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G.P.-S.25617—1974-75—3 000 J 219

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

S. A. I. R. *Appellant,*

versus

W. S. Cartwright *Respondent*

Appellant's Attorney Dep SA (13) (X) *Respondent's Attorney* Rosenbaums V. d. B.
Prokureur vir Appellant R Shakenovsky SC *Prokureur vir Respondent*

Appellant's Advocate I E M du Toit *Respondent's Advocate* R S Welsh Q.C.
Advokaat vir Appellant *Advokaat vir Respondent* R J Goldstone SC

Set down for hearing on
Op die rol geplaas vir verhoor op

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Corams: Wessels, Trollip, Corbett, Viljoen JJ.A.
et Trengove A.JA.

(1 T S C)

9.45 am —— 11.00 am
11.15 am —— 12.20 pm

Mr Welsh not called upon

C. A. V.

The Court dismisses the appeal with costs, including the costs consequent upon the

P.T.O.

Writ issued
Lasbrief uitgereik

Date and initials
Datum en paraaf

Bills taxed—Kosterekenings getakseer

Date Datum	Amount Bedrag	Initials Paraaf

IN THE SUPREME COURT OF SOUTH AFRICA

(APPELLATE DIVISION)

In the appeal of -

SECRETARY FOR INLAND REVENUE ..... appellant

versus

W.S. GALLAGHER ..... respondent

Coram: WESSELS, TROLLIP, CORBETT, MILLER, JJ.A., et TRENGOVE, A.J.A.

Date Heard: 24 November 1977

Date of Judgment: 23 February 1978.

J U D G M E N T

CORBETT, J.A.:

This matter comes before us by way of a case stated in terms of sec. 86 of the Income Tax Act, 58 of 1962, ("the Act") by the Special Court for the hearing of income tax appeals within the area of the Transvaal, the parties having

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consented to an appeal direct to this Court. The appeal relates to assessments of normal tax raised upon respondent (Mr. W.S. Gallagher) by the appellant (the Secretary for Inland Revenue) for the years of assessment ended 28 February 1969, 28 February 1970 and 28 February 1971. Respondent appealed successfully against these assessments to the Special Court and appellant now seeks a reversal of the decision of that Court.

It appears from the statement of case, read together with the judgment of the Court a quo, that at the time of the hearing of the appeal in the Court a quo the essential facts giving rise to this appeal were shortly the following. Respondent, a qualified mining and electrical engineer, was employed as technical director of the Anglo-American Corporation of South Africa Limited ("Anglo-American"). He had joined the Anglo-American group in 1937 and had held various positions with different companies within the group before being appointed technical director. In the course of his work for Anglo-

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American respondent had found it necessary to do much travelling, sometimes in small aircraft or helicopters and under difficult circumstances. He regarded this as hazardous and evidently the thought of his premature death had been present to his mind more readily perhaps than would have been the case if he had been engaged in a more sedentary occupation.

In February 1968 the respondent entered into a scheme for the ultimate benefit of his children. This scheme was the cause of the taxation dispute between the parties. At that time respondent held shares in public companies, quoted on the Johannesburg stock exchange, to a total market value of R395 107. In addition he owned shares in a private investment company, W.S. Gallagher Investments (Pty.) Ltd. ("W.S.G."), valued at R59,342 and had a claim against W.S.G. on loan account amounting to R286 383. On 15 February 1968 respondent caused to be formed a company named Stanley Patrick Holdings (Pty.) Ltd. ("SPH") which at all material times had an issued share capital of R1000 divided

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into 1000 shares of R1 each. These were subscribed for by and issued to respondent.

On 27 February 1968 respondent executed three notarial deeds of donation creating trusts for the benefit of his three children, a married daughter, then aged 24, an unmarried daughter, aged 22, and a minor son, aged 13. In terms of the deeds respondent donated to each of the trusts in favour of his daughters 250 fully paid-up shares in SPH and to the trust in favour of his son 500 such shares. In terms of the trust deeds, which all contain identical provisions, the trustees are directed to distribute income received to the donee (the child concerned) or other beneficiary (there are substitute beneficiaries in the event of the donee dying during the continuation of the trust), after making provision for disbursements and expenses. It is further provided that the trust is not to terminate until the donee attains the age of 30 years or until after the death of the donor, whichever occurs later. The trustees are further empowered to continue or terminate the trust or postpone payment to,

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or vesting in, beneficiaries at their discretion. In consequence of these donations the trustees of the three trusts became holders of the entire share capital of SPH.

Also on 27 February 1968 respondent entered into a written agreement with SPH, in terms of which he sold to the company the aforementioned assets held by him, viz. the shares in public companies, the shares in WSG and the loan account with WSG. The total consideration for the sale was R740 832, which represented the current value of these assets as at 16 February 1968. The purchase price remained a debt owing by SPH to respondent, payable on demand. There was no provision for the payment of interest on the unpaid purchase price.

And finally on 27 February 1968 respondent entered into a written shareholders' agreement with the trustees of the three trusts wherein the latter, as holders of the entire issued share capital in SPH, gave certain undertakings in regard

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to increasing the capital of the company, appointing respondent or his nominee as the sole director of SPH, the disposal or encumbering of the assets of SPH and the disposal of such assets in the event of SPH being required to pay the purchase price to respondent.

In the years of assessment in issue, viz. 1969, 1970 and 1971, SPH earned certain income by way of dividends and interest, the total sum in each year amounting, respectively, to R12 593, R11 623 and R13 461. These amounts represented income which had ceased to accrue to the respondent as a result of his having divested himself of the assets from which the income was derived, in the circumstances described above. Taking into account the consequent reduction in respondent's taxable income, on the one hand, and the taxes payable by SPH on this income, on the other hand, the net loss in income tax to the fiscus as a result of the implementation of the whole scheme in the tax years in question was the following:

/ Year....

Year of Assessment.	Tax avoided by Respondent	Tax payable by SPH	Net Loss.
1969	R6 659	R2 990	R3 669
1970	5 173	2 450	2 723
1971	6 046	3 552	2 494
	R17 878	R8 992	R8 886

In determining respondent's liability for normal tax for the 1969, 1970 and 1971 tax years the appellant, applying the provisions of sec. 103(1) of the Act, included the amounts of income derived by SPH from the assets sold to it by respondent in respondent's income and assessed him accordingly. Respondent objected and appealed and the crisp issue raised by the appeal was whether appellant was justified in taking action under sec. 103(1). The Special Court found that he was not. On appeal to this Court it has been contended that in so finding the Special Court erred.

It is not necessary to quote sec. 103(1) in full because the various requisites which must co-exist in order to justify the Secretary invoking his powers under the sub-section were enumerated in SIR v Geustyn, Forsyth and Joubert

(1971 (3) SA 567 (AD), at p 571 E - H) as follows:

> " (a) a transaction, operation or scheme entered into or carried out;
>
> (b) which has the effect of avoiding or postponing liability for tax on income or reducing the amount thereof; and which
>
> (c) 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 that
>
> (d) the avoidance, postponement or reduction of 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."

With these requisites, more particularly requisite (d), must be read the provisions of sec. 103(4)(a) which create a presumption (until the contrary is proved) that the sole purpose or one of the main purposes of the transaction, operation or scheme in issue was the avoidance, postponement or reduction

of income tax, once it is proved that the transaction, operation or scheme would result in such avoidance, postponement, etc. Section 103 (4) also expressly makes any decision of the Secretary under, inter alia, section 103(1) subject to objection and appeal. The effect of this is that, although a major criterion prescribed by sec. 103(1) is the "opinion of the Secretary" (see requisites (c) and (d) above), this does not debar the Special Court from re-hearing the whole case and, if it so decides, substituting its own decision for that of the Secretary. Any party dissatisfied with the decision of the Special Court thus given under sec. 103(4) may then appeal in the usual way, with the necessary consent, to this Court on the ground that the decision is "erroneous in law". (See SIR v Geustyn, Forsyth and Joubert, supra, at p 572 A - D).

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It has been conceded on respondent's behalf that requisites (a), (b) and (c) above have been shown to be present in the instant case. The sole issue, therefore, concerns the existence or otherwise of requisite (d): i.e., whether or not the avoidance, postponement or reduction of income tax was the "sole purpose" or "one of the main purposes" of the scheme entered into by the respondent.

It is submitted in the heads of argument of appellant's counsel that in determining the purpose of a transaction, operation or scheme an "objective" test should be applied. By an objective test in this context is evidently meant a test which has regard rather to the effect of the scheme, objectively viewed, as opposed to a "subjective" test which takes as its criterion the purpose which those carrying out the scheme intend to achieve by means of the scheme. Although

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appellant's counsel did not press this submission in argument before us, he did not abandon it. In the circumstances it is appropriate to state that, in my view, the test is undoubtedly a subjective one. This was obviously the view of OGILVIE THOMPSON, CJ., when he delivered the judgment of this Court in SIR v Geustyn, Forsyth and Joubert (supra, at p 576 G - H); and in Glen Anil Development Corp. v SIR (1975 (4) SA 715 (AD), at p 730 H) BOTHA, JA, relying on Geustyn's case, also adopted a subjective test in applying the analogous provisions of sec. 103(2) of the Act. Sec. 103 (1) draws a clear distinction between the "effect" of a scheme and the "purpose" thereof (see requisites (b) and (d) above) and this virtually rules out an interpretation which seeks to give "purpose" an objective connotation and to equate it, more or less, to "effect".

If the subjective approach be adopted (as it must), then it is obvious that of prime importance in determining

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the purpose of the scheme would be the evidence of respondent, the progenitor of the scheme, as to why it was carried out. Respondent testified before the Special Court. According to the statement of case, his evidence was, briefly, to the following effect.

At the beginning of 1968 the respondent was, as indicated above, possessed, either directly or through WSG, of very considerable holdings in the share market. Before entering into the scheme he consulted a Mr. Barnett, then a partner in a Johannesburg firm of attorneys and an expert on trusts. (Mr. Barnett died prior to the hearing by the Special Court.) At this consultation respondent explained, firstly, that he wished to create a trust for the benefit of his children and, secondly, that in view of the rapid rise in the share market during 1967 and of the fact that the market was "out of control" in early 1968, he felt it was absolutely essential that something should be done about limiting the liability of his estate for estate duty in the event of his death.

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Another relevant fact in this connection was that the type of work in which he was engaged carried "a more than normal hazard". The nature of the advice received by respondent and the action taken by him in purusance thereof are thus described in the statement of case:

> "(14) Mr Barnett's advice to the Respondent was to the effect that the aforesaid Trusts in favour of the Respondent's children be formed and that under the arrangements proposed it would be possible to freeze liability for estate duty. The Respondent was aware that under the proposed arrangements he would be parting with shares which produced dividends and that his own income from dividends would thereby be correspondingly reduced and he would pay less income tax. However, he looked at the overall situation. Mr Barnett had advised Respondent that such arrangements would not be effective as a means of saving income tax and the Respondent accepted such advice. Mr Barnett had not prepared any calculations in regard to income tax and had not been asked to do so. The Respondent would not have implemented the scheme if he had thought that there would be no saving of estate duty on his death.
>
> (15) Having been concerned with the tremendous escalation in the share-market and the impact thereof from the point of view of estate duty,

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> the respondent accepted the advice of his advisers, Messrs. Barnett and Rees, and decided to implement the arrangements proposed by them. In so deciding, the Respondent recalled Mr. Barnett having stated that there would be no income tax advantage arising out of the proposed arrangements. No details were considered concerning the overall income tax situation and the Respondent did not give much thought at the time as to what the policy of S.P.H. would subsequently be with regard to the payment of dividends, nor did he give thought to, or could he say, whether he had any intention at the time concerning the payment of dividends by S.P.H."

Also called as a witness on respondent's behalf was a Mr. L.B. Clemans, an actuary of 12 years standing. He had not been consulted at the time but he had made a study of the trust deeds and the relevant agreements. He was asked to put himself back to February 1968 and, postulating that he had been consulted by respondent at the time, to give an opinion as to the probable effects of the scheme in relation to the avoidance or reduction of liability for estate duty and income tax. Mr. Clemans expressed the view that, in the hypothetical situation postulated, he would probably have advised that the scheme was likely to have brought about a great saving of

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estate duty but no significant savings of income tax. He calculated that the estate duty saving arising from the scheme would have been R105 000, on the assumption that the rate of estate duty remained at 25 per cent. In making this calculation, Mr. Clemans was compelled to make a number of assumptions about matters of great uncertainty. Having taken into account these assumed factors his advice would have been that any gain or loss in income tax would have been "problematical" and would not have been anywhere near as significant as the saving of estate duty. In reaching his conclusion Mr. Clemans looked upon respondent's family as a unit and he set off against the saving of income tax in respondent's hands the undistributed profits tax which SPH would probably have to pay and the income tax which would have to be paid ultimately by the children of the appellant upon the declaration of dividends by SPH. (It must be borne in mind that under the trusts the trustees were directed to distribute the income thereof.)

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Subject to one qualification the Court a quo accepted the respondent's evidence, and more particularly that relating to the purpose of the scheme and his own state of mind in regard to the scheme. In his judgment, the learned President of the Court (COLMAN, J), dealing with an argument that the court is not bound to accept what a taxpayer says, even on oath, with regard to his intentions at a particular time or with regard to any other matter, observed:

> "That is true. But, on the other hand, the sworn testimony of a witness, given with the appearance of truthfulness and candour, is not lightly to be discarded unless some reason appears for disbelieving the witness. What he says may be discarded if there is credible evidence to the contrary, or if there are such weighty probabilities against what he has deposed to, that the Court does not feel justified in accepting his evidence. A witness may be found to have been wilfully untruthful, or he may be found to have been mistaken or confused."

COLMAN, J, went on to point out that in the case under consideration there was no evidence to contradict that of the respondent nor could any criticism be made of the manner in

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which he gave his evidence. The one qualification made by the Court to the acceptance of respondent's evidence was that he (respondent) must have been mistaken on one point of importance, viz. "the question whether a saving of income tax was in his mind when he went to consult Mr. Barnett". The Court concluded that the respondent's memory failed him in this regard and that this was "almost certainly because income tax avoidance was felt, at the time, to be a very minor consideration in comparison with other purposes of the proposed scheme".

In passing, there is just one observation which I wish to make in regard to this aspect of the matter. It is to be inferred from the learned President's remarks that this criticism of respondent's evidence was based upon his having stated in evidence that a saving of income tax was not on his mind when he went to consult Mr. Barnett. It is very possible that he did make such a statement in the

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course of giving evidence. On the other hand, there is no statement to this effect in the stated case and when summarizing respondent's evidence in his judgment the learned President referred specifically to the fact that respondent had told the Court that he did not have the avoidance of income tax in mind when he decided to adopt the scheme and when he caused it to be put into operation. There is a substantial difference between the two statements and if the criticism of the respondent's evidence was in truth based on the latter statement, then it seems to me that it loses much of its force.

Having fully considered the respondent's evidence the Court a quo concluded:

> "We believe that in truth the appellant was advised, and accepted the advice, that the scheme would yield little or no advantages in relation to income tax, and we consequently accept the evidence that the avoidance, postponement or diminution of liability for income tax was not one of the purposes, still less the sole or a major purpose of the operation which he thereupon undertook. It follows that in our view Section 103 was not applicable and that the appeal must succeed."

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With regard to the evidence of Mr. Clemans the Court stated that some of the assumptions made by him invited criticism and that it was difficult to attach much weight to any conclusion which rested upon so uncertain a base. Mr. Clemans was merely called, however, to show that Mr. Barnett might well have taken the view which, according to respondent, he did take when the scheme was under discussion. This the Court was willing to accept.

The finding of the Court a quo to the effect that the avoidance, postponement or reduction of liability for income tax was not one of the purposes, still less the sole or a "major" (clearly meaning thereby "main") purpose, of the scheme is cardinal to the applicability of sec. 103(1) of the Act. Consequently, unless appellant can overcome this finding, he cannot possibly succeed in this appeal. Moreover, the finding is manifestly a finding of fact (see SIR v Geustyn, Forsyth and Joubert, supra, at p 576 H; Glen Anil Development Corp. v SIR, supra, at p 730 B) with the result that it is not subject to appeal except on the ground that there was no evidence upon which the finding

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could reasonably have been made. It is only upon this ground, therefore, that the finding can be overcome by appellant. Furthermore, the task confronting appellant is made even more formidable by reason of the fact that this finding of fact as to the purpose of the scheme was necessarily based largely, if not entirely, upon the evidence of respondent, which the Court a quo found to be credible and worthy of acceptance. Indeed, the admitted or proven facts set forth in paragraphs 14 and 15 of the statement of case (quoted above), and more particularly the stated fact that respondent "would not have implemented the scheme if he had thought that there would be no saving of estate duty on his death", are virtually conclusive of the issue and scarcely leave any room for a contention that an avoidance, postponement or reduction of income tax was the sole or one of the main purposes of the scheme. Nevertheless, appellants counsel did submit that the finding of the Court a quo as to the purpose of the scheme was one which on the evidence

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could not reasonably have been made. In support of this submission counsel advanced a number of arguments. Many of these would no doubt have been relevant, and perhaps even cogent, arguments if addressed to the Court a quo before it made its finding but, that finding having been made, they fall far short, in my view, of a persuasive case on appeal that there was no evidence upon which that finding could reasonably have been made.

Thus, counsel argued that the Court a quo, in coming to its finding, overemphasized the impression made by respondent's demeanour as a witness and failed to have due regard to the improbabilities inherent in respondent's evidence. It is clear from the judgment of the Court a quo that respondent did make a favourable impression in the witness box and that this weighed substantially with the Court. I can find nothing in the statement of case to show that this impression was erroneous, let alone one which could not reasonably have been gained by the Court a quo.

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As regards inherent improbabilities, the main point made by appellant's counsel appeared to be that respondent could not have failed to appreciate that by divesting himself of considerable income-producing assets he would thereby substantially reduce his liability for income tax and that consequently such reduction must have been at least one of the main purposes of the scheme. To my mind, this argument overlooks one of the facts stated, viz. that, in his discussions with Mr. Barnett and in deciding to implement the scheme, respondent looked at the overall situation, i.e., took into account not only his reduced liability for income tax but the corresponding new or increased liability to be incurred by SPH and the beneficiaries under the trusts. On the facts stated I do not think that it can be said that upon such an overall view it is improbable (i) that respondent could have been advised that there would be no income tax advantage to be derived from the scheme and (ii) that respondent could have accepted the advice and embarked upon

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the scheme without having the reduction of income tax as one of his main purposes.

Appellant's counsel also referred to a statement in the Court's judgment reading -

> "... what he (meaning respondent) had to prove was his purpose in carrying what may properly be called his scheme, into effect." —

and argued that this indicated that the Court had applied the wrong test and unduly narrowed the enquiry in that what respondent had to establish was that the avoidance, etc. of income tax liability was not one of the main purposes of the scheme. In my view, there is no substance in this argument. A reading of the judgment as a whole convinces me that the Court a quo was fully appreciated the nature of the onus confronting respondent and that it applied the correct tests in determining whether that onus had been discharged. The citation of snatches from a judgment can often be misleading. The above-cited sentence, taken from a discussion as to whether the test is a subjective or an

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objective one, does not indicate, to my mind, any misapprehension on the part of the Court a quo as to the true onus. It merely states a fairly obvious truth, viz. that where a taxpayer wishes to negative tax avoidance as one of the purposes of the scheme, it is generally incumbent upon him to establish positively what the purpose, or purposes, of the scheme in fact were.

Then counsel for the appellant referred to the fact that it appeared that, before approaching Mr. Barnett, respondent had consulted an accountant, a Mr. Rees, who was present at the consultation with Mr. Barnett; and argued that respondent's failure to call Mr. Rees should give rise to an adverse inference against respondent. In my view, this is not a point which can appropriately be raised in these proceedings. Counsel conceded that the point had not been taken in the Court a quo and consequently it is not referred to in either the statement of case or the judgment. At this stage and on a stated case procedure it is impossible for this Court to determine what substance,

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if any, there might be in this contention.

At the end of its judgment the Court a quo stated the following:

> "I will add this: The Accountant Member of this Court has pointed out that if income tax avoidance or saving had been an object, there was a refinement which could have been introduced into the scheme which would have assisted the appellant in that regard. It was the sort of refinement which Mr Barnett could hardly have overlooked in an income tax avoidance scheme, and the fact that he did not introduce it tends to support the evidence of the appellant to the effect that the scheme was not an income tax avoidance scheme in his mind, or in the mind of Mr. Barnett."

Neither the judgment nor the stated case disclose what refinement the Court had in mind. It was submitted by appellant's counsel that the Court should not have relied upon this unknown factor in arriving at its conclusion. Without knowing what the refinement was and without a full knowledge of the proceedings before the Court a quo it is difficult to determine whether or not the Court did err in relying on this factor. Nevertheless, reading the above-cited passage in its context, I am satisfied that

whatever reliance the Court did place on this factor it was of minimal significance and that even without this factor the Court would have come to the same conclusion, and reasonably so.

Appellant's counsel advanced a number of other arguments in similar vein. I have endeavoured to deal with what appear to have been the main arguments. After considering them all I am satisfied that there is no ground for holding that the finding by the Court a quo, i.e., that the avoidance, postponement or reduction of income tax liability was not the sole purpose or one of the main purposes of the scheme, was one which could not reasonably have been made.

The appeal is dismissed with costs, including the costs consequent upon the employment of two counsel.

M.M. CORBETT.

WESSELS, J.A.)
TROLLIP, J.A.) CONCUR.
MILLER, J.A.)
TRENGOVE, A.J.A.)