632 60 SATC 71, where Mr A had recovered a sum of over R800 000 from the company, which sum was reflected in the company's balance sheet as a loan, the court held that as the benefits of the loan were akin to that of a dividend rather than a loan, the loan falls on the continuum far closer to dividend than it does to the loan hence the application of the deeming provisions of s 64(c)(2)(g) of the Act.

[17] In this Court, XYZ relied on the decision of this Court in *ABC (Pty) Ltd v The Commissioner for the South African Revenue Service*, Case No 13512, handed down on 30 March 2015 as authority that the loans should not be regarded as deemed dividends.

[18] Reliance on *ABC (Pty) Ltd v The Commissioner for the South African Revenue Service* by XYZ is misplaced. The facts in that matter are distinguishable to the facts in this matter. In that matter, the court (Van Oosten J) dealt with a company taxpayer while in the present matter, this Court is dealing with a close corporation taxpayer. Furthermore, in that matter, the court was concerned with the exemption provided for in terms of s 64C(4)(bA) of the Act, which is not the issue in this matter.

[19] Similarly, in that matter the court in para [20] reasoned that '...*The outgoing loans matched the benefits the appellant received by way of*

incoming loans. It accordingly clearly constituted a quid pro quo which the appellant received in return for making the outgoing loans …'.

[20] In the present matter, the outgoing loans do not match the benefits of incoming loans. There is therefore no *quid pro quo* as in *ABC* above.

[21] It is worth recalling what the court in *CSARS v Airwold EC and Another* [2008] 2 All SA 593 (SCA), said, when interpreting the scheme and purpose of s 64 of the Act. It said the following in para [23]:

> '*In an ideal State, where every person, natural or juristic, is aware of the benefits which the population derives from collated tax and of the consequent responsibility to contribute what is due, the Legislator would presumably have been content to let section 64B stand on its own. But the legislator in this imperfect world must be ever alert to thwart the relentless ingenuity of accountants, tax consultants, lawyers and even the layperson, by anticipating possible ways and means by which the prescripts of tax legislation might be avoided. And that was the obvious purpose behind the inclusion of Section 63C. The Legislator foresaw that a company might find other ways of transferring its profits to its shareholders than by the process of distributing them directly in the form of dividends. So the "mischief" which the Legislator bought to prevent by enacting section 64C was the avoidance by companies of liability for STC, by disguising what was in truth a dividend distribution as some other form of transaction …*'

[22] In the present matter, XYZ disguised what in truth is a dividend distribution to Mr. B as a loan. The ingenuity, in my view, must be seen for what it is: a dividend distribution attracting STC in terms of the Act.

[23] On the basis of the above, the appeal must fail. The Commissioner, however, does not persist with an order for costs.

[24] In the result, the following order is made –

24.1 The appeal is dismissed.

24.2 The assessments are confirmed.

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M P TSOKA
JUDGE OF THE HIGH COURT OF SOUTH AFRICA
GAUTENG LOCAL DIVISION, JOHANNESBURG

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(insert initials and surname)

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(insert initials and surname)

DATE OF HEARING: 10 September 2015