40/71

G.P.-S.43575—1969-70—2,000 J 219

40/71

In the Supreme Court of South Africa
In die Hooggeregshof van Suid-Afrika

(APPELLATE ~~Provincial~~ Division)
(Provinsiale Afdeling)

Appeal in Civil Case
Appèl in Siviele Saak

SECRETARY FOR INLAND REVENUE *Appellant,*

versus

GEUSTYN, FORSYTH & JOUBERT *Respondent*

Appellant's Attorney Dep.State Atty.
Prokureur vir Appellant

Respondent's Attorney Naude & Naude
Prokureur vir Respondent

Appellant's Advocate M. J. Monty S.C
Advokaat vir Appellant & H. J. Pieiar

Respondent's Advocate D A Meiamet S.C
Advokaat vir Respondent & L F Vlieger

Set down for hearing on
Op die rol geplaas vir verhoor op 3 - 5 - 1971

1. 4. 5. 7. 9

Ogilvie Thompson C J Holmes, Jansen, Rabie J.J.A.
et Corbett A J A.

TPD 9.45 am ——— 11.00 am
11.15 am ——— 12.45 pm

O. a. V.

18-5-71

Order for Ogilvie Thompson C J :-
appeal dismissed with Costs to include costs
of two Counsel.

Writ issued Lasbrief uitgereik	Bills Taxed—Kosterekenings Getakseer		
	Date Datum	Amount Bedrag	Initials Paraaf
Date and initials Datum en paraaf			

IN THE SUPREME COURT OF SOUTH AFRICA.
(APPELLATE DIVISION).

In the matter between:

SECRETARY FOR INLAND REVENUE ..... Appellant

and

GEUSTYN, FORSYTH AND JOUBERT ..... Respondent.

Coram: OGILVIE THOMPSON, C.J., HOLMES, JANSEN, RABIE, JJ.A., et CORBETT, A.J.A.

Heard: 3rd May 1971. Delivered: 15th May 1971.

J U D G M E N T.

OGILVIE THOMPSON, C.J.:

Respondent is a company which was, on 25th May 1966, incorporated with unlimited liability pursuant to the provisions of sec. 5(c) of the Companies Act (No. 46 of 1926). Since 1st June 1966 the respondent has carried on the business of Consulting Engineers. In respect of the year of assessment ended 28th February 1967 the respondent's taxable income was R72,840, upon which

the/.....

the normal tax payable would have been R29,136. In determining respondent's liability for normal tax for that year of assessment, the appellant (hereinafter referred to as "the Secretary") however invoked sec. 103 (1) of the Income Tax Act (No. 58 of 1962, hereinafter referred to as "the Act") and allocated the whole of respondent's aforementioned taxable income to its only three shareholders during the tax year in issue (to wit: P.J. Geustyn, K.W. Forsyth and J.D. de B. Joubert). In consequence, the Secretary issued respondent with an assessment reflecting that it had no taxable income in the year of assessment in question. Against this assessment respondent lodged an objection on the ground that it incorrectly reflected that respondent had no taxable income for the tax year in issue despite the fact that respondent's income for that year was R72,680 (this being the figure reflected in respondent's profit and loss account for the period 1st

June...../

June 1966 to 28th February 1967). The objection was overruled and respondent appealed to the Transvaal Income Tax Special Court. That court held that the circumstandes of the case do not rightly fall within the ambit of sec, 103 of the Act and that, consequently, the assessment should be set aside and remitted to the Secretary for amendment. Against that decision the Secretary - the written consents prescribed by sec. 86 (1) (b) of the Act having been duly lodged - now appeals direct to this Court.

The salient facts as set out in the statement of case may be briefly stated. From 1961 onwards the aforementioned P.J. Geustyn, K.W. Forsyth and J. de B. Joubert - all of whom are qualified Civil Engineers and members of the South African Association of Consulting Engineers - had practised in partnership as Consulting Engineers. The partnership practice expanded fast, and by May 1966 the firm employed a staff of 42 white persons, including 17 qualified engineers, and, in addition, 18 non-white persons. Pursuant to a decision of the partners

- arrived at for reasons hereinafter mentioned - to form an unlimited company to take over the partnership business, respondent company was on 25th May 1966 incorporated with a share capital of R5,000 divided into 5,000 shares of R1.00 each. The assets and liabilities of the partnership were taken over by the respondent company at the figures reflected in the balance sheet of the partnership as at 25th May 1966. In addition, the respondent undertook to pay the partnership R240,000 for goodwill and to employ the three partners at an annual salary of R10,000 each. All the shares in the respondent were issued to the three former partners in equal shares. The three partners became the sole directors of the respondent company. In respondent's books the goodwill of R240,000 was credited to the directors' loan accounts in equal amounts of R80,000 each. Save for a shareholders' agreement imposing, in the event of a former partner ceasing to be a shareholder, a restraint against practice unless he forfeit his share of goodwill, no written

agreements.../

agreements were concluded between any of the respective persons concerned. In particular, no service contract was entered into between the respondent and the former partners. The respondent furnished no guarantee for the payment of the goodwill, the former partners relying solely upon their control of respondent to secure such payment.

So far as is relevant to the present case, sec. 103 of the Act reads:

> "(1) Where any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property) has been entered into or carried out which has the effect of avoiding or postponing liability for any tax, duty or levy on income (including any such tax, duty or levy imposed by a previous Act), or of reducing the amount thereof, and which in the opinion of the Secretary, having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out -
>
> (i) was entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or

(ii) has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question,

and the Secretary is of the opinion that the avoidance or the postponement of such liability, or the reduction of the amount of such liability was the sole or one of the main purposes of the transaction, operation or scheme, the Secretary shall determine the liability for any tax, duty or levy on income and the amount thereof as if the transaction, operation or scheme had not been entered into or carried out or in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.

(2) .....

(3) .....

(4) Any decision of the Secretary under sub-section (1), (2) or (3) shall be subject to objection and appeal, and whenever in proceedings relating thereto it is proved that the transaction, operation, scheme, [redacted] ..... in question would result in the avoidance or the postponement of liability for payment of any tax, duty or levy on income or in the reduction of the amount thereof, it shall be presumed, until the contrary is proved -

(a) in the case of any such transaction, operation or scheme, that its sole or one of its main purposes was the avoidance or the postponement of such liability or the reduction of the amount of such liability; or

(b) ..... "

To warrant a determination by the Secretary of liability

for.../

the amount of such liability was, in the opinion of the Secretary, the sole or one of the main purposes of the transaction, operation or scheme.

In terms of sub-sec. (4) (a), once it is proved that the transaction, operation or scheme in issue would result in the avoidance, postponement or reduction of tax, it is, until the contrary is proved, presumed that the sole purpose, or one of the main purposes, of the transaction, operation or scheme was the avoidance, postponement or reduction of tax. Subject to this presumption, all the four requisites listed (a), (b), (c) and (d) above must, however, coexist in order to justify the Secretary in invoking Sec. 103 (1) of the Act.

Although a major criterion prescribed by sub-sec. (1) is the opinion of the Secretary, his decision thereunder is by sub-sec. (4) expressly rendered "subject to objection and appeal". Consequently, the Special Court may, on appeal to it by the taxpayer, re-hear the whole case and, if it so decides, substitute

its..../

its own decision for that of the Secretary (cf. Rand Ropes (Pty.) Ltd. v. Commissioner for Inland Revenue, 1944 A.D. 142 at 148 - 151). Relying primarily upon that case, counsel for respondent in the present appeal submitted that the decision of the Special Court could only be altered upon review grounds - that is to say, upon it being shown that the Special Court acted mala fide, or did not properly apply its mind to the matter, or committed some other irregularity. That is, however, to take too narrow a view of the position. For, sec. 86 (1) of the Act provides that, although no appeal lies against the decision of the Special Court "on a question of fact", the taxpayer or the Secretary may, "upon the determination of an appeal" by the Special Court, appeal to the appropriate Provincial or Local Division - or, by consent, direct to the Appellate Division - if dissatisfied with the Special Court's determination "as being erroneous in law". A decision of the Special Court given under sec. 103 (4) plainly falls within the

expression "the determination of an appeal", occurring in sec. 86 (1) of the Act. Accordingly, a party - i.e., the Secretary or the taxpayer - who is dissatisfied with the decision of the Special Court given under sec. 103 (4), may appeal against that decision as being "erroneous in law".

In deciding whether or not the Secretary correctly invoked the provisions of sec. 103 (1) of the Act, the Special Court must first find the primary facts and then determine what inferences rightly flow therefrom. Such inferences will themselves usually also constitute findings of fact - the so-called secondary facts; see Willcox & Others v. Commissioner for Inland Revenue, 1960 (4) S.A. 599 (A.D.) at 602 - but may, under certain circumstances, also include questions of law (cf. Commissioner for Inland Revenue v. Stott, 1928 A.D. 252 at 259; Morrison v. Commissioner for Inland Revenue, 1950 (2) S.A. 449 (A.D.) at 455; Secretary for Inland Revenue v. Cadac Engineering, 1965 (2) S.A. 511 (A.D.) at 520 - 521.)

Difficulty...../

Difficulty not infrequently arises in differentiating between questions of fact and questions of law; and, although a Special Court's enquiry may of course in any given case entail a decision upon a matter which is incontrovertibly a question of law, the aforementioned difficulty is no less liable to present itself in the context of appeals against the decisions of Special Courts given under sec. 103 (4) of the Act. It is, however, unnecessary for the decision of this case to elaborate on these matters. It is sufficient to emphasise that any party seeking to set aside the decision of a Special Court given under sec. 103 (4) of the Act must show that decision to be "erroneous in law". Consequently, in so far as an appellant attacks the decision of a Special Court, given pursuant to sec. 103 (4) of the Act in relation to what is in reality "a question of fact", he can only succeed if he shows that the Special Court's conclusion is one which could not reasonably have been reached (Strathmore Holdings (Pty.) Ltd. v. Commissioner for Inland Revenue, 1959 (1) S.A. 460 (A.D.) at 467 (H);

Goodrick v. Commissioner for Inland Revenue, 1959 (3) S.A. 523 (A.D.) at 527 - 529) or, as the matter is sometimes expressed, that "the true and only reasonable conclusion contradicts the determination" made by the Special Court (Commissioner for Inland Revenue v. Strathmore Consolidated Investments, 1959 (1) S.A. 469 (A.D.) at 475 H.). This was, indeed, not disputed by counsel for the Secretary in the present appeal who advanced his submissions on that basis.

In deciding in favour of the respondent, the Special Court found that there was nothing abnormal either in the aforementioned conversion of the partnership into an unlimited company or in relation to the latter's undertaking to pay R240,000 for goodwill, and came to the conclusion that "the transaction was not abnormal as contemplated by sec. 103 of the Act, and that the reduction or postponement of tax was not a factor which was taken into consideration by the partners in deciding to practise (as) an unlimited company".

It..../

It is common cause that on the facts of the present case the first two requisites - i.e., those lettered (a) and (b) supra - of sec. 103 (1) of the Act are established (see Smith v. Commissioner for Inland Revenue, 1964 (1) S.A. 324 (A.D.) at 333 E.). In submitting that the only reasonable conclusion to be drawn from the facts is that the third of the above-mentioned requisites is also established, counsel for the Secretary criticised the formation of a company by the partners and pointed to various features of the case, more especially the following: the disparity between the partnership's earnings and the salary of R10,000 p.a. which each of the partners accepted from the respondent; the R240,000 goodwill; the absence of any security therefor or of any stipulation governing payment at any particular time; the absence of any service contracts binding the former partners to continue to work for respondent. The cumulative effect of these considerations is such - so the submission ran - as irresistibly to reveal the transaction in issue

as...../

as being both abnormal in terms of 103 (1) (i) and establishing rights or obligations which "would not normally be created between persons dealing at arm's length" within the meaning of those words as they appear in sec. 103 (1) (ii) of the Act.

Generally speaking, there is nothing abnormal in transferring an existing partnership business to a company: indeed, such a transaction may, I think, fairly be regarded as relatively commonplace in the commercial world. That professional men carrying on their profession in partnership should transfer their practice to an unlimited company may no doubt at first sight appear to be somewhat extraordinary. In the present case, however, the undisputed facts place a different complexion on the matter. Not only has the South African Association of Consulting Engineers - of which, as already mentioned, the afore-named three erstwhile partners are members - expressly sanctioned its members forming unlimited companies to conduct their practices, but more than half the Associations.../

sociation's membership has already adopted that form of practice. Similarly, it is said that more than half of the twenty-eight known non-members of the Association who are practising as Consulting Engineers are at present registered companies. Nor is this peculiar to the Republic; for, according to the stated case, the majority of Consulting Engineers in England, Canada, France, Switzerland and Japan practise in corporate form. Moreover, the stated case shows that the erstwhile partners regarded as considerable the advantages to be derived from incorporation, as contrasted with partnership which was liable to dissolution consequent upon death, resignation and the like. Such advantages inter alia embraced the facility of participation in consortiums of engineers engaged upon large projects, the ability to increase the participation in profits by qualified Engineer-employees while, at the same time, eliminating the necessity to restrict the number of partners to the legal limit of twenty. In this last-mentioned connection, it is not

inapposite..../

inapposite to mention that on 1st March 1967 the three original shareholders in respondent sold 1,500 shares to six new shareholders, each receiving 250 shares. These six new shareholders were all qualified Engineers employed by the respondent. The admission of more Employee-Engineers as shareholders was contemplated, and it was anticipated that the total number of shareholders would in the forseeable future rise to fifteen. In addition to a salary of R10,000 p.a. each, the three aforenamed erstwhile partners each received a director's fee of R7500 for the tax year in issue and interest calculated at 8½ per cent on their respective loan accounts. All these receipts were, of course, subject to tax. The figure of R240,000 for goodwill was arrived at by aggregating three years' profits, a computation which, in itself, is not criticised by the Secretary. The absence both of any security furnished by respondent and of any service contracts binding the erstwhile partners to continue to work for respondent is explicable by reason of

the.../

the inherent circumstances that the aforenamed erstwhile partners made over their practice to respondent, of which they remained in full control.

Having regard to the various considerations indicated in the preceding paragraph hereof, a conclusion that the transaction in issue was not abnormal within the meaning of sec. 103 (1)(i) is not, in my judgment, a conclusion which could not reasonably be reached by the Special Court.

Whether the same can rightly be said to obtain in relation to sec. 103 (1) (ii) of the Act presents more difficulty. Sec. 103 (1) is couched in very comprehensive terms, but, in forming his opinion in relation to sub-paragraphs (i) and (ii) of the section, the Secretary is required to have regard "to the circumstances under which the transaction, operation or scheme was entered into or carried out". The criterion of "persons dealing at arm's length" mentioned in sec. 103 (1) (ii) is, however, not easy of application in a

case such as the present. For the section enjoins the application of that criterion in relation to a transaction, operation or scheme "of the nature of the transaction, operation or scheme in question". Yet the Court is in the present case ex hypothesi concerned with partners who have, in the circumstances outlined above, made over their practice, not to an independent third party with whom they would ordinarily deal "at arm's length", but to an unlimited company of which they are the sole shareholders and directors and whereof they have full and complete control. However, inasmuch as it is not essential for the decision of this case to pronounce upon this particular aspect of the matter (which was not exhaustively argued before us), I prefer to express no conclusion upon the point. I shall accordingly assume, without deciding, in favour of the Secretary that, despite the Special Court's afore-cited conclusion that the transaction was "not abnormal as contemplated by sec. 103 of the Act", it erred in law in not finding

that...../

that the transaction in issue "created rights or obligations which would not normally be created between persons dealing at arm's length" within the meaning of those words as they occur in sec. 103 (1) (ii) of the Act.

Notwithstanding this assumption, the appeal can only succeed if it be shown that the Special Court could not reasonably have concluded that the fourth requirement of sec. 103 of the Act (viz: that the avoidance, postponement or reduction of tax "was the sole or one of the main purposes of the transaction") had not been established. In this regard the Secretary is, as already mentioned, greatly aided by the presumption created by sec. 103 (4) for, inasmuch as it is common cause that it was proved that the transaction in issue would result in the avoidance, postponement or reduction of liability for tax, there was thus an onus upon respondent to prove the contrary to the Special Court.

The statement of case contains the following paragraph, viz:

"The...../

2 (11). "The question of income tax was also considered and the partners were advised by their accountants that although there would be an immediate advantage by forming the partnership into a company, in the long run there would be little tax advantage to the partners, and that this was not a factor in deciding whether to convert the partnership into a company".

It was suggested by counsel for respondent that the concluding words of this paragraph were decisive against the Secretary. I am unable to agree. The paragraph is no doubt somewhat unhappily worded and must certainly be regarded as ambiguous. But I cannot conceive that the Secretary intended - as is now the effect of the submission advanced by counsel for respondent - by this paragraph to admit that tax advantage was not a factor in the decision to convert the partnership into a company. Such an admission would be a negation of the whole appeal. In my judgment, paragraph 2(11) of the stated case should be read as conveying no more than that the partners were advised that tax advantage was not a factor in relation to the afore-mentioned decision. This reading is in entire conformity with the following passage occurring

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in the judgment of Hill, J., delivering the unanimous decision of the Special Court, viz:

> "The question of possible tax savings was discussed with Mr. Johnson before the partners decided to form a company, but both Mr. Forsyth and Mr. Johnson testified that the saving of income tax was not a factor in deciding to convert the partnership into a company. In fact Mr. Johnson advised the partners that any immediate tax advantages should be disregarded as such would merely be of a temporary nature. This evidence was unchallenged and we can find no reason to doubt the truthfulness of the two witnesses. We also agree with the submission that it would be unreasonable to suppose that three professional men, each earning in excess of R30,000 per annum, would have regarded one year's tax saving of R1,456 as a prime motive for changing their partnership into a company with all the attendant costs."

The figure of R1,456 here mentioned was the witness Johnson's calculation of the true amount of tax saved, during the year of assessment in issue, consequent upon the conversion of the partnership into a company. This evidence - which was accepted by the Special Court - was given in refutation of the contention, based upon a schedule which now constitutes annexure "B" of the stated case, that, consequent upon allocating respondent's

afore-mentioned taxable income of R72,840-00 equally amongst the three erstwhile partners, the aggregate taxes payable would be R19,955-00 more than they would be were respondent to pay the normal tax (namely R29,136-00) upon the said R72,840-00.

Calculation of the amounts of tax payable before and after the conversion of the partnership into a company must, of course, be made with due regard to the provisions of sections 19 (3) and 50 (f) of the Act. Before this Court, counsel for the Secretary did not criticise the afore-mentioned figure of R1,456-00 or question that any initial tax advantage consequent upon conversion of the partnership into a company would diminish with the years, but based his attack against the Special Court's conclusion on this part of the case mainly upon the following submission. Inasmuch as, pending the limit fixed by sec. 50 (f) of the Act, it will be open to respondent, without incurring tax liability, to defer distribution of dividends, it could, said counsel for the Secretary, in the meantime apply the balance of

its profits remaining after payment of normal tax in repaying the loan accounts. The creation of the loan accounts, so the argument continued, thus rendered considerable tax advantages possible since it would enable the three former partners to obtain, under the guise of capital and without paying tax thereon, what are in reality the profits of the engineering business which would, but for the formation of the company, have been taxable as such in the hands of the respective partners. This benefit, when considered together with such admitted initial tax advantages as are conceded by respondent to flow from the conversion of the partnership into a company, leads irresistibly - so counsel's submission ended - to the conclusion that the avoidance, postponement or reduction of tax liability must have been at least one of the main purposes of converting the partnership into a company.

This submission is not without some force but, for the reasons which follow, it cannot, in my judgment, succeed. While it may well be that "effect" and "result" as respectively used in sub-sections

(1) and (4) of sec. 103 of the Act have the same meaning, it is clear that the former sub-section distinguishes between "effect" and "purpose". The vital enquiry on this part of the case relates to the question of whether or not avoidance, postponement or reduction of tax was "the sole or one of the main purposes" of the conversion of the partnership into a company. The intention or purpose with which any particular transaction is entered into is a question of fact (see Commissioner for Inland Revenue v. Richmond Estates (Pty.) Ltd., 1956 (1) S.A. 602 (A.D.) at 606 - 607; Secretary for Inland Revenue v. Cadac Engineering (supra) at 520 A): and cf., in relation to the somewhat similar wording occurring in sec. 28 of the English Finance Act 1960, Commissioners of Inland Revenue v. Brebner, 43 T.C. 705 at 718). As indicated earlier in this judgment, there existed various reasons, quite unrelated to the incidence of tax, in favour of converting the partnership into a company. The Special Court's finding that tax avoidance was not a factor which

was...../

was taken into consideration by the partners in deciding to practise as an unlimited company was a finding on a question of fact. That finding was made with full appreciation of the onus imposed by sec. 103 (4) of the Act, and there was evidence - namely, that of Mr. Forsyth and Mr. Johnson mentioned in the above extract from Hill, J,'s judgment and which was accepted by the Special Court - to support that finding. Under those circumstances, it is not possible for this Court to say that the conclusion reached by the Special Court that tax avoidance was "not a factor which was taken into consideration" in converting the partnership into a company is a conclusion which could not reasonably be reached by it. It follows that this Court cannot disturb the judgment of the Special Court.

For the foregoing reasons, the appeal is dismissed with costs; such costs are to include the fees of two counsel.

HOLMES, J.A.)
JANSEN, J.A.)
RABIE, J.A.) Concur.
CORBETT, A.J.A.)