30.10.78. 303/78

G.P.-S.51994—1976-77—3 000 (P) J 219

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

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

303/78

Appeal in Civil Case
Appèl in Siviele Saak

N J HICKLIN Appellant,

versus

SECRETARY FOR INLAND REVENUE Respondent

Appellant's Attorney / Prokureur vir Appellant: McINTYRE & Co

Respondent's Attorney / Prokureur vir Respondent: D S A BLOEMFONTEIN

Appellant's Advocate / Advokaat vir Appellant: SHAW. SWERSKEY BROMBERG

Respondent's Advocate / Advokaat vir Respondent: HARMS

Set down for hearing on / Op die rol geplaas vir verhoor op: 1979

(ITSC) 55 2 2 14

CORAM: TRAUP AR, MULLER AR, DIEMONT AR
GALGUT WAR, BOTHA WAR

Adv SHAW: 9h45 - 11h00 11h17 - 11h34 14h50 - 15h15

Adv HARMS: 11h34 - 12h45 14h15 - 14h50

UITSPRAAK 9-11-79 HOF 2 @ 9.45

See judgment for order

CAV

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:

N.J. HICKLIN ..... Appellant

AND

THE SECRETARY FOR INLAND REVENUE ..... Respondent.

Coram: TROLLIP, MULLER, DIEMONT, JJ.A. GALGUT et BOTHA, A.JJ.A.

Heard: 20 September 1979.

Delivered: 9 November 1979.

J U D G M E N T

TROLLIP, J.A. :

This is an appeal by the appellant taxpayer under the new section 86A of the Income Tax Act, No. 58 of 1962 ("the Act"), against the decision of the Transvaal Income Tax

Special .... /2

Special Court. Leave to appeal direct to this Court was granted by the learned President of that Court under section 86A(5).

The problem raised by the appeal is whether or not the Secretary (respondent) justifiably invoked the tax avoidance provisions of section 103 of the Act for the purpose of attributing liability to appellant for tax on part of the distributable profits of a dormant, private company of which he had been a shareholder. To solve that problem the facts giving rise to the appeal have to be canvassed in some detail. But first, before doing that, a few observations on the new appeal procedure under section 86A. It was introduced into the Act by section 24(1) of Act No. 103 of 1976.

The old section 86 is not applicable to this appeal because the judgment of the Special Court was given after

section .... /3

section 86A became operative - see sections 86(6) and 86A(1).

In terms of section 86 an appellant was bound by the facts reasonably found by the Special Court; he could only assail its determination as being erroneous in law on a stated case setting out those facts. Under section 86A, on the other hand, an appellant has a full right of appeal "against any decision of that court" (subsection (1)), i.e., on fact or law or both, on the full record of the proceedings (subsection (17)). The appeal is therefore a re-hearing of the case in the ordinary, well-known way in which this Court, while paying due regard to the findings of the Special Court on the facts and credibility of witnesses, is not necessarily bound by them. Contrast this new approach under section 86A with that of this Court under section 86 in, for example, S.I.R. v. Geustyn, Forsyth and Joubert 1971 (3) S.A. 567 (A)

at .... /4

at p. 577 and S.I.R. v. Gallagher 1978 (2) S.A. 463 (A) at pp. 473 H - 474 C. They were cases similar to the present one. In the present case the Special Court made no findings as to the demeanour or credibility of the witnesses who testified before it. It determined the issues on the admitted facts and the probabilities. This Court is therefore in as good a position as it was to make its own findings of fact where necessary. Section 86A is silent about the powers of this Court in such an appeal. Contrast that with the powers which are expressly conferred on it by section 86(1) in an appeal under that section. Manifestly the intention was that under section 86A this Court is to have those general powers that are conferred upon it by section 22 of the Supreme Court Act, No. 59 of 1959.

The relevant facts in this appeal can be

summarized .... /5

summarized as follows:

1. Appellant and two others, P. du T. Viljoen and G.W. Milroy, were the shareholders and directors of a company called Reklame Bestuur (Edms.) Beperk ("Reklame"). It was registered on 4 March 1968 with an authorized capital of R3 000 comprising 3 000 shares of R1 each of which 2 880 were issued. They were held thus -

P. du T. Viljoen	2130 shares	(73,96%)
G.W. Milroy	510 shares	(17,71%)
Appellant	240 shares	(8,33%)

Reklame's main activity was the management of another company, Adverto (Pty.) Ltd. ("Adverto"), an advertising agency, in which the abovementioned shareholders were also interested. Reklame itself acquired 40% of the shares in Adverto. It also acquired

other .... /6

other interests but these were not important.

2. From Reklame's inception its income or profits were retained for use as working capital for Adverto or for investment if a suitable opportunity therefor arose. No dividends were declared or paid out. By 1 March 1971 these accumulated, undistributed profits ("distributable profits") amounted to some R97 000. They were not at any stage subjected to undistributed profits tax under the Act since they apparently were within the exemption mentioned in section 50(f) as amended from time to time.

3. With effect from 1 March 1971 Reklame and Adverto sold their businesses to a new company in which an overseas advertising agency, appellant and his two co-shareholders acquired shares. Reklame was to receive R150 000 for the sale of its business. This was a capital accrual and shown on its balance

sheets as a "non-distributable reserve". The new company took over the name of Adverto in order to retain the goodwill attaching to that name. I shall refer to this company as "the new Adverto". The old Adverto changed its name to P. Viljoen Advertisers (Pty.) Ltd. ("Viljoen Advertisers"). This latter company then apparently became the wholly owned subsidiary of Reklame. Reklame's balance sheet of 28 February 1972 shows an investment by it of 4000 R2 shares in Viljoen Advertisers at a cost of R100 000. In consequence of these transactions both Reklame and Viljoen Advertisers became dormant companies. Thereafter Reklame borrowed money from Viljoen Advertisers. During the year ended 28 February 1973 the amount was R48 093; as at 28 February 1974 it totalled R80 342; and by 31 December 1974 it amounted to R94 742. The note on the balance sheet of 28 February 1974 says that it was an interest-free

loan .... /8

loan repayable when funds became available,

4. From time to time after the transactions mentioned in the preceding paragraphs appellant and his co-shareholders caused Reklame to make interest-free and unsecured loans to them. From the balance sheets it appears that the following amounts were lent during the periods ending on the dates indicated.

	29.2.72	28.2.73	28.2.74	31.12.74	Totals
P. du T. Viljoen	R28 031	R29 801	R58 213	R21 744	R137 789
G.W. Milroy	6 872	6 981	13 938	5 206	32 997
Appellant	3 303	3 212	6 559	2 450	15 524
Totals	R38 206	R39 994	R78 710	R29 400	R186 310

The amounts of the loans were roughly proportioned to the shareholding of each of them in Reklame. The shareholders were also directors of Reklame but, since it was a private company, such loans were permissible under section 70(1)(a) of the Companies' Act, 1926, and its successor, section 226(1) of the present Companies' Act, No. 61 of 1973.

5. The shareholders, in causing Reklame to make these loans to them, probably did not consciously or deliberately use its distributable profits for the purpose but used any sources of money that happened to be available in Reklame at the time. There were other such resources: the amounts paid from time to time by the new Adverto in respect of the R150 000 and the loans from Viljoen Advertisers. Indeed, appellant indicated in his evidence that Reklame's distributable profits, which had become available prior to March 1971, were not used for that purpose. He said that during the year ending 29 February 1972 they "had been invested in various assets .... had been used as capital". This probably refers to Reklame's investment in Viljoen Advertisers. As at 31 December 1974 the new Adverto had paid R92 957 (i.e. the R150 000 less R57 043 still owing according to the balance sheet of that

date .... /10

date). At that date the loans from Viljoen Advertisers amounted to R94 742. These two sources therefore totalled R187 699 and the loans to the shareholders R186 310. It is therefore by no means clear that the loans to shareholders came wholly or even mainly from Reklame's distributable profits prior to 1975.

6. At the annual general meeting of Reklame on 30 July 1973, attended by appellant and his co-shareholders, they resolved that a dividend of R30 000 should be paid out of its distributable profits. The dividend was obviously to be set-off against the shareholders' loans. A draft balance sheet of 28 February 1974 reflected the proposed reduction in the loans. However, the resolution was not implemented. The shareholders as directors subsequently decided not to pay or give effect to the payment of the dividend. The balance sheet was accordingly altered. The

directors' ..../11

directors' report for the year ending 28 Feburary 1974 stated -

> "Despite the fact that it was recommended at our previous Annual General Meeting that the Company pay a dividend in the year under review, it was decided that because of the money market generally, this recommendation would not be carried out and no dividend was paid. There is, however, the intention to pay a dividend when matters improve."

That, however, did not truly reflect the real reason or intention of the shareholders. According to appellant and the major shareholder, Viljoen, the real reason for not proceeding with the dividend payment was that the shareholders would have become liable to income tax on it. They therefore abandoned all intention of declaring and paying dividends out of the distributable profits for the foreseeable future ("unless something unforeseen happened"). And indeed thereafter no dividends were declared while they still controlled Reklame.

7 .... /12

7. According to Reklame's balance sheet of 31 December 1974 its financial position was this:

Issued share capital	R 2 880
Non-distributable reserve	150 000
Distributable profits	96 906
Loan from Viljoen Advertisers	94 742
	R344 528
Investment in Viljoen Advertisers	100 000
Loan Levy	1 275
Balance due by the new Adverto for purchase of business	57 043
Loans to directors (shareholders)	186 310
	R344 628
Less current liabilities	100
	R344 528.

8. The difficulty confronting appellant and the other shareholders was what to do with the dormant Reklame with its large loans to them. According to appellant and Viljoen the company was "untidy", presumably meaning that it was a business

anachronism .... /13

anachronism: it was not operating; its annual audit fee and licence had to be paid (R90 p.a.); and if any of them died, problems could arise about paying estate duty and also repaying the loans in order to dissolve Reklame. Three courses, they thought, were open to them:

(a) simply to liquidate Reklame and receive its profits and reserves;

(b) to declare regular annual dividends out of its profits and reserves with a view to ultimately liquidating or dissolving it;

(c) to maintain it in existence indefinitely without declaring any dividends.

As stated above in paragraph 6, they started on course (b) but then thought better of it. The adoption of (a) or (b) would have

enabled .... /14

enabled them to repay the loans but it would have subjected them to liability for substantial income tax. For that reason course (c) was preferred and decided on.

9. Thereafter, early in 1975, appellant met one Hyslop socially at the Pretoria Country Club. The latter then managed the Pretoria office of Ryan Nigel Corporation Ltd. ("Ryan Nigel"). In the course of general conversation about the business conducted by Ryan Nigel, Hyslop mentioned that it was on the look out for the acquisition of dormant companies with distributable profits. Appellant mentioned Reklame. Hyslop showed interest in it. He was given a copy of its balance sheet of 28 February 1974. Ultimately Ryan Nigel drew up an agreement for the purchase of the shareholders' shares in Reklame. It was tendered to them as an offer which they had to accept or reject as it stood. The

shareholders .... /15

shareholders, after discussing it with their auditor, decided to accept it. It represented another way, and a satisfactory one, they considered, of getting rid of the "untidy", dormant Reklame. The agreement was signed by all parties on 1 July 1975. It is hereafter referred to as "the RN agreement".

10. The RN agreement was fairly detailed, containing 15 clauses. Its relevant features were these. In terms of clause 2 the shareholders sold their Reklame shares, i.e., its entire issued share capital, to Ryan Nigel. In clause 3 they warranted that, as at 30 June 1975, Reklame would have no liabilities and no assets other than the loan levy and their loan indebtedness, and that the non-distributable reserve (R150 000) and distributable profits (R96 996) would be the same as shown in the balance sheet of 28 February 1974. According to clause 4(1)(ii) and (iii)

they .... /16

they undertook to produce a balance sheet as at 30 June 1975 reflecting that those warranties had been duly fulfilled. The purchase price for the shares was to be calculated under clause 4(2) as follows:

> "The purchase price of the share is the net asset value of the company as reflected in the balance sheet referred to in Clause 4(1)(ii) less an amount equivalent to 10% (TEN PER-CENT) of the distributable reserves shown therein."

Clause 5(1) provided for the handing over to Ryan Nigel on 1 July 1975 of the share certificates in transferable form, the resignations of appellant and the others as directors, and a resolution by them as directors approving of the transfer of the shares to Ryan Nigel and appointing its nominees as directors. According to clause 5(2) the purchase price, less an amount equal to the loan levy with interest, had to be paid by Ryan Nigel simultaneously

with .... /17

with the compliance with the sellers' obligations mentioned in clause 5(1). The loan levy with interest was to be paid when the Revenue Authorities repaid it to Reklame. Clause 5(3) required that the loans by Reklame to the shareholders had also to be discharged on 1 July 1975.

11. In anticipation of signing the RN agreement appellant and his co-shareholders took steps to put Reklame into the warranted state. By their resolution of 13 June 1975 as shareholders they acquired from Reklame its investment of 4000 shares in Viljoen Advertisers for R100 000 and the outstanding indebtedness of R57 043 of the new Adverto; and, as against that, they assumed Reklame's liabilities of R100 to sundry creditors and R94 742 for its loan from Viljoen Advertisers. (These items are reflected in paragraph 7 above.) The amounts were apparently debited and

credited .... /18

credited respectively to their existing loan accounts with Reklame in proportion to their shareholdings. The result was that the total of their loan accounts was increased by a net R62 201 to R248 511, but Reklame was cleared of its other assets (except the R1 275 loan levy) and all its liabilities. These assets totalling R249 786 were represented in the balance sheet of 30 June 1975 by the issued share capital R2 880, the non-distributable reserve R150 000, and the distributable profits R96 906. Hence, at that late stage it was correct, as appellant conceded when testifying, that the loans must be regarded as having come partly out of the distributable profits. But the additional loan of R62 201, the result of the bookkeeping entries mentioned above, was a purely temporary expedient. It was only to endure from 13 June to 1 July 1975 when it and the rest of the loan indebtedness were to be

liquidated .... /19

liquidated out of the proceeds of the sale of the shares.

12. In terms of clauses 4(2) and 5(2) of the RN agreement the purchase price of the shares was therefore R236 419 arrived at as follows -

The net asset value of Reklame as at 30 June 1975		R249 786
Less 10% of its distributable profits of R96 906		9 691
		R240 095
Less stamp duty on share transfers	R2 401	
and loan levy	1 275	3 676
		R236 419

In effect therefore the shareholders would pay R12 092 (the discount R9 691 and stamp duty R2 401) for getting rid of the dormant Reklame and for the liquidation of their loan indebtedness to Reklame while Ryan Nigel would derive a gain of R9 691 from the transaction.

13. Both sides duly implemented the RN agreement on 1 July

1975 .... /20

1975. Appellant and his co-shareholders gave Ryan Nigel a cheque drawn by the new Adverto for R248 511 in repayment of their loans and simultaneously Ryan Nigel gave them in payment of the shares a cheque for R236 419 which was deposited in the new Adverto's banking account.

14. Thereafter, by resolution on 27 August 1975 the new directors of Reklame declared its distributable profits of R96 906 as a dividend. By further resolution on 30 December 1975 the new directors declared the non-distributable reserve of R150 000 as a "pre-deregistration dividend". These dividends must have been paid out since Reklame was subsequently deregistered. The record does not disclose whether or not any income tax was exigible and paid on these dividends. Presumably none was payable or paid on the dividend out of the distributable profits since dividends

received .... /21

received by a company are exempt from tax under section 10(1)(k)(i).

15. It is quite clear that in consequence of the RN agreement Reklame passed completely out of the hands of appellant and his co-shareholders. They did not retain any association with or interest in it or any control over its affairs. In particular they had nothing to do with the subsequent declaration of the dividends just mentioned. Indeed, appellant testified that, in negotiating and concluding the RN agreement, the shareholders were not interested in, concerned with, or informed precisely about what Ryan Nigel wanted to do with Reklame after it acquired the shares. He assumed that the discount of 10% would be Ryan Nigel's ultimate gain from the transaction. The testimony of Hyslop, called by respondent, tended to confirm appellant's version on this aspect. It must therefore be accepted as being

correct .... /22

correct. All that negatives the finding by the Special Court that appellant and his co-shareholders, by entering into the RN agreement, "participated in an operation known as dividend-stripping" of Reklame. For reasons just given they were not associated at all with any such operation conducted by Ryan Nigel after it acquired the shares. Cf. the decisions to the same effect in similar circumstances under the tax avoidance section 260 of the Australian Act in Slutzkin v. FC of T. 7 A.T.R. 166 (High Court of Australia) and Hennessey v. FC of T. 5 A.T.R. 179 (Supreme Court of South Australia), to which appellant's counsel referred us.

16. In regard to the year of assessment that ended on 29 February 1976 the respondent, in a letter to appellant of 22 September 1977, expressed the opinion that

> "the payment you received from Ryan Nigel .. for your interest in Reklame .. was received as a result of a scheme

which .... /23

which falls within the scope of section 103 of the Income Tax Act, 1962. Consequently your share of R8 072 in the total distributable reserve of R96 906 is regarded as a dividend received (and) taxable in your hands. An additional 1976 assessment wherein this dividend is incorporated is attached."

Appellant objected thereto. The respondent disallowed his objection. He appealed to the Special Court which dismissed the appeal and confirmed the assessment. It is against that decision that appellant has now appealed to this Court.

That concludes the summary of facts.

Section 103 of the Act, before its amendment by section 14(1) of Act No. 101 of 1978, read as follows (irrelevant parts being omitted):

"(1) Where any transaction, operation or scheme (... 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 ..., or of reducing the amount thereof,

and .... /24

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 arms' 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."

Section 103(4) provided:

"Any decision of the Secretary under sub-section (1), (2)

or .... /25

or (3) shall be subject to objection and appeal, and whenever in proceedings relating thereto it is proved that the transaction, operation, scheme ... 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."

The four requirements of section 103(1) that have to be fulfilled before its provisions can be invoked by the respondent are conveniently summarized as (a), (b), (c), and (d) in Geustyn's case, supra, 1971 (3) at pp. 571 E to 572 E, and Gallagher's case, supra, 1978 (2) at p. 470 D to H. According to those decisions, although the application of the provisions of section 103(1) is made dependent initially upon "the opinion of the Secretary", the Special Court may re-hear the whole case and either

uphold .... /26

uphold that opinion or overrule it and substitute its own opinion. But whereas under the old section 86 this Court on appeal could hitherto only interfere with the Special Court's decision and substitute its own opinion if that decision was erroneous in law (see the above cases of Geustyn and Gallagher), it can under the new section 86A now interfere and substitute its own opinion if the decision is erroneous in law or fact or both.

As to requirement (a) of section 103(1) - a transaction, operation or scheme, including one "involving the alienation of property" - that obviously covers the RN agreement under which the shares of appellant and the other shareholders of Reklame were alienated. But respondent's counsel contended for a much wider "scheme". He argued that the conduct of the shareholders from 1971/2 onwards must be regarded as the scheme, i.e.,

their .... /27

their continual borrowing from Reklame out of its distributable profits, interest free and unsecured; their keeping Reklame, although dormant, in existence merely in order to preserve those loans; their abandoning all intention of declaring dividends out of those profits; their ultimately entering into and carrying out the RN agreement in 1975; and Reklame's subsequent dividend declarations. All that constituted, counsel submitted, an entire, integrated scheme under section 103(1) involving inter alios the appellant. That argument is untenable. On the facts recited in the above paragraphs there was no such comprehensive, entire scheme. Firstly, it is by no means clear that, prior to the first contact with Ryan Nigel, the shareholders' loans came wholly or even mainly from the distributable profits (see paragraph 5 above). Secondly, and in any event, such loans were not made with any intention of

eventually .... /28

eventually selling their shares to Ryan Nigel or anyone else. Thirdly, their contact and subsequent negotiations with Ryan Nigel was fortuitous and not designed. Fourthly, they had nothing to do with the subsequent declarations of dividends by Reklame when it was under the control of Ryan Nigel (see paragraph 15 above). Consequently, in my view, the transaction, operation or scheme in issue here is only the RN agreement. That was also the approach of the respondent according to his letter of 29 February 1976 (see paragraph 16 above) and of the Special Court. The problem must therefore be canvassed on that basis.

That does not mean, however, that the RN agreement must be looked at with blinkers on. Indeed, section 103(1) itself enjoins the respondent, and hence any court seized with the problem, to have regard to "the circumstances under which the

transaction .... /29

transaction, operation or scheme was entered into or carried out". That would comprehend the financial position of Reklame at the time, including the loans made to the shareholders.

As to requirement (b) of section 103(1), did the RN agreement have the effect of avoiding liability for any tax on income? "Liability" there means that of the taxpayer concerned, in this case the appellant. The liability for income tax on Reklame's distributable profits would and could only attach to appellant and his co-shareholders if and when they caused Reklame to declare them as dividends. They decided during the year ending on 28 February 1974 not to declare such dividends for the foreseeable future - see paragraph 6 above. That decision was still operative when they entered into the RN agreement on 1 July 1975. Does the requirement (b) still apply in those circumstances?

"Liability .... /30

"Liability" in section 103(1) does not refer to an accrued or existing one, for such a liability cannot be avoided by any transaction, etc. (see C.I.R. v. King 1947 (2) S.A. 196 (A) at p. 207). And, in any event, so to confine its meaning would deprive the elaborate provisions of section 103(1) of all practical effect. That could never have been the legislature's intention. Consequently in the cases of King at p. 207 and C.I.R. v. Smith 1964 (1) S.A. 324 (A) at p. 333 E - G, "liability" was held to connote "an anticipated liability". As STEYN, C.J., put it in the latter case -

> "The ordinary natural meaning of avoiding liability for a tax on income is to get out of the way of, escape or prevent an anticipated liability."

(See too Newton & Others v. Commissioner of Taxation (1958) 2 All E.R. 759 (P.C.) at p. 763 F - G, per Lord DENNING). That means

a .... /31

a liability for tax that the taxpayer anticipates will or may fall on him in the future.

Now such a liability may vary from an imminent, certain prospect to some vague, remote possibility. Compare the queries thereanent raised by Lord WILBERFORCE in Mangin v. I.R.C. (1971) 1 All E.R. 179 (P.C.) at p. 189 H in respect of the tax avoidance section 108 of the New Zealand Tax Act of 1954. In Newton's case, supra, Lord DENNING spoke of "a liability which is about to fall on you" (ibid.), which suggests one of some imminence. However, it is unnecessary and hence unadvisable to decide here whether a vertical line should be drawn somewhere along that wide range of meanings in order to delimit the connotation of "an anticipated liability". It suffices to say merely that, in my view, the liability of appellant and the other shareholders to tax on

Reklame's .... /32

Reklame's distributable profits, albeit a liability contingent upon their declaring them as dividends, was clearly "an anticipated liability" within the contemplation of section 103(1). After all, they were always mindful that something unforeseen might occur that would compel them to declare them as dividends and incur the ensuing tax liability, as for example, the early death of one of them. And, as will presently appear, the possibility of some such contingency occurring was sufficiently proximate and pressing to induce them to sell their shares under the RN agreement in order "to get out of the way of, escape or prevent" such liability from falling on them. The RN agreement undoubtedly had the effect of avoiding that anticipated tax liability of theirs. Hence requirement (b) of section 103(1) was also fulfilled.

It is appropriate and convenient to deal next

with .... /33

with requirement (d). Was the avoidance of that anticipated liability the sole or one of the main purposes of the RN agreement? The test being subjective - see Gallagher's case, supra, 1978 (2) at p. 471 B - E - the inquiry is what purpose or purposes did the shareholders have in mind in entering into the RN agreement. I have little doubt that, while such avoidance was not their sole purpose, as the Special Court found, it was one of their main purposes. True, according to appellant and Viljoen, their purpose was to rid themselves of the "untidy", dormant Reklame. But the only reason why the shareholders themselves had not hitherto liquidated, dissolved, or deregistered Reklame was that that would have landed them in liability for substantial tax on its distributable profits - see paragraph 8 above. The appellant was a qualified chartered accountant although he did not practise as such. And in regard to

the .... /34

the affairs of Reklame and the question whether or not they should enter into the RN agreement, they were advised by their auditor, Mr Bulling. In all those circumstances the inference is irresistible that one of the main purposes they probably had in mind in entering into the RN agreement was the avoidance of the above anticipated liability. In any event, as that agreement had the effect or result of such tax avoidance, as has already been found in regard to requirement (b), the onus was on appellant to prove that that was not one of their main purposes - see section 103(4)(a) quoted above. Certainly, that onus was not discharged. Requirement (d) was therefore also fulfilled.

In regard to the effect and purpose of the RN agreement the Special Court proceeded on the basis that "the distributable profits were in reality the income of the shareholders".

Similarly .... /35

Similarly, respondent's counsel contended that by entering into and implementing the RN agreement, appellant and his co-shareholders in reality received the distributable profits of Reklame, even though they had not been declared as dividends. In essence counsel's contention was this. Before and also at the time of clearing Reklame of its assets and liabilities for the sale of its shares, the shareholders caused Reklame to lend them inter alia the whole of its distributable profits. The purchase price of the shares received by them from Ryan Nigel was used to liquidate those loans. So in effect and reality, said counsel, the shareholders received those distributable profits.

In my view that approach by the Special Court and counsel was wrong, at any rate at this stage of the inquiry. The former's approach erred because it ignored the factors that

Reklame had its own juristic personality, separate and distinct from its shareholders (cf. Ochberg v. C.I.R. 1931 A.D. 215 at p. 232), and that in law therefore its distributable profits did not belong to the shareholders until declared as dividends (see King's case, supra, 1947 (2) at pp. 213, 217). And counsel's argument wrongly ignored the form, substance, and legal effect of the loans to the shareholders and the RN agreement. After all, the loans and RN agreement were not simulated or sham transactions. On the contrary, they were genuine and bona fide. Now at the stage when one is still inquiring whether or not the requirements of section 103(1) have been fulfilled, none of those factors can be ignored; they must be duly accorded their full legal effect. It is only if and when the requirements of section 103(1) are all fulfilled that the form, substance, or legal effect of those factors

may be wholly or partly ignored. For then, in accordance with section 103(1), the appellant's liability for tax must be determined either "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" is deemed appropriate for preventing the avoidance of the tax liability. But until that stage of the inquiry is reached - and as will presently emerge it will in the present case not be reached - it must be premised that Reklame's distributable profits belong to it and not to its shareholders; that the shareholders in fact did not receive them; that they were subsequently declared by Ryan Nigel as dividends to itself; that under the RN agreement the shareholders received the money from Ryan Nigel as the purchase price for the sale of their shares; and that they used the money to liquidate their loan indebtedness

to .... /38

to Reklame.

It is true, of course, that the shareholders could have repaid their loans by declaring Reklame's reserves and assets as dividends thereby incurring the ensuing tax liability. But they were not obliged to do that. They were perfectly entitled to try to avoid such tax liability by adopting some other legitimate course (see C.I.R. v. Estate Kohler 1953 (2) S.A. 584 (A) at pp. 591 F - 592 H). It does not necessarily follow that, because a transaction, operation or scheme was aimed at and had the effect of avoiding an anticipated liability for tax, it is hit by the provisions of section 103(1). For they are inapplicable if that transaction, etc. falls within the limits of normality of means, manner, rights, and obligations prescribed by section 103(1)(i) and (ii) - see Smith's case, supra, 1964 (1) at p. 332 E - G.

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I turn now to consider this latter, crucial part of the problem - whether requirement (c) in section 103(1)(i) or (ii) relating to normality was fulfilled. A few preliminary observations about paragraphs (i) and (ii) of the subsection.

When the "transaction, operation or scheme" is an agreement, as in the present case, it is important, I think, to determine first whether it was one concluded "at arms' length". That is the criterion postulated in paragraph (ii). For "dealing at arms' length" is a useful and often easily determinable premise from which to start the inquiry. It connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself. Indeed, in the Afrikanns text the corresponding phrase is "die uiterste voor-waardes beding". Hence, in an at arms' length agreement the rights

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and obligations it creates are more likely to be regarded as normal than abnormal in the sense envisaged by paragraph (ii). And the means or manner employed in entering into it or carrying it out are also more likely to be normal than abnormal in the sense envisaged by paragraph (i). The next observation is that, when considering the normality of the rights or obligations so created or of the means or manner so employed, due regard has to be paid to the surrounding circumstances. As already pointed out section 103(1) itself postulates that. Thus, what may be normal because of the presence of circumstances surrounding the entering into or carrying out of an agreement in one case, may be abnormal in an agreement of the same nature in another case because of the absence of such circumstances. The last observation is that the problem of normality or abnormality of such matters is mainly a factual one.

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The court hearing the case may resolve it by taking judicial notice of the relevant norms or standards or by means of the expert or other evidence adduced thereanent by either party. It is unnecessary to decide what happens if at the end of the day, because of the lack of its own knowledge or such evidence, the court cannot resolve the problem.

Now here the relevant circumstances prevailing at the time when the RN agreement was mooted were those features of Reklame's financial position set out in paragraph 7 above, including the loans to the shareholders. I repeat and emphasize that this position was not brought about by the shareholders for the purpose of entering into the RN agreement and selling their shares to Ryan Nigel. It just happened to be its position at that time. Ryan Nigel was made fully aware of it. It was therefore

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inevitable that the terms of the sale of the shares would be conditioned by those features so as to make the transaction sufficiently attractive or worth-while for the shareholders to sell their shares and for Ryan Nigel to buy them. That has to be borne in mind when considering the normality of the rights and obligations created by the RN agreement.

In entering into that agreement both sides manifestly dealt with each other at arms' length. Neither Reklame nor its shareholders, as directors or otherwise, were associated with or interested in Ryan Nigel. Nor did the latter hold any sway over them. It was also Ryan Nigel who drew up the agreement and tendered it to them as an offer to purchase their shares on an accept-it-or-reject-it basis. It was part of Ryan Nigel's business to purchase the shares of companies with capital and distributable

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reserves, and this offer was made in the ordinary course of that business. To the shareholders the advent of Ryan Nigel with its offer was the deus ex machina for solving their problem of having to keep the "untidy", dormant Reklame in existence. All that confirms that both sides dealt with one another at arms' length. And the respective rights and obligations so created? The agreement obliged the shareholders to divest themselves of their shares and control of Reklame. Against that Ryan Nigel had to pay them the purchase price. Those reciprocal obligations were, of course, normal incidents of such a contract of sale. The shareholders also undertook to clear Reklame of its liabilities and its assets, including their loans, and to leave only the issued share capital and reserves intact. Ryan Nigel insisted on that because of the nature of the business it conducts and of its reason in

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taking Reklame over. There was thus nothing abnormal about that undertaking. As previously stated the shareholders' loan indebtedness to Reklame was an existing circumstance that obviously had to be dealt with in the RN agreement. That the latter required it to be repaid by the shareholders on 1 July 1975, the implementation date, was inevitable and therefore normal in an at arms' length agreement of this kind. Moreover, Mr Jaffe, an attorney well-experienced in drafting agreements for the taking over of shares in private companies, confirmed that the form of the RN agreement was a normal one containing the rights and obligations that are to be ordinarily expected in an agreement of that kind. The point was pressed by respondent's counsel (and made by the Special Court) that it was abnormal for the shareholders to undertake to pay Ryan Nigel to take the shares from them. Normally, it was said, that

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is not the kind of obligation a seller of shares undertakes. This refers to the discount of 10% of Reklame's distributable profits that was to accrue to Ryan Nigel under clause 4(2) of the RN agreement. True, the shareholders were in effect to pay R12 902 and Ryan Nigel was to receive R9 691 under the transaction (see paragraph 12 above). But having regard to the circumstances prevailing at the time and that this was an agreement at arms' length, I do not think that this was an abnormal obligation or right. It seems an eminently reasonable consideration for the shareholders to have to pay in order to be rid of the stubborn, "untidy", dormant Reklame, their loan indebtedness to it, and their anticipated substantial tax liability, and for Ryan Nigel to receive a reward for fulfilling its part of the bargain. Besides, the offer of such consideration did not emanate from the shareholders but from

Ryan Nigel who fixed and insisted on it. The rights and obligations created by the RN agreement were therefore, I think, normal in the sense envisaged by paragraph (ii).

As to paragraph (i), there was nothing abnormal about the means or the manner of entering into the RN agreement for reasons just given. But respondent's counsel concentrated on the means or manner of carrying it out, which, he contended, was abnormal in certain respects. True, for the purpose of fulfilling their obligations of clearing Reklame of its assets and liabilities the shareholders had to borrow the net excess from Reklame by debiting and thereby increasing their existing loan indebtedness to it (see paragraph 11 above). But this was obviously done with the knowledge and consent of Ryan Nigel, and, this being an at arms' length agreement, I do not think that there was anything

abnormal .... /47

abnormal about that, even though this further loan was also interest-free and unsecured. After all, under section 226(1) of the Companies Act, No. 61 of 1973, a private company can make loans to its directors with the requisite consent of its shareholders; Reklame was able to accommodate them for the further loan; and it was merely a very temporary expedient from 13 June to 1 July 1975 when the whole indebtedness of the shareholders was to be repaid out of the proceeds of the sale of the shares (see paragraph 11 above). That such indebtedness was paid out of those proceeds by the simultaneous exchange of cheques (see paragraph 13 above) was also criticized as being abnormal. I do not agree. It was not only normal, but a sound business and common sense way of both sides fulfilling their respective obligations in an at arms' length agreement. Some point was also made that the purchase price was

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paid, not to the shareholders, but to the new Adverto, and that the cheque for repayment of the loan indebtedness was paid to Ryan Nigel and not Reklame. But the new Adverto was obviously acting on behalf of the shareholders and Ryan Nigel on behalf of Reklame in those payments. There was nothing abnormal about that. Hence, the manner and means of entering into and carrying out the RN agreement were normal in the sense envisaged by paragraph (i).

The conclusion is therefore that requirement (c) in section 103(1)(i) and (ii) was not fulfilled. The Special Court erred in coming to the contrary conclusion. It follows that respondent's invocation in the 1975/6 year of assessment of the provisions of section 103(1) against appellant in order to render him liable on "a dividend" of R8 072, being a proportionate share of Reklame's distributable profits (see paragraph 16 above),

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was not justified. The appeal therefore succeeds. The following orders are made.

A. The appeal succeeds with costs, including those relating to two counsel.

B. The order of the Special Court is set aside and the following order is substituted:

"The appeal succeeds and the revised assessment for the year ending on 29 February 1976 is set aside. The matter is remitted to the Secretary for Inland Revenue in order to re-assess appellant on the basis that the amount of R8 072 is excluded from his taxable income."

W.G. TROLLIP, J.A.

MULLER, J.A.
DIEMONT, J.A.
GALGUT, A.J.A.
BOTHA, A.J.A. } concur