



Republic of South Africa
IN THE TAX COURT OF SOUTH AFRICA
(HELD AT THE WESTERN CAPE DIVISION: CAPE TOWN)

Case No: IT 24502

U TAXPAYER

Applicant

and

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

Respondent

Court: Justice J I Cloete

Heard: 11 May 2023

Delivered electronically: 2 June 2023

JUDGMENT

CLOETE J:

[1] This is an opposed interlocutory application in terms of rule 51(2) of the tax court rules¹ for ‘a *legality review in limine as part of*’ the appellant’s pending tax

¹ Promulgated under s 103 of the Tax Administration Act 28 of 2011 (“TAA”).

appeal. In this judgment unless otherwise indicated reference to a “rule” is to a tax court rule.

[2] The *‘principal purpose’* of the application is to seek the separate, advance determination of three “legal issues”. If the court grants the principal relief, the *‘secondary purpose’* is twofold and *‘to the extent necessary’*: (a) for leave to amend the applicant’s rule 32 statement “consequentially”; and (b) permitting the applicant to raise a *‘collateral, defensive or reactive’* challenge to the lawfulness of the additional assessments referred to below. According to the applicant the three legal issues are potentially dispositive of the pending appeal, and if any one of them is determined in his favour there will be no need for the appeal to proceed for the hearing of evidence.

[3] The dispute between the parties has its origin in a tax-driven scheme to create a pool of reserves giving rise to STC² “credits” that could offset the anticipated STC liabilities arising on future dividend declarations by third party South African companies that acquired them. According to the respondent (“SARS”) this occurred in order to convert taxable income of those South African companies into tax-exempt dividend income.

[4] In the appeal SARS contends that the applicant and another individual, P, were the promoters of the scheme through amongst others two South African private companies, T and – in the case of P – J. SARS asserts that the applicant and P directly and indirectly earned substantial fees for their efforts. In the case of the

² Secondary tax on companies.

applicant this amounted to just over R44 million (P has since fallen out of the picture after arriving at a settlement with SARS).

[5] However, SARS maintains, these “fees” were not paid to the applicant (and P) as taxable income – as they should have been – but as repayments of loan claims received in the form of tax-free dividends flowing to the applicant and a certain trust which was not only the shareholder of J but to which P was connected. It is in respect of these “fees” that SARS assessed the applicant and P for tax, relying on the powers of the Commissioner under the general anti-avoidance rules (“GAAR”) contained in Part IIA of the ITA.³

[6] In the SARS rule 31 statement the following allegations are made which are directly relevant to determination of this interlocutory application:

‘Creation of an STC credit pool

10. *What is set out below is a summary of the purchase and sale transactions which, to the best of the Commissioner’s knowledge, were undertaken by T from time to time for the purpose of creating a stock of secondary tax on companies (“STC”) credits. T formed an integral part of the arrangements designed by the appellant to carry out the impermissible tax avoidance schemes that resulted in the assessments appealed against.*

11. *T’s purchase and sale transactions involved two separate [offshore] companies, namely E and R, about which more is said below.*

The E transactions

...

³ Income Tax Act 58 of 1962.

The R transactions

...

The effect and use of the STC credit pool

...

The fee portion and rights of U

...

53. *As stated previously, the Commissioner contends that all of the transactions, their constituent parts and the cash flows described above constitute an impermissible avoidance arrangement for the purposes of Part IIA of the IT Act.*
54. *The “arrangement” or “arrangements” consist/s of the following:*
- 54.1 *The transactions between T, its subsidiaries and the [offshore] companies, giving rise to certain T subsidiaries holding promissory notes issued by T;*
- 54.2 *The declaration of certain T promissory notes to U (described in detail in paragraphs 37 to 42 above);*
- 54.3 *The “settlement” of the promissory notes held by U via T becoming obliged to pay those parties the net income from specific transactions involving specific T subsidiaries (described in paragraphs 37 to 42 above); and*
- 54.4 *In each case following a sale by T, the payment by T of amounts to U for services rendered.*
55. *Each arrangement involving the steps listed above is a separate arrangement for the purposes of the GAAR, consisting of a set of preconceived transactions which, separately and together, constitute a “scheme”... and the definition of “arrangement” in section 80L.*
56. *Each arrangement was entered into to obtain a tax benefit, is in any event presumed in terms of section 80G to have been entered into to obtain a tax benefit, and factually resulted in a “tax benefit” for U in that*

(by virtue of the way that the arrangements were structured, including the tax/accounting treatment adopted by T) the fee amounts paid by the counterparties flowed in part to U without South African income tax or STC being levied at any stage.

57. *Had the T structure not been employed, the fee amounts would have been taxable in the hands of the recipients, including U...'*

[emphasis supplied]

[7] On 8 May 2020 the applicant launched an application for the striking-out of certain portions of the rule 31 statement. The underlying basis was the inclusion in paragraph 55 of that statement of the words '*separately and*' before '*together*' which had not appeared in the preceding s 80J notice and finalisation of audit letter. According to the applicant this was an impermissible attempt by SARS to broaden (or novate) its case.

[8] The striking-out application was dismissed in the tax court by Ndita J who found inter alia that the words '*separately and together*' is only relevant to what the Commissioner considers to be a '*scheme*' for purposes of GAAR. She pertinently found:

'[76] ...I understand this to be so because in terms of the rule 31 statement, a "scheme" is constituted by each arrangement separately or by viewing any of the arrangements together, whereas in terms of the section 80J notice and the finalisation of audit letter a "scheme" is constituted by viewing each of the arrangements together. It follows that the introduction of the words "separately and" in the Rule 31 statement does not alter the basis upon which [the applicant] was assessed. Neither do they constitute the novation of the whole of the factual or legal basis of the disputed assessment.'

- [9] In the present application the applicant essentially advances the same argument which failed before Ndita J in support of two of his three “legal issues”, albeit in a different guise. These are what he has characterised the ‘*impossibility*’ and ‘*legality*’ issues. In truth they are also actually one issue.
- [10] The applicant contends that the relevant subparagraphs of the rule 31 statement are only capable of two possible interpretations, namely either each of the “steps” contained in subparagraphs 54.1 to 54.4, or each combination of those steps, is an arrangement which resulted in a tax benefit to him. He maintains that, for a host of legal and ‘*factual*’ reasons, these two interpretations are not sustainable. (His assertions and submissions about a ‘*tax benefit*’ to him were not pursued in argument).
- [11] In advancing the above, the applicant places great reliance on the contents of an affidavit deposed to by Dr Matthew Marcus in opposition to the previous striking-out application. Dr Marcus is a senior specialist in the SARS audit department and he is responsible for the applicant’s audit. In that affidavit he provided an explanation for why he disagreed that the paragraphs complained of impermissibly broadened (or novated) SARS’ grounds of assessment.
- [12] Leaving aside the fact that SARS disputes the applicant’s interpretation of Dr Marcus’ evidence, such evidence is inadmissible. Interpretation is a matter of law, not fact.⁴ In addition, as found by Ndita J:

⁴ *KPMG Chartered Accountants (Pty) Ltd v Securefin Ltd and Another* 2009 (4) SA 339 (SCA) at para [39].

[75] Whereas, one understands the need to explain the notices on the part of Mr Marcus, it must be stated from the outset that it is not only undesirable, but impermissible for Mr Marcus to attempt to proffer an explanation of what his intention was when he issued any of the notices. His explanation of his intention is ex post facto. In National Lotteries Board v South African Education Project⁵ the court held that further reasons are ex post facto justifications, not the true reasons for the decision, and accepting them would be unfair to an applicant for judicial review. The court further endorsed the following approach of the English Appeal Court in R v Westminster City Council, ex parte Ermakov⁶...

Although the foregoing was said in the context of a judicial review application, it is, by parity of reasoning equally applicable in casu...'

- [13] In any event the applicant's argument that the relevant subparagraphs are only capable of the above two interpretations is fundamentally flawed. This is because paragraph 54 cannot be read in isolation. Although it identifies the 'arrangement' or 'arrangements' as consisting of what follows in subparagraphs 54.1 to 54.4, paragraph 55 expressly commences with the words '[e]ach arrangement involving the steps listed above is a separate arrangement for the purposes of the GAAR'. The applicant's approach also overlooks the other pleaded paragraphs and it is trite that the pleading in question must be read, for purposes of interpretation, as a whole.
- [14] The third "legal issue" which the applicant seeks to have determined in advance is what he has characterised the 'compensating adjustments issue'. This is formulated by the applicant as follows:

⁵ 2012 (4) SA 504 (SCA) at para [27].

⁶ [1995] 2 All ER 302 (CA) at 315h-316d.

'10.1.7 This is a purely legal issue as there are no disputes of fact. The Commissioner , by his own admission, did not make what I contend are mandatory compensating adjustments. He has explained why (see 10.2.6 below), and I submit that the court must make a decision based on that explanation. In fact, the Commissioner cannot be allowed to offer ex post facto evidence of his reasoning. He has made a decision and must stand or fall by it. Any attempt by the Commissioner to argue that a dispute of fact exists here should, I submit, therefore be rejected.'

[15] This is answered by SARS as follows:

'118.2 I am advised that the jurisdictional prerequisite for the Commissioner to make compensating adjustments arises in the event that the Commissioner is satisfied that the compensating adjustments are "necessary and appropriate". If the Commissioner is not so satisfied, he is not required to make compensating adjustments. Thus the section 80B(2) requirement that the Commissioner make compensating adjustments is in the first instance dependent on the Commissioner's satisfaction that such compensating adjustments are indeed necessary and appropriate.

118.3 The applicant's contention that the failure by the Commissioner to make compensating adjustments renders the assessments issued invalid and unlawful is denied:

118.3.1 First, the issue of compensating adjustments is relevant to taxpayers other than the assessed taxpayer i.e. the applicant. The tax affairs of other taxpayers (T) have no bearing on the assessments issued against the applicant.

118.3.2 Second, the Commissioner was satisfied that compensating adjustments are not "necessary and appropriate"...

118.4 *Any contention that the Commissioner failed to exercise his discretion to make compensating adjustments correctly could have formed the subject matter of a complaint by the affected party, in respect of which the applicant does not have locus standi. It is for the party that claims it is entitled to compensating adjustments (such as T), to take such steps to claim them as may be necessary.'*

[16] Section 80B(2) of the ITA provides in relevant part that:

'...the Commissioner must make compensating adjustments that he or she is satisfied are necessary and appropriate to ensure the consistent treatment of all parties to the impermissible avoidance arrangement.'

[emphasis supplied]

[17] The Commissioner's stance on this score is undoubtedly correct. The requirement that the Commissioner make compensating adjustments is in the first instance dependent on his satisfaction that such compensating adjustments are indeed necessary and appropriate. Clearly, his decision not to make adjustments must be rationally connected to the power given to him in s 80B(2), but the applicant has no *locus standi* to challenge this.

[18] The applicant's contention that the Commissioner is obliged to make compensating adjustments and by not doing so, he renders the applicant's assessment invalid and unlawful is devoid of merit. First, the Commissioner is not "obliged" to make compensating adjustments as is clear from the wording of the subsection itself. Second, the issue of compensating adjustments is relevant to taxpayers other than the assessed taxpayer, i.e. the applicant. Put

differently, the tax affairs of other taxpayers (T) had no bearing on the assessments issued against the applicant. It is for T, should it claim that it is entitled to compensating adjustments, to take such steps to claim them as may be necessary (which, as I understand it, has not occurred).

[19] The primary purpose of the relief sought by the applicant is thus without foundation. No purpose would be served by granting him leave to amend his rule 32 statement to support his flawed interpretation of SARS' pleading and the same applies to his quest for a collateral challenge (leaving aside the considerable merit in SARS' argument that the applicant put the cart before the horse).

[20] That leaves the issue of costs as provided for in s 130(3)(b) of the TAA. This is where the litigation history between the parties to date becomes relevant. The pleadings proper commenced with the Commissioner's rule 31 statement on 31 January 2018. The applicant's rule 32 statement was delivered on 29 May 2018, followed by SARS' rule 33 statement on 27 June 2018.

[21] Some two years later, on 9 April 2020, the applicant substantially amended his rule 32 statement. Thereafter on 8 May 2020 he launched the striking-out application referred to above. Ndita J delivered her judgment on 12 November 2020. The applicant appealed the dismissal of the striking-out application to the High Court. The appeal was heard on 28 January 2022 and judgment was delivered on 10 March 2022. The High Court dismissed the appeal with costs on the basis that Ndita J's order was not appealable. Undeterred, the current

application was brought by the applicant some 27 months after the judgment of Ndita J and 11 months after the dismissal of the appeal by the High Court.

[22] The significance of the delay lies in the fact that the foundational basis of the present application is the striking-out application and, in large measure, the affidavit deposed to by Dr Marcus in those proceedings. Moreover during November 2022 the appeal itself was allocated to me for hearing from 2 to 12 May 2023. The applicant only launched this application on 20 March 2023, a mere six weeks prior to the scheduled commencement of the appeal, with the consequence that it could not proceed. The applicant appears to place passing reliance on having had sight of the decision in *Forge Packaging*.⁷ However that decision was handed down on 13 June 2022; and, as far as can be gleaned from his papers, the only reliance which the applicant places thereon is with reference to his so-called collateral challenge.

[23] The applicant's founding papers (including his direct reference to the striking-out application) ran to 609 pages. Although I accept that he is now representing himself, he is hardly a lay person. Given the delay; the length of his papers; the inordinate amount of time which this court had to expend trawling through those papers; the inevitable and unnecessary cost to SARS in having to deal therewith; and what is a baseless application, I conclude that this is one of those instances where the applicant must bear the costs. In this regard, it is noted that he was not ordered to pay costs in the striking-out application.

⁷ *Forge Packaging (Pty) Ltd v The Commissioner for the South African Revenue Service* (21634/2021) [2022] ZAWCHC 119 (13 June 2022).

[24] The following order is made:

'The application is dismissed with costs on the scale as between party and party, including the costs of two counsel where so employed.'

J I CLOETE