REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT CAPE TOWN)

Case No.: **45840**

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

15/04/2025 ……………………
DATE **SIGNATURE**

In the matter between:

THE COMMISSIONER FOR THE SOUTH REVENUE SERVICE **APPLICANT**

and

TAXPAYER SC (PTY) LTD **RESPONDENT**

J U D G M E N T

DOLAMO, J

INTRODUCTION

[1] This is an opposed interlocutory application in terms of rule 35(2), by the Commissioner for the South African Revenue Service (SARS), for leave to amend its rule 31 statement of grounds of assessment and opposing an appeal. The rules applicable to this matter are promulgated in terms of section 103 of the Tax Administration Act[1], read with rule 28 of the Uniform Rules of Court. The proposed amendment relates to a pending income tax appeal concerning the application by SARS of section 31(2) of the Income Tax Act[2] (IT Act) to SC (Pty) Ltd 2015 and 2016 years of assessment. SC(Pty) Ltd is opposing the application for the proposed amendment on the ground that the effect thereof would be to introduce into the appeal a new ground or basis of assessment that formed no part of the transfer pricing assessments (additional assessments) which are the subject matter of the tax appeal.

[2] SARS applied section 31(2) of the IT Act, which empowers it to adjust the taxable income of a resident, where the resident entered into a transaction, operation, scheme, agreement, or understanding with a non-resident connected person and any term or condition of that transaction, operation, scheme, agreement, or understanding is different from any term or condition that would have existed had those persons being independent persons dealing at arm's length and such difference resulted in deriving a tax benefit.

FACTUAL BACKGROUND

[3] SHL is an Investment Holding Company listed on the Johannesburg Stock Exchange Limited (JSE) and comprises the following wholly owned subsidiaries: SCL, SINV; RWL; SICL; and SIL. The group's headquarters are situated in XXX, Western Cape, South Africa. The Taxpayer group of companies operate 1751 corporate and 360 franchise outlets in 14 countries across Africa and the Indian Ocean islands. The primary business of the Taxpayer Group is food retailing, and selected non-food products typically found in supermarkets, to consumers of all income levels. Of key importance within its operating model is the successful rollout and implementation of a standardised and efficient deployment of the Taxpayer Group's intellectual property (IP) across the Taxpayer Group.

[4] The main operating subsidiaries in the group are SCL and SIL. These are both wholly owned subsidiaries of SHL. In many of the cases the Taxpayer Group trades outside of South Africa through subsidiaries of SIL. These companies are referred to as "the non-RSA Group

[1] Act 28 of 2011
[2] Act 58 of 1962

Companies". As the investment holding company for the Group's non-RSA investments outside of the Common Monetary Area (CMA). SIL's subsidiaries are referred to as non-RSA Group Companies outside the CMA. This holding structure was adopted because of the South African Reserve Bank's (SARB) regulations which disapproved of what is referred to as a "loop structure". A "loop Structure" essentially means that a South African resident, for exchange control purposes, is prohibited from holding any South African asset indirectly through a non-resident entity. To get around this restriction the Taxpayer Group elected to hold its trademarks in Mauritius through SIL because that country does not have exchange control provisions. The advantage derived from this arrangement enables SIL to provide loan funding or to inject further capital into existing subsidiaries without first having to obtain South African exchange control approval.

[5] SIL operates from business premises in Mauritius which are suitably stuffed with on-site managerial and operational employees. This premises have facilities for conducting the primary operations of the business. SIL provides investment capital and loan funding for the non-RSA Group Companies (outside the CMA). As the owner of all trademarks, SIL provides the know-how and sets standards for the non-RSA Group Companies in terms of franchise agreements which regulate the use of the Taxpayer Group's international trademarks. SIL provides investment applications with a view to obtaining investment incentives. It also fulfils treasury functions by managing currency flows from the non-RSA Group Companies. In this respect it assumes responsibility for the investment of surplus funds and debt factoring services to SCL by the prompt payment for goods exported and the collection of debts.

[6] Other treasury functions performed by SIL, which benefit the non-RSA Group companies include paying for stock on behalf of its subsidiaries and recovering the monies later, and assisting with acquisitions and securing leases for new and existing sites. SARS is of the view that some transactions may have been lost had SIL not been based in Mauritius. This would have left the Taxpayer Group at a disadvantage to its rivals. The offshore presence in Mauritius also enables the Taxpayer Group to obtain US Dollar financing cheaper than through South African banks; being able to deal in all currencies; and paying for service providers and maintenance contractors when funds could not flow to the non-RSA divisions. The location of the treasury in Mauritius also helps in obtaining investment licences and tax incentives. SIL exert substantial management and control of the treasury function, bearing the associated risk in relation to the non-RSA Group Companies.

[7] During the period in question, the South African entities, within the Taxpayer Group, concluded transactions with non-resident connected parties which qualified as 'affected transactions' for purposes of section 31 of the IT Act. In terms of these agreements, the

South African entities provided administration and procurement services, including the collection of franchise fees and remuneration, due to the non-RSA Group Companies. The South African entities also provided know-how services and other related intellectual property to franchisees outside of RSA. But as the owner of all trademarks for the non-RSA subsidiaries, SIL provided the know-how and set standards for the non-RSA subsidiaries in terms of franchise agreements. The franchise agreements also regulate the use of the Taxpayer Group's international trademarks. All branding standards relating to logos, designs, and store layout are set by SIL through the franchise agreements. This is being done to assist the non-RSA subsidiaries to improve their business operations. The Taxpayer and associated brand names have value in those jurisdictions where the group trades.

[8] It is the responsibility of SIL to ensure brand development, maintenance, and protection, although the responsibility for local implementation in terms of a franchise agreement lies with the relevant non-RSA subsidiary. In consideration of the rights granted in terms of the franchise agreements entered between SCL and the non-RSA subsidiaries, a franchisee is obliged to pay to the franchisor a franchise fee equal to 1% of the franchisee's gross sales. The basis applied to determine the royalty percentage is the sales price of products sold by the franchisee through the outlet, exclusive of excise duties, and other taxes.

[9] After conducting the transfer pricing audit SARS concluded that, it was evident from the conduct of both SIL and SCL, their employees, the decisions of their respective boards and the general correspondence provided to SARS, that it was in fact SCL and SHL that determined the strategies with respect to Taxpayer's expansion into the African market. It was SCL and SHL that set the standard with respect to the development of the marketing intangibles in the non-RSA jurisdiction. This, according to SARS, is key to increasing Taxpayer's market share as the preferred supermarket outlet in each of the non-RSA jurisdictions. It was SCL's extensive research, feasibility assessments, and market analysis, performed by SCL's employees that made this possible. SIL was only responsible for entering into the franchise agreements after they were drafted and vetted by employees of SCL and, through its treasury functions, to also collect the franchise fees payable by the non-RSA subsidiaries.

[10] This led SARS to conclude that SCL did not receive any royalties from the non-RSA subsidiaries for the actual development, enhancement, maintenance, protection, and exploitation (DEMPE) of the trademarks, know-how, and related intangibles by SIL in terms of the franchise agreements concluded with the non-RSA subsidiaries. SARS found that SCL only received compensation from SIL to the value of R458 3860.00 in 2015 and R528 328.00

in 2016 for the provisions of the know-how services in relation to the non-RSA subsidiaries which is based on a transfer pricing policy of cost plus 3.5%. SARS rejected SCL's view that SIL was responsible for their DEMPE of the trademarks, Know-how and related intangibles as outlined contractually in terms of the franchise agreements entered with the non-RSA subsidiaries.

[11] According to SARS the rate of 1% percent applied in calculating the royalty fees payable fell below the arm's length range (interquartile range of 4% to 5.3%). SARS maintained that the applicable rate should have been 4% of sales. Based on the above SARS concluded that SCL did not receive an arm’s length compensation for the actual DEMPE for the 2015 and 2016 years of assessment. SARS held that this resulted in SCL obtaining a tax benefit for the 2015 and 2016 years of assessment and this triggered the application of section 31(2) of the IT Act.

[12] In determining that an arm’s length return for SCL would have been 4% of sales SARS used the Comparable Uncontrolled Pricing method (the CUP method) to determine the royalty rate. This is one of the methods that can be used to determine or test the arm’s length nature of prices in transactions concluded between related parties. Another method that can also be used is the Profit Split Method (the PSM method). The CUP and PSM methods are but two of the transfer pricing guidelines methods suggested by the Organization of Economic Cooperation and Development (OECD) for use in determining the arm’s length nature of prices in transactions concluded between related parties. However, it is beyond the scope of this judgement to go into the finer details or efficacies of any of these two methods. Such an inquiry, if necessary, will be undertaken by the court which would hear the appeal. This court is only seized with determining whether SARS should be granted leave to amend its rule 31 statement of grounds of assessment and opposing the appeal.

[13] After conducting the above audit SARS adjusted the taxable income of SCL in terms of section 31(2) of the IT Act for the 2015 and 2016 years of assessment. This was on the basis that the franchise fees payable by the non-RSA group companies would have been equal, on an arm’s length basis, to 4%, and not 1% of sales. An adjustment was made to SCL’s taxable income by adding an amount of R422 528 219.00, resulting in additional income tax of R118 307 901.00 for the 2015 year of assessment. For the 2016 year of assessment an additional R579 780 975.00 taxable income was raised resulting in an additional income tax of R162 338 673.00. Consequently, a secondary adjustment, as required in terms of section 31(3) of the IT Act was effected, resulting in dividends tax liability to SCL for the 2015 and 2016 years of assessment.

[14] It is against the application of section 31(2) of the IT Act that SCL objected to and subsequently appealed against the disallowance of the objections. SCL contended that the arrangements did not give rise to non-arm's length revenue streams and that, even if any amounts in the form of franchise fees were not attributed to SCL despite the absence of an agreement between it and the non-RSA group companies, the CUP method adopted by SARS was defective and inapplicable. After SCL had lodged its appeal SARS delivered its statement of the grounds of assessment and opposition to the appeal. Subsequently, on or about 16 September 2024 SARS also delivered an expert report by Dr Maning. However, SCL objected to this report and accordingly notified SARS of its objection. SCL contended that the report not only did not support SARS grounds of assessment pleaded but positively rejected them, that the report therefore could not serve any relevant purpose in the tax appeal as pleaded, and that should be withdrawn.

[15] In response to SCL's objection SARS proposed to amend its rule 31 statement by including a paragraph at the end thereof to refer to Dr Maning's report. SARS pleaded that it relies on this report for purposes of supporting the assessment raised and the determination of an arm's length compensation. According to SARS, the proposed amendment merely introduces an alternative method in support of SARS' assessment of an arm's length basis on which SCL should be compensated, without in any way derogating from its original assessment. SCL, on the other hand, contended that the amendment sought by SARS will amount to an innovation of the factual basis of the assessment and will require the issue of revised assessments.

AMENDMENT OF PLEADINGS IN GENERAL

[16] It is a well-established principle that amendments ought to be granted where they are necessary to facilitate the proper ventilation of the dispute between the parties. An application for amendment will always be allowed unless the application to amend is mala fide or unless such amendment would cause an injustice to the other side which cannot be compensated by costs, or by some other suitable order such as postponement.[3] It is a further established principle that the granting or refusal of an application for the amendment of pleadings is a matter for the discretion of the court, to be exercised judicially. The aim should be to do justice between the parties by deciding the real issues between them. The mistake or neglect of one of the parties in the process of placing the issues on record is not to stand in the way of this, his punishment is in his being mulcted in wasted costs[4], where that is

[3] See *Imperial Bank Limited v Barnard and Others* 2013 (5) SA 612 (SCA) at par [8]
[4] See *Trans-Drakensberg Bank Ltd (under judicial management) v Combined Engineering (Pty) Ltd and Another* 1967 (3) SA 632 (D) at 640H-641B

applicable.

[17] In terms of rule 35(2) the parties may agree on the amendment of a rule 31 statement. If the other party does not agree to the amendment, the party who requires an amendment may apply to the Tax Court for an order allowing such amendment. SCL opposes the application by SARS to amend its rule 31 statement on the ground that the proposed amendment, in contravention of rule 31(3), constitutes a novation of the whole of the factual basis of assessment, and requires the issue of revised assessments. This, according to SCL, is an impermissible amendment.

[18] In terms of rule 31 SARS must deliver to the appellant a statement of the grounds of assessment and opposing the appeal. Rule 31(2)(*c*) provides that the statement of the grounds of opposing the appeal must set out a clear and concise statement of the material facts and legal grounds upon which SARS relies in opposing the appeal. Rule 31(3) provides that SARS may include in the statement a new ground of assessment or basis for the partial allowance or disallowance of the objection unless it constitutes a novation of the whole of the factual or legal basis of the disputed assessment or which requires the issue of a revised assessment. In terms of this sub-rule SARS is precluded from including in the statement (a) a ground that constitutes a novation of the whole of the factual or legal basis of the disputed assessment, or (b) a ground which requires the issue of a revised assessment.

[19] The question to be determined is whether the proposed amendment will violate the provisions of rule 31(3). Put differently, does the proposed amendment constitute a novation of the whole of the factual or legal basis of the disputed assessment or requires the issue of a revised assessment.

[20] SCL submitted that, based on specific factual premises, the impugned assessments arose on the strength of SARS exercising its power under section 31 (2) of the IT Act to calculate SCL's taxable income for the 2015 and 2016 year of assessment. SCL contended that the proposed amendment seeks to justify it being taxed under section 31(2) on an entirely new factual basis. For such a basis to be legitimately in issue in the appeal it would require the issue of revised assessments pursuant to a fresh exercise of the section 31(2) power. It contends that this is, however, not permitted in terms of rule 31(3). SCL further contended that the section 31(2) power is an extraordinary power which allows SARS to apply a hypothetical basis, which by definition differs from the actual terms on which the taxpayer dealt. SCL submitted that SARS' power under section 31(2) is not itself an assessment but a decision capable of independent scrutiny as an exercise of administrative power. That being the case, the general principle of administrative law, which provides that where the lawfulness of a decision is challenged on review, the administrator is not permitted

to rely on a different reason or a different basis for making the decision, as SARS attempts to do, is equally applicable to a decision under section 31(2), SCL submitted.

[21] SCL further submitted that the factual conclusion that 4% of sales was the arm's length fee that would have been payable, was the result of SARS applying the CUP method as the most appropriate method for determining an arm's length royalty rate. It went on to contend that SARS belatedly sought to amend its rule 31 statement by incorporating reference to, and reliance on, Dr Maning's expert report which states that the PSM is the most appropriate method to determine the franchise fee that the non-RSA Group Companies should have paid to SCL; and that the PSM analysis shares no factual characteristics whatsoever with the CUP method which was adopted by SARS as the basis for the assessments. According to SCL, this is a wholly new, both in method and factual foundation, assessment.

[22] Dr Maning stated in his report that the CUP method is not the most appropriate method to determine the franchise fee that the non-RSA companies should pay to SCL for the Taxpayer franchise concept. However. SCL contends that Dr Maning rejected the CUP method and that the irrefutable inference to be drawn from Dr Maning's dismissal of the CUP method as applied by SARS, and the latter's failure to provide any other expert report for its chosen basis of assessment, is that SARS has abandoned reliance on that basis of assessment.

[23] SCL also challenged SARS' submission that the proposed amendment merely introduces an alternative method in support of SARS' assessment of an arm's length basis on which SCL should have been compensated, without in any way derogating from the SARS original assessment. According to SCL the Dr Maning report does not support the assessment raised, which is 4% of sales fees using the CUP method but states that the CUP method is not applicable. It follows therefore that SARS' original assessment is no longer applicable, notwithstanding that it formally remains on the pleadings, it submitted.

[24] SCL also contended that the language of the proposed amendment is much wider than SARS represents it to be, as it states that SARS also relies on the report for purposes of the determination of an arm's length compensation. The interpretation of this phrase, SCL submits, is that SARS intends to use the expert report to ask the Tax Court to endorse the PSM method as applied by Dr Maning's transfer pricing mechanism, even though this was not part of the assessments. Consequently, SCL contended that the proposed amendment would novate the actual grounds of assessment and will necessarily require the issue of revised assessments, which will contravene rule 31(3). It added that rule 31(3) must be read in the statutory context of SARS' actual assessment in a particular amount and based on

specific grounds in accordance with (starting point is to determine the factual basis for the impugned assessment. The facts in *Lion Match Company (Pty) Ltd v Commissioner for the South African Revenue Services*[5] provide an illuminating example of what constitute the factual basis of an assessment. In that matter at issue was the base cost of shares disposed of by *Lion Match* in two companies in the 2008 year of assessment. This was determined by relying on the valuation report of an expert who reviewed the valuation of *Lion Match's* investment in these two companies. SARS arrived at a lower base cost for the shares disposed of and consequently the capital gain was determined at a higher amount than that disclosed by *Lion Match*. However, in the statement of grounds of assessment in terms of rule 31 delivered subsequently SARS changed the evaluation assumptions and factual basis on which the 2013 assessment was determined and substituted the 2013 determination with the determination of the 2015 assessment. *Lion Match* contended that, by revising and increasing the 2013 assessment, SARS made a new determination of its tax liability and included grounds in its rule 31 statement that constituted novation of the whole of the factual and legal basis of the 2013 assessment in respect of which SARS ought to have issued a revised assessment.

[26] In rejecting *Lion Match's* objection the court held that:[6]

> "[46] Therefore the thrust of the objection by Lion Match is some of the valuation assumptions which affected the determination of capital gain were changed. But 'assumptions' are not the factual or legal basis for the assessment as they do not constitute the foundation or basis for the assessment. Assumptions are by their very nature 'assumed or taken for granted, a supposition or …
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> [47] The factual basis for the 2013 assessment is the disposal of the shares and that Lion Match adopted the market value of the shares as at 1 October 2001. The factual basis for the 2015 assessment is set out in paragraphs 15 – 18 of the Rule 31 statement. Thereafter SARS proceeds to discuss the disparate valuation of the shares and sets out the valuation assumptions utilised by KPMG on which Lion Match relies and the valuation assumptions utilised by SARS. It is at this stage that 'the new ground' objected to in the founding affidavit by Mr Trikamjee is introduced. But the factual basis in the Rule 31 statement is the same as in the 2013 assessment viz the disposal of the shares by Lion Match and the value asserted by Lion Match. Consequently as there is no change to the factual basis, there can be no novation.
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> [48] The legal basis for the 2013 assessment is paragraph 26(1) read with paragraph 29(7)(*b*) of the Eighth Schedule to the IT Act. In the Rule 31 statement the legal basis for the 2015 assessment remains unchanged as it is premised on the same relevant

[5] (IT 13950) [2017] ZATC 5 (30 January 2017)
[6] *Lion Match*, *supra* at paras [46] to [48].

> paragraphs of the Eighth Schedule. The law applicable at the time of the disposal has been applied by SARS in both assessments. In the premises the legal basis is unchanged and has not been novated in the 2015 determination."

[27] What are the jurisdictional facts for the application of section 31(2) in this case? They are (i) the affected transaction; (ii) entered into or effected between a person who is a resident and one who is a non-resident and, who are connected in relation to one another; (ii) and any term or condition of the transaction in question which is different from a transaction concluded by parties dealing with each other at arm's length. The CUP method is not part of the factual or legal basis of the assessment.

[28] SCL admits that Dr Maning's report deals with the two methods of calculating the arm's length fee that would have been payable by the non-RSA Group Companies. Whereas SARS used the CUP method Dr Maning, on the other hand, criticised this method preferring the PSM method. He motivated why the PSM method would be suitable in the circumstances of this case. However, SCL contends that Dr Maning rejected the CUP method and the PSM method of analysis that he used shares no factual characteristics whatsoever with the CUP method (used by SARS) as bases for the assessments. This, according to SCL, is wholly new, both in method and factual foundation of the assessments.

[29] SCL's contention is without merit. It is immaterial whether Dr Maning concluded that the CUP method is not suitable, or as SCL submitted, completely rejected it in favour of the PSM method. Neither the CUP nor the PSM method forms part of the factual basis. The use of any of the two methods will not change the factual basis of the assessments. This accordingly is not a novation of the whole of the factual basis, which is prohibited by rule 31(3). Even if a new factual basis of assessment would have been introduced by the amendment sought it would not have given rise to a novation of the whole of the factual or legal basis of assessment. On what amounts novation the court in *Lion Match* held that:[7]

> "[37] The term 'novation' is usually applied in the context of contracts: a contract is novated when an existing legal obligation, created by contract, is replaced by a new obligation, which discharges the existing one. But the essence of the concept of novation is that there must be a prior legal obligation that is replaced by a new one; the old obligation being the *justa causa* for the new. The word 'novation' is defined in the Oxford English Dictionary as 'the introduction of something new; a change, an innovation' and in the context of a contract, as 'a substitution of creditor, debtor, contract'. There is, in my view, no reason to find that the word 'novation' is inappropriate in the context in which it is used in Rule 31 or that is renders the rule inoperable. Instead it is consonant with the objective of Part E of the rules to provide clear guidelines to

[7] *Lion Match*, *supra*, at para [37].

be followed by the parties in the procedures before the tax court."

[30] In my view, the introduction of the Dr Maning report wherein he advocates for the use of the PSM method to calculate the rate of the franchise fee that would have been payable does not equate to an abandonment of the CUP Method. Construed in context of the whole of his report Dr Maning merely advocates for his preferred method, highlighting its benefits. Nor is SARS signifying through the proposed amendment, an intention to abandon the CUP method. It merely seeks to place on record an alternative method of calculating the franchise fee payable. Only where the new factual or legal basis amounts to a novation or requires the issue of a revised assessment would the amendment run foul of rule 31(3). I am accordingly satisfied that the proposed amendment does not violate the provisions of rule 31(3).

[31] In the result I make the following order:

31.1 SARS is granted leave to amend within 30 days of this order, its rule 31 statement of grounds of assessment and opposing the appeal, and

31.2 Taxpayer SC (Pty) Ltd is ordered to pay the costs of the application for leave to amend including the cost of two Counsel where so employed, on scale C of the tariffs.

M J DOLAMO
JUDGE OF THE HIGH COURT

Coram: Dolamo J

Matter heard on: Monday 10 February 2025

Judgment delivered electronically: Tuesday 15 April 2025