REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT CAPE TOWN)

CASE NO: VAT 1922

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

In the matter between:

TAXPAYER ZAW **APPELLANT**

and

THE COMMISSIONER FOR **RESPONDENT**
THE SOUTH AFRICAN REVENUE SERVICE

J U D G M E N T

GROBBELAAR, AJ:

INTRODUCTION

[1] This is an appeal in terms of the Tax Administration Act, 28 0f 2011 ("the Tax Administration Act") against The Respondents', The Commissioner for the South African Revenue Services' ("SARS") dismissal of the Appellant's ("Taxpayer ZAW") objection against the disallowance of certain Value Added Tax ("VAT") input tax deductions, the levying of VAT on imported services as well as the levying of understatement penalties.

[2] At the hearing, Taxpayer ZAW led the evidence of three witnesses.

[3] Taxpayer ZAW Group Finance Director, Mr Zacs.

[4] The tax practitioner at F Company who provided Taxpayer ZAW with various opinions in respect of the 'Des' transaction, Mr E.

[5] Taxpayer ZAW Head of Treasury and Tax, Mr Tom.

[6] SARS did not call any witnesses.

COMMON CAUSE FACTS

[7] Taxpayer ZAW is a registered VAT vendor listed on the Johannesburg Stock Exchange and holds 100% of the issued share capital of Taxpayer ZAW (Pty) Ltd and various other companies, local and international.

[8] On 9 April 2014, Taxpayer ZAW announced its acquisition of the entire issued share capital of Des Limited ("Des"), one of Australia's oldest and most prominent department stores.

[9] Taxpayer ZAW's board announced that it intended to raise a gross total of R10 billion through a fully underwritten, renounceable rights offer ("the Rights Offer") for purposes of repaying an Equity Bridge Facility (subject to the satisfaction of certain conditions) which facility was used to finance the acquisition.

[10] The Rights Offer was a rights issue wherein an invitation was extended to existing shareholders to purchase additional new shares in the company at a discount on the market price on a stated future date.

[11] The Rights Offer was made to resident and non-resident shareholders.

[12] Taxpayer ZAW entered into an unsecured syndicated facility agreement with different local and international financial companies, for the provision of a short-term equity bridge facility in a principal amount of up to R11 billion ("the Equity Bridge Facility"). These were, amongst others Citibank, N.A., London Branch, J.P. Morgan Limited, and the Standard Bank of South Limited ("SBSA") as mandated lead arrangers and bookrunners.

[13] The acquisition was completed on 1 August 2014 when Taxpayer ZAW acquired the entire share capital of 'Des' for a purchase consideration of R21.4 billion (A$2.1 billion). Taxpayer ZAW acquired the entire share capital by using two of its Australian subsidiaries in the following manner.

[14] Taxpayer ZAW holds 100% of the shares in Entity A, Entity A holds 100% of the shares in Entity B, Entity B acquired 100% of the shares in Des.

[15] To implement the acquisition Taxpayer ZAW entered into a Scheme Implementation Deed with 'Des' and Entity B.

[16] The acquisition was funded by a combination of existing cash, new debt facilities and equity funding raised by the Rights Offer. For the purposes of funding the acquisition on completion, the Equity Bridge facility was secured, and was repaid with the proceeds of the Rights Offer.

[17] Service providers, both local and non-resident, assisted Taxpayer ZAW with arranging and executing the Equity Bridge Facility and the Rights Offer to assist with raising capital to acquire Des.

[18] Taxpayer ZAW incurred expenses in respect of the Rights Offer pertaining to services supplied by the local and non-resident service providers.

[19] Approximately six months after the acquisition, F Company VAT Specialists (Pty) Ltd approached Taxpayer ZAW and advised them that there was the potential for them to claim input tax on certain amounts paid in relation to the acquisition and that they may also be liable to pay output VAT on imported services relating to the services.

[20] F Company had previously given VAT advice on several occasions in terms of a longstanding letter of appointment.

[21] F Company was of the opinion that Taxpayer ZAW was entitled to claim an input tax credit on the acquisition of the shares in 'Des' and the attendant right issues and while they would be liable for output tax on imported services from non-resident, non-VAT registered suppliers, they would not be liable for the full value of such services.

[22] Mr E, a registered tax practitioner, who holds B Comm LLB and LLM degrees is the author of a written F Company opinion in this regard.

[23] Relying on the opinion Taxpayer ZAW submitted the VAT Return in issue in this case, which relate to the February 2015 tax period, on the following basis:

> Input tax deduction: With regard to the services rendered by the South African resident service providers, Taxpayer ZAW incurred VAT in the amount of R18 609 841.00 in respect of the underwriting fees. Taxpayer ZAW claimed a deduction of input tax in respect of services acquired from local bankers relating to the rights issue in the amount of R8 847 752.06, which it calculated at the rate of 45.56% of the sum of R18 609 841. The 45.56% deduction from the input tax was claimed because 45.56% of the value of the Rights Offer was taken up by non-resident shareholders and is zero rated VAT.
>
> Imported services: With regard to the services rendered by non-resident service providers in respect of the rights issue, Taxpayer ZAW declared an amount of only R15 489 266 VAT payable in respect of "imported services", based on the fact that 54.44% of the value of the Rights Offer was taken up by resident shareholders in effect claiming a reduction of output VAT payable in the amount of R12 883 990.78 in respect of the services supplied by non-resident service providers relating to the acquisition.

[24] SARS raised an additional assessment in respect of the February 2015 tax period and:

[24.1] disallowed the R8 478 752.06 input tax reduction;

[24.2] required payment of the full amount of R28 373 356.90 output tax in respect of services supplied by non-resident service providers; and

[24.3] levied a 10% understatement penalty in the amount of R2 136 274.28 on the understated amounts in terms of section 223 of the Tax Administration Act.

[25] Taxpayer ZAW objected to this, but SARS disallowed the objection which gave rise to this appeal.

[26] Taxpayer ZAW noted an appeal against the Objection Outcome on 12 October 2018.

[27] SARS delivered its statement of grounds of assessment and opposing appeal in terms of Tax Court Rule 31.

[28] Taxpayer ZAW delivered its statement of grounds of appeal in terms of Tax Court Rule 32.

RELEVANT PROVISIONS IN THE VALUE-ADDED TAX ACT, 89 OF 1991 ("THE VAT ACT")

[29] The relevant part of section 7 reads:

> "**7. Imposition of value-added tax—**(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax—
>
> (*a*) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him;
>
> (*b*) ….
>
> (*c*) on the supply of any imported services by any person on or after the commencement date, calculated at the rate of 15 percent on the value of the supply concerned in the importation, as the case may be.
>
> (2) Except as otherwise provided in this Act, the tax payable in terms of paragraph (*a*) of subsection (1) shall be paid by the vendor referred to in that paragraph, the tax payable in terms of paragraph (3)
>
> (*a*) ….
>
> (*b*) and the tax payable in terms of paragraph (*c*) of that subsection shall be paid by the recipient of the imported services."

[30] Thus, the Act provides that the vendor of goods described in subsection 7(1)(*a*) must pay VAT as well as the recipient of imported services described in subsection 7(1)(*c*).

[31] The VAT Act defines **"enterprise"** as *inter alia* :

> "(*a*) in the case of any vendor, any enterprise or activity which is carried on continuously or regularly by any person in the Republic or partly in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration, whether or not for profit, including any enterprise or activity carried on in the form of a commercial, financial, industrial, mining, farming, fishing, municipal or professional concern or any other concern of a continuing nature or in the form of an association or club.
>
> (*b*) …

Provided that—

…

(v) any activity shall to the extent to which it involves the making of exempt supplies not be deemed to be the carrying on of an enterprise;…." [1]

[32] An **"exempt supply"** is "a supply that is exempt from tax under section 12".

[33] Section 12 of the VAT Act lists the supply of goods and services that are exempt from VAT as imposed under section 7(1)(*a*), and lists in paragraph (*a*) thereof, the supply of any financial services, excluding the supply of financial services which would otherwise be charged with tax at a rate of zero percent under section 11 of the VAT Act but for being included in section 12.

[34] **"Financial services"** are "the activities which are deemed by section 2 to be financial services".

[35] Section 2(1) provides in the relevant part:[2]

"2(1) For the purposes of this Act, the following activities shall be deemed to be financial services:

(*a*) The exchange of currency (whether effected by the exchange of bank notes or coin, by crediting or debiting accounts, or otherwise);

(*b*) the issue, payment, collection or transfer of ownership of a cheque or letter of credit;

(*c*) the issue, allotment, drawing, acceptance, endorsement or transfer of ownership of a debt security;

(*d*) the issue, allotment or transfer of ownership of an equity security or a participatory security;

(*e*) …

(*f*) the provision by any person of credit under an agreement by which money or money's worth is provided by that person to another person who agrees to pay in the future a sum or sums exceeding in the aggregate the amount of such money or money's worth;

(*g*) …

(*h*) …

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1 See the definition of **"enterprise"** in section 1 of the VAT Act.
2 See section 2 of the VAT on **"financial services"**.

(*i*) the provision, or transfer of ownership, of a long-term insurance policy or the provision of reinsurance in respect of any such policy: Provided that such an activity shall not be deemed to be a financial service to the extent that it includes the management of a superannuation scheme;

(*j*) the provision, or transfer of ownership, of an interest in a superannuation scheme;

(*k*) the buying or selling of any derivative or the granting of an option: Provided that where a supply of the underlying goods or services takes place, that supply shall be deemed to be a separate supply of goods or services at the open market value thereof: Provided further that the open market value of those goods or services shall not be deemed to be consideration for a financial service as contemplated in this paragraph;

(*l*) …

(*m*) …

(*n*) …

(*o*) the issue, acquisition, collection, buying or selling or transfer of ownership of any cryptocurrency:

Provided that the activities contemplated in paragraphs (*a*), (*b*), (*c*), (*d*), (*f*) and (*o*) shall not be deemed to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant's discount or similar charge, excluding any discount cost."

[36] **"Input tax"** means (in relation to a vendor and in terms of the relevant parts of the definition of that term[3]):

"(*a*) tax charged under section 7 and payable in terms of that section by:

(i) a supplier on the supply of goods or services made by that supplier to the vendor; or

(*b*) ….

(*c*) …

where the goods or services concerned are acquired by the vendor **wholly for the purposes of consumption, use or supply in the course of making taxable supplies** or, where the goods and services are acquired by the vendor partly for such purpose, to the extent (as determined in accordance with the provisions of section 17) that the goods or services concerned are acquired by the vendor for such purpose)."

(My emphasis)

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[3] See the definition of **"input tax"** in section 1 of the VAT Act.

[37] **"Output tax"** means, in relation to any vendor, "the tax charged under section 7(1)(*a*) in respect of the supply of goods and services by that vendor".[4]

[38] Therefore, suppliers of services to Taxpayer ZAW that are vendors must impose "output tax" on their supplies. As a vendor itself, Taxpayer ZAW must also impose "output tax" on supplies made by it.

[39] A vendor (such as Taxpayer ZAW) must pay a VAT amount to SARS in respect of each tax period, determined by deducting the vendor's "input tax" for that period from its "output tax" for that period. This requirement is line with section 16(3) of the VAT Act, the relevant parts of which read:

> "… the amount of tax payable in respect of the tax period shall be calculated by deducting from the sum of the amounts of output tax of the vendor which are attributable to that period … the following amounts, namely—
>
> (*a*) in the case of a vendor who is…required to account for tax payable on an invoice basis, the amounts of input tax—
>
> (iv) in respect of supplies of goods and services … made to the vendor during that tax period…"

[40] However, a registered vendor who carries on an enterprise, and has paid VAT on goods or services which the vendor acquired wholly for the purpose of consumption, use or supply in the course of supplying goods or services supplied in the course or furtherance of its enterprise are entitled to deduct the input tax paid by it in the calculation of its VAT.

[41] As far as imported services are concerned, **"Imported services"** means "a supply of services that is made by a supplier who is resident or carries on business outside the Republic to a recipient who is a resident of the Republic to the extent that such services are utilised or consumed in the Republic otherwise than for the purpose of making taxable supplies" (emphasis added).

[42] A **"taxable supply"** is any supply goods or services which is chargeable with tax under the provisions of section 7(1)(*a*), including tax chargeable at a rate of zero percent under section 11.

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[4] See the definition of "**output tax**" in section 1 of the VAT Act.

[43] Section 11 of the VAT Act provides for zero-rating and provides in relevant part[5]

> "(2) Where, but for this section, a supply of services, other than services contemplated in section 11(2)(*k*) that are electronic services, would be charged with tax at the rate referred to in section 7(1), such supply of services shall, subject to compliance with subsection (3) of this section, be charged with tax at the rate of zero per cent where—
>
> …
>
> (*l*) the services are supplied to a person who is not a resident of the Republic, not being services which are supplied directly—
>
> (i) in connection with land or any improvements thereto situated inside the Republic; or
>
> (ii) in connection with movable property (excluding debt securities, equity securities or participatory securities) situated inside the Republic at the time the services are rendered, except movable property which—
>
> (*aa*) is exported to the said person subsequent to the supply of such services; or
>
> (*bb*) forms part of a supply by the said person to a registered vendor and such services are supplied to the said person for purposes of such supply to the registered vendor; or
>
> (iii) to the said person or any other person, other than in circumstances contemplated in subparagraph (ii)(*bb*), if the said person or such other person is in the Republic at the time the services are rendered, and not being services which are the acceptance by any person of an obligation to refrain from carrying on any enterprise, to the extent that the carrying on of that enterprise would have occurred within the Republic;"

[44] Thus, there is no import tax payable on services supplied by a foreign supplier to a local resident who utilise or consume it in the Republic in the course of supplying goods and services in the course of furtherance of any enterprise carried on by him or her.

THE ISSUES IN DISPUTE

[45] SARS disallowed the input tax deduction and levied additional output tax relating to the services supplied to Taxpayer ZAW in the 'Des' purchase on the basis that it was not acquired

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5 See section 11 of the VAT on "**zero-rating**".

wholly for the purpose of consumption, use or supply in the course of supplying goods or services supplied in the course of furtherance of the enterprise of Taxpayer ZAW as follows:

[45.1] The services rendered in respect of the Rights Offer were not rendered for the purpose of consumption, use or supply in the course of making taxable supplies by Taxpayer ZAW;

[45.2] Taxpayer ZAW has not engaged in any trading activities which constitute the rendering of services in respect of the issuing of shares prior to the acquisition of 'Des' and has not continued to render any services in respect of the issuing of shares;

[45.3] Taxpayer ZAW does not carry on the said activity (the issuing of shares) in a continuous, unchanged or uninterrupted manner; and

[45.4] Taxpayer ZAW did not render the services in respect of the Rights Offer in the course of making taxable supplies, as it did not carry out these activities continuously or regularly.

[46] This dispute regarding the nature of Taxpayer ZAW's enterprise has been the central dispute throughout these proceedings. SARS initially disallowed the input tax deduction and levied output tax on all of the "imported services" on the basis that Holdings conducted an enterprise as a "fast moving consumable goods retailer" (SARS later admitted that this was incorrect).

[47] SARS then disallowed the input tax deduction and levied additional output tax on the basis that:

[47.1] Taxpayer ZAW does not conduct an enterprise of offering rights issues;

[47.2] The shares were issued as an isolated activity and, therefore, did not constitute an enterprise activity;

[47.3] The issuing of shares is not a sufficiently continuous or regular activity so as to constitute an enterprise activity.

[48] The argument for SARS is thus that for the amount claimed to be input tax for Taxpayer ZAW, the services must have been acquired by Taxpayer ZAW wholly for the purpose of consumption, use or supply in the course of making taxable supplies in furthering its enterprise.

[49] These requirements, SARS argues, are not met as it is critical to appreciate that the investment that Taxpayer ZAW holds in its subsidiaries and the management thereof cannot be regarded on their own as constituting an 'enterprise' as defined in section 1 of the VAT Act.

[50] They further argue that the shares issued, the Rights Offer and the expenses related thereto form an isolated activity which is neither carried on continuously or regularly by Taxpayer ZAW and Holdings and that Taxpayer ZAW's main and continuous trading activity does not constitute the rendering of services in relation to rights offers or the issuing of shares. The services rendered in respect of the Rights Offer were not rendered wholly for the purpose of consumption, use or supply in the course of making taxable supplies.

[51] According to SARS, Taxpayer ZAW has not engaged in any trading activities which constitute the rendering of services in respect of the Rights Offer or the issuing of shares prior to the acquisition of 'Des' and has not, since the conclusion of the Rights Offer, continued to render any services in respect of the making of rights offers or the issuing of shares.

[52] In conclusion SARS argue that Taxpayer ZAW did not render the services in respect of the Rights Offer as a part of and in the course of making taxable supplies, as it did not carry out these enterprises or activities continuously or regularly, as part of an enterprise within the narrow meaning of that term in the VAT legislation.

[53] Taxpayer ZAW argue that the VAT was deductible input tax and that some of the foreign services were not "imported services" for the purpose of the VAT Act.

[54] It contends that the services in respect of the Rights Offer were acquired in the course and furtherance of Taxpayer ZAW's enterprise and are costs incurred for the purpose of making taxable supplies, its enterprise includes the management of its subsidiaries, holding investments and the making and funding of acquisitions as contemplated in the definition of input tax.

[55] It argues that the enterprise that it conducts is wider than making Rights Offers or issuing of shares to raise capital, but that such activities form part of their enterprise.

[56] The issue to be decided is the meaning of "taxable supplies" and, more particularly, the meaning of "in the course or furtherance of any enterprise carried on" by Taxpayer ZAW.

[57] An enquiry into the nature of Taxpayer ZAW's enterprise is required to determine this issue.

THE EVIDENCE LED BY TAXPAYER ZAW

[58] Taxpayer ZAW led the following evidence regarding the enterprise that it carries on.

[59] Mr Zacs (the Group Finance Director of Taxpayer ZAW) and Mr Tom (the head of Tax and Treasury) gave evidence regarding Holdings' enterprise, which can be summarised as set out below.

[60] Taxpayer ZAW conducts business as an active investment holding company and is listed on the Johannesburg Stock Exchange ("JSE").

[61] As an investment holding company, Taxpayer ZAW:

[61.1] holds or owns the various subsidiaries of the Group as investments such as Taxpayer ZAW in South Africa and the rest of Africa, Taxpayer ZAW Financial Services, Entity C in Australia, including Entity C, Entity D, Entity E, Entity M and Entity P, Des, Entity A and Entity B;

[61.2] holds cash instruments, derivative instruments for hedging purposes (of interest rates and currency) and other investments in financial markets;

[61.3] endeavours to grow its business organically (by enabling its subsidiaries to grow their businesses) and by acquisitions (such as Des);

[61.4] earns dividends from its subsidiaries;

[61.5] earns interest from loans made to subsidiaries; and

[61.6 earns management fees.

[62] Taxpayer ZAW is an active investment holding company in the sense that it actively participates and assists in the management of its subsidiaries. Taxpayer ZAW provides financial services and management services for its subsidiaries. For these management services Taxpayer ZAW charges a fee. In this regard, Mr Tom testified as follows in cross-examination (underlining added):

> "MR B: … <u>you manage your investments</u> as a holding company. The provisions of services to subsidiaries is an incidental part of managing your investment.
>
> MR TOM: I would not say an incidental part. It is a – <u>that is what you do as</u> <u>an active investment holding company</u>."

And later,

> "MR B: … And where it supplies services to its subsidiaries, that is incidental to its supervising its investments and looking after its investments, correct.
>
> MR TOM: I would say it is an integral part of it."

[63] A key component of the management and financial services provided by Taxpayer ZAW is the management of the Group's capital, to wit the treasury function of the Group. In this regard, Taxpayer ZAW is regularly concerned with:

[63.1] raising the most cost-effective capital for the benefit of its subsidiaries and shareholders, including to deal with contingencies such as was the case during the Covid pandemic;

[63.2] ensuring that sufficient capital is available for the expansion of its business, whether by organic growth or suitable acquisitions (such as Des, but other examples include the acquisition of Entity C, Entity E and Entity M and the minority interest in Entity C from Mr Lew) and for the needs of subsidiaries.

[63.3] ensuring that the capital structure of the Group is appropriate at a group as well as at an individual subsidiary level and the most beneficial to subsidiaries and shareholders (i.e. that the mix of debt and equity is appropriate) and critical to the credit rating given to Taxpayer ZAW by the credit rating agencies;

[63.4] addressing the risks associated with the Group's capital structure for example, the risk of breaching borrowing covenants, the risks of having insufficient liquidity for acquisitions and/or working capital and the risks associated with borrowings in different currencies and at different interest rates; and

[63.5] consideration of and the actual raising of capital whether by issuing of bonds for example by way of domestic medium-term notes or debt for example by way of borrowings from banks and other financial institutions, or scrip dividends, or issuing and purchasing Holdings' own shares.

[64] The board of Taxpayer ZAW determines capital management policy and makes capital management decisions in relation to its own capital as well as that of its subsidiaries. The board has a Treasury committee that reports to it. The reports are considered and inform the capital management decisions made by the board.

[65] Capital management is an essential element of Taxpayer ZAW's function and capital raising is an essential element of capital management. Mr Tom testified that capital may be raised in a

number of ways and that a rights issue is just one of the “tools in the toolbox” of capital management.

[66] Moreover, Taxpayer ZAW is listed on the JSE *inter alia* to gain access to capital markets for the purpose of raising capital. The listing affords Taxpayer ZAW the ability to raise capital by rights issue to its (public) shareholders and thereby access a very large pool of capital (that might not be available to private companies or subsidiaries). As a holding company (that prepares consolidated group accounts), Taxpayer ZAW is able to negotiate (for the benefit of its subsidiaries and shareholders) the most cost-efficient capital. The scale of the Group’s capital requirements enables it to negotiate and obtain more competitive rates or costs, for example, by demanding lower interest rates in respect of debt capital.

[67] A number of skilled persons are employed and involved in providing the capital management services (that are not available at the level of the various subsidiaries), including the members of the treasury committee.

DISCUSSION

[68] It is common cause that the impugned costs were incurred by Taxpayer ZAW to raise capital by rights issue, to wit capital in the form of equity rather than debt to acquire an investment, Des, through its subsidiaries Entity A and Entity B, which it holds and controls.

[69] SARS contends that management services were only rendered by Taxpayer ZAW to ‘Des’ sometime after its acquisition and as such the expenses incurred in respects of the rights offer were not incurred in respect of providing management services to one of Taxpayer ZAW Holding’s subsidiaries on which it charged and made a taxable supply. They also contend that the services for which the expenses were paid were in any event not sufficiently related to the providing of management services to its subsidiaries to qualify as services acquired in the course of making taxable supplies in furthering its enterprise.

[70] Taxpayer ZAW’s case is that its enterprise as a listed, active investment holding company involves acquiring and holding investments and capital management of those investments as well as providing financial and management services to its investment subsidiaries. An integral component of capital management involves raising capital, including by rights issue, which was the correct “tool in the toolbox” for raising the capital necessary for the acquisition of Des. The expenses incurred in that regard were incurred in the course of rendering management services not only to ‘Des’ but to and for the benefit of all its subsidiaries, its shareholders and itself.

[71] SARS relied primarily on the case of *CSARS v De Beers Consolidated Mines Ltd*[6] "the De Beers case" and criticised Taxpayer ZAW for resorting to foreign law to try and support their case.

[72] We agree with SARS that little guidance can be found in foreign case law in this instance, the VAT legislation in terms of which the foreign cases are decided differs from the South African VAT legislation.

[73] This case can be determined by applying the VAT Act to the facts of the case and with reference to South African case law which deal with "enterprise" as defined in the VAT Act.

[74] In the De Beers case the question of whether costs were incurred in the course or furtherance of De Beers' enterprise arose. De Beers had acquired services and incurred costs from local and non-resident service providers because it was the target of a takeover by related parties

[75] It was obliged to incur these costs to comply with its statutory obligations.[7] SARS refused an input tax deduction in respect of the costs incurred from local service providers and treated the services received from non-resident service providers as "imported services" (and levied output VAT thereon). The Supreme Court of Appeal identified the issue for determination and then held as follows (underlining added):

> "The first issue for decision is whether NMR's services were utilised or consumed by DBCM [De Beers] for the purpose of making taxable supplies in the course or furtherance of DBCM's enterprise of buying and selling diamonds.
>
> … DBCM's reason for engaging NMR … was to acquire advice in relation to a takeover by parties to which it was related. Accordingly, its board had a duty to report to the independent unit holders as to whether the offer was fair and reasonable and to obtain independent financial advice in that regard. Those duties were imposed by the Securities Regulation Code … the 1973 Companies Act and by the Listing Requirements of the JSE.
>
> … NMR's services were unrelated to DBCM's core activities, which were the mining and sale of diamonds. NMR was not providing services directed at making any of DBCM's businesses better or more valuable. It was the interest of DBCM's departing shareholders and investors, rather than the interest of DBCM itself, that formed the focus of NMR's services."[8]

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6 2012(5) SA 344 (SCA).
7 At par 25 to 26 and 53.
8 At par 18 and 25 to 26 read with par 28.

[76] And, regarding the contention on behalf De Beers that the advice obtained from the service providers in large part related to shares held in Anglo American PLC, which shareholding it was submitted was integral to the diamond business enterprise, it was held:

> "… unless one conducts business as an investment company, the investments one holds cannot conceivably be regarded on their own as constituting an enterprise within the meaning of that term in the Act."[9]

[77] In summary, the court held that the services acquired by De Beers:

[77.1] were "unrelated" to its enterprise of "mining, marketing and selling diamonds";

[77.2] were not "acquired to enable DBCM to enhance its VAT 'enterprise'", which enterprise was "not in the least affected by whether or not DBCM acquired NMR's services"; and

[77.3] could not "contribute in any way to the making of DBCM's 'taxable supplies''

(underlining added).[10]

[78] In our view the current case is distinguishable from the De Beers case.

[79] The costs incurred by De Beers regarding the takeover were clearly not utilised or consumed by De Beers for making taxable supplies in the course or furtherance of De Beers' enterprise, which is buying and selling diamonds.

[80] Taxpayer ZAW's business is not that of a consumable goods retailer. Taxpayer ZAW indeed conducts business as an investment company, but its business is not limited to holding shares in companies and earning dividends. An integral part of its business is providing financial and management services to its subsidiaries for remuneration, thereby adding value to its subsidiaries in the Taxpayer ZAW Group to the benefit of the subsidiaries and ultimately Taxpayer ZAW.

[81] A further part of the business of Taxpayer ZAW is to acquire shares in further subsidiary companies, not only earning it dividends but earning it income by providing it with financial and management services.

[82] The costs incurred in the acquisition of the shares in 'Des' by way of Entity A and Entity B was for the benefit of both its investments (its subsidiaries or businesses) to which it renders

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[9] At par 34.
[10] At par 53

financial and management services for remuneration and itself by way of increased management fees and dividends to make its business better and more valuable.

[83] In the matter of *Consol Glass (Pty) Ltd v CSARS*[11] the Court had to decide a similar issue, whether, in respect of services acquired relating to a debt restructuring, Consol was entitled to an input tax deduction in respect of costs incurred from local service providers and whether Consol was obliged to pay output tax on services acquired from non-resident service providers because such services met the definition of imported services. Unterhalter JA identified the issues for determination and then held as follows (the extract is from various paragraphs, as identified in the footnote):

> "Two issues require determination … First, for what purpose did Consol acquire the services? Second, did Consol do so in the course of making taxable supplies. The relationship between the purpose for which the services were acquired and the use to which these services were put lies at the heart of the matter …
>
> Neither the original issuance of the Eurobonds, nor the loans secured from the local consortium, transformed Consol from a vendor engaged upon the enterprise of selling glass containers into a vendor engaged also upon the enterprise of supplying financial services …
>
> Consol was not a supplier of financial services. Consol was a manufacturer and supplier of glass containers.
>
> … there was no functional link between the [costs] and the making of taxable supplies… the purpose of using these services was to … finance the reorganisation that had taken place …"[12]

[84] The Supreme Court of Appeal considered the question of how closely the services acquired should be associated with the enterprise for them to be considered for the "purpose of making taxable supplies", i.e., in the "course or furtherance of conducting an enterprise". The court referred to a "functional link" between the costs/services and the enterprise.

[85] As dealt with above, the evidence led by Taxpayer ZAW establishes that its business enterprise is that of an active, investment holding company. This encompasses *inter alia* the supply of capital management services and financial services for remuneration. The question then is whether there is a functional link or connection between the services acquired and Holdings'

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[11] 2020[ZASCA] 175 (18 December 2020)
[12] At par 12, 14, 20, 22,
26, 36, 37 and 43

enterprise, to wit was the purpose of the services acquired sufficiently closely linked to Taxpayer ZAW's enterprise to be considered "in the course or furtherance" thereof.

[86] We find that such a functional link or connection exists because:

[86.1] Taxpayer ZAW acquired the services for the purpose of raising capital and, ultimately, for the purpose of acquiring Des;

[86.2] This was not the first time that Taxpayer ZAW acquired businesses and financed such acquisitions by raising capital, it is not an isolated incident;

[86.3] Taxpayer ZAW's business enterprise involves capital management and the efficient and cost-effective raising of capital, whether in the form of debt or equity;

[86.4] Taxpayer ZAW's business enterprise involves the acquisition, holding and managing of its investments;

[86.5] Taxpayer ZAW provides management services to its subsidiaries and is remunerated for it.

[86.6] Taxpayer ZAW utilised its subsidiaries Entity B and Entity A to hold the shares in Des;

[86.7] Taxpayer ZAW expanded its business and enterprise by the acquisition of Des, this leads to it earning additional management fees, on which it pays output tax and also earns other income in the form of dividends and, when applicable, interest);

[86.8] Taxpayer ZAW chose, after detailed consideration and as part of its capital management services, to raise the capital for the acquisition by way of a rights issue to ensure an appropriate capital structure was maintained in the interest of Holdings and its shareholders; and

[86.9] Taxpayer ZAW rendered partly zero-rated financial services by issuing shares to raise the capital.

[87] We find that Taxpayer ZAW's actions in expanding its business and incurring costs, both local and foreign, in the course thereof has a functional link to the making of its VAT taxable supply of management services to its subsidiaries and that the expenses incurred in this regard were incurred wholly for the purpose of consumption, use or supply in the course of supplying goods and services (taxable supplies) and in the course or furtherance of its enterprise.

[88] The result is that regarding the 'Des' acquisition Taxpayer ZAW was entitled to deduct the impugned input tax paid by it in the calculation of its VAT and was not liable to pay VAT on the impugned services supplied by foreign entities.

[89] Consequently, SARS was not entitled to levy understatement penalties.

[90] In view of our decision, we cannot find any reason why the additional assessment should be referred back to SARS for further examination and assessment in terms of section 129(2)(*c*) of the Tax Administration Act.

[91] Although SARS made some unfortunate allegations regarding the date of the F Company opinion and the furnishing thereof to SARS we cannot find that the decision of SARS to issue the additional assessment is unreasonable and therefore we do not make any order as to costs.

[92] In the circumstances we make the following order:

(a) The appeal is upheld;

(b) the additional assessment dated 14 December 2017 for the tax period February 2015 is set aside; and

(c) the understatement penalty is to be remitted to Taxpayer ZAW Limited

DATED at CAPE TOWN this 14th day of MARCH 2023

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E S Grobbelaar

Acting Judge of the Tax Court

I agree

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T Pasiwe

Member of the Tax Court

I agree

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E Gouws

Member of the Tax Court