Some Drastic Measures to Close a Loophole: The Case of *Pienaar Brothers (PTY) LTD v Commissioner for the South African Revenue Service* (87760/2014) [2017] ZAGPPHC 231 (29 May 2017) and the Targeted Retroactive Amendment of Section 44 of the *Income Tax Act* 58 of 1962

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Abstract

A taxpayer has the right to arrange his tax affairs within the constraints of the law to his best advantage to pay the least amount of tax. Coupled with this right is the taxpayer's right to certainty, which entails that the time of payment of taxes, the manner of payment, and the amount of payment must be clear and plain to the taxpayer and to any other person. Accordingly, a taxpayer must have peace of mind that revenue laws will not be amended arbitrarily, retrospectively, and with the effect that the taxpayer's position is affected negatively. The South African tax legislation allows the deferral of tax liability when amalgamation transactions, asset for share transactions, and mergers and acquisitions are embarked upon by a taxpayer. This article analyses the judgment in *Pienaar v Commissioner: South African Revenue Services* (87760/2014) [2017] ZAGPPHC 231 (29 May 2017) critically with specific reference to amalgamation transactions, the taxpayer's right to tax certainty, and the application of retroactive amendments to completed transactions.

Keywords

Retroactive amendments; secondary taxes on companies; roll-over relief; tax avoidance; share premium; share capital; contributed tax capital.

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1 Introduction

It is a well-known principle in taxation that a taxpayer has the right to arrange his tax affairs within the constraints of the law to his best advantage to pay the least amount of tax. Coupled with this right is the taxpayer's right to certainty, which entails that the time of payment of taxes, the manner of payment, and the amount of payment must be clear and plain to the taxpayer and to any other person.[1] Accordingly, a taxpayer must have peace of mind that revenue laws will not be amended arbitrarily, retrospectively, and with the effect that the taxpayer's position is affected negatively. In contrast, SARS has the right to collect the maximum amount of tax which the law permits. The principle of efficiency requires the optimal collection and allocation of revenue to enhance policy objectives such as economic growth and increased production.[2] The global financial crisis in 2008, increased budget deficits, and slower than expected economic growth globally have caused revenue authorities to become more meticulous in their tax collection methods and quite aggressive in their enforcement of tax legislation.[3]

South African tax legislation allows for the deferral of tax liability when amalgamation transactions, asset for share transactions, and mergers and acquisitions are embarked upon by a taxpayer.[4] These corporate roll-over rules deviate from the normal rules that apply to the taxation of a distribution of profit from a company to its shareholders when specific transactions are embarked upon. The purpose of these rules is to grant tax relief when such

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1 Smith *Wealth of Nations* 825-826.

2 In an efficient tax system, the rules must not contribute to erosion via legal or illegal means, must not be overly reliant on one specific type of tax for revenue, and must have an objective basis for the levying of tax. There must be an identifiable transaction or reason for levying tax which can easily be ascertained, it must be enforceable and indeed be enforced with a reasonable penalty system and a low cost of collection. See Tanzi *Public Finance* 164; Krishna *Fundamentals of Canadian Income Tax* 11-12; Hogg, Magee and Li *Principles of Canadian Income Tax* 65; McGee and Yoon state that efficiency is enhanced when the most resources are left in the private sector and governments do not seek to maximise the amount of tax they can collect from the taxpayers. See McGee and Yoon "Enhancing Efficiency of Government Budget and Fiscal Policy" 52.

3 SARS *Strategic Plan* 4-6; NPC *National Development Plan* 51-53.

4 Sections 41-47 of the *Income Tax Act* 58 of 1962; De Koker, Koekemoer and Williams *Silke on South African Income Tax* para 24; Stiglingh *et al Silke South African Income Tax Vol I* 507, 522.

mergers or complex corporate finance restructuring activities are undertaken.

Section 44 of the *Income Tax Act* 58 of 1962 is one example of a specific provision which grants tax relief to taxpayers who are involved in amalgamation transactions. In *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service*[5] the High Court was called upon to rule on the retro-activity of amendments to section 44 of the *Income Tax Act* 58 of 1962.

In this article we analyse this decision by explaining the background and rules that apply to the taxation of company distributions to indicate the context in which this dispute arose. This is followed by a discussion of the retroactivity of revenue laws, and concluding remarks. As this article examines two important aspects in tax law, namely the taxation of company distributions and the retroactivity of amendments to revenue laws, the importance and relevance of this discussion to the legal fraternity is obvious.

2 The facts

Pienaar Brothers (Pty) Ltd ("Pienaar") is a duly registered company that was previously known as Serurubele Trading 15 (Pty) Ltd ("Serurubele"). Serurubele changed its name from Serurubele Trading 15 (Pty) Ltd to Pienaar Brothers (Pty) Ltd on 7 August 2007.[6] Both companies were involved in the business of supplying and distributing personal protective clothing.

On 16 March 2007 the two companies, namely Serurubele and Pienaar, entered into an amalgamation transaction in terms of which all the assets of Pienaar were deemed to be acquired by Serurubele on 1 March 2007 as a going concern.[7] A sale of business agreement was signed on 16 March 2007, which was effective from 1 March 2007.[8] As part of the consideration for this business, Serurubele issued shares to Pienaar at a value of the purchase price minus the liabilities which it assumed, referred to as the "equity consideration". From this equity consideration an amount equal to the par value of the shares was subtracted and the remaining amount was credited to the share premium account of Serurubele.[9] On 1 April 2007 the

5 *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service* (87760/2014) [2017] ZAGPPHC 231 (29 May 2017) (hereafter the *Pienaar* case).
6 *Pienaar* case para 7.
7 *Pienaar* case para 7.
8 *Pienaar* case para 7.
9 *Pienaar* case para 2.

business was transferred to Serurubele and the purchase price paid by crediting the share premium account.

The attorneys of Pienaar advised them to follow the above course of action as the most tax effective manner in which the amalgamation of the two companies and the inclusion of a BEE partner could be achieved. Accordingly, the transaction was based on commercial reasoning.

At the time of this transaction, namely 16 March 2007, the tax consequences of this transaction were regulated in terms of section 44(9) of the *Income Tax Act* 58 of 1962.[10] For the amalgamation transaction to be completed, the old company had to be terminated.

As part of the purchase price, Serurubele distributed the consideration shares to its shareholders in proportion to their respective shareholding. Serurubele was liquidated thereafter. On 3 May 2007 the directors of Serurubele - as it then was - decided to make a distribution of a total amount of R29 500 000 to the shareholders of the company in proportion to their respective shareholding, out of the share premium account of Serurubele. This distribution was completed on the same date. On 7 May 2007, as part of the BEE transaction, the existing shareholders of Pienaar sold 25.1 [per cent] of the issued share capital to a BEE partner, namely, Naha Properties (Pty) Ltd.[11]

At the time of the decisions and payment of the distribution (3 May 2007), the proviso in paragraph (f) of the definition of a dividend in section 1 of the *Income Tax Act*[12] excluded amounts that were distributed from the share premium account of a taxpayer. In addition, section 44(9) of the *Income Tax Act*, which applied at the time of the transactions, allowed for the tax-free distribution of shares in the course of an amalgamation transaction. The parties agreed that the distribution in question had not been a dividend as defined, and excluded this question from the ambit of the dispute between them.[13] If this distribution had been a dividend as defined at the time it was made, the taxpayer would have been liable for Secondary Taxes on Companies ("STC") and it would have been liable to submit a STC return by 30 June 2007.

10 *Pienaar* case para 6.
11 *Pienaar* case para 7.
12 *Income Tax Act* 58 of 1962.
13 *Pienaar* case para 10.

Several legislative amendments were in the process of finalisation during the time of the transactions entered into by Pienaar. In the budget speech of 21 February 2007 it was announced that section 44(9), which provided for the exemption from STC liability which is incurred in the course of amalgamation transactions (and the provision upon which the applicant had based its course of action during this amalgamation transaction), would be withdrawn.[14] At this time the alternative provision that would apply in the place of section 44(9) was not clarified. On 27 February 2007 the Draft *Taxation Laws Amendment Bill*, 2007 was published, which proposed the repeal of section 44(9) and (10) of the *Income Tax Act* with retroactive effect from 21 February 2007. On 7 June 2007 the *Taxation Laws Amendment Bill*, 2007 was published in which the repeal of these paragraphs was no longer the only suggestion, but the insertion of a new section 44(9A) of the *Income Tax Act* was included. The new section 44(9A) deemed a distribution to be a dividend when the resultant company made a distribution after an amalgamation. On 8 August 2007 the *Taxation Laws Amendment Act* 8 of 2007 was promulgated. Specifically, paragraphs (9) and (10) of section 44 were repealed and replaced by section 44(9A) with retrospective effect from 21 February 2007.[15] Section 44(9A) applied to any reduction or redemption of share capital or share premium of the resultant company, including the acquisition by a company of its own shares. It was common cause between the parties that this legislative amendment was promulgated after the amalgamation and distribution had been completed.

On 6 December 2011 the commissioner launched an audit into Pienaar's tax affairs. On 13 December 2011 the commissioner issued an assessment for STC on Pienaar.[16] In terms of this assessment, the commissioner claimed that the specific dividend cycle for STC purposes started on 23 September 2005 and ended on 3 May 2007.[17] The commissioner not only

14 *Pienaar* case para 11.

15 It is interesting to note that the facts as explained in the judgment indicate that paragraphs (9) and (10) of s 44 were repealed when s 44(9A) was enacted on 8 August 2007. Upon closer investigation of this specific amendment, the authors noticed (in the explanatory notes after each section in the *Income Tax Act* 58 of 1962 which contains the cross references to the dates, detailed sections, as well as effective dates of applicable amendment acts) that s 44(9)(a) was substituted by other sections during 2011 and only eventually repealed by s 93(1)(1) of the *Taxation Laws Amendment Act* 31 of 2013 which was deemed to come into operation on 24 October 2013. S 44(9)(b), which is still in force and was not amended or repealed at any stage, grants an exemption upon the disposal of shares acquired by a company as part of an amalgamation transaction and deems such a disposal not to be a dividend. In addition, s 44(9A) was inserted on 8 August 2007 with retrospective effect and repealed in 2010 as is explained in more detail later below.

16 *Pienaar* case para 11.

17 *Pienaar* case para 12.

assessed Pienaar on the amount of STC that he considered outstanding but he also levied interest from 1 July 2007 to 5 January 2012 (this is the date that the commissioner considered STC to be payable in terms of the assessment).[18] Pienaar objected to this assessment without success. The dispute was referred for arbitration, which failed. Eventually, Pienaar approached the Gauteng North High Court for a declaratory order on the constitutionality of the retroactivity of the amendments.

3 The judgment

The question in dispute before the court was whether the distribution of the amount of R29 500 000 made on 3 May 2007 by Serurubele from its share premium account could be subject to STC based on the application of section 44(9A), which was a retrospective amendment of section 44(9) of the *Income Tax Act* 1962.[19] Pienaar averred that the only reason for the assessment by SARS on this distribution was due to the retrospective changes to the act which enabled SARS to apply section 44(9A) to this distribution.[20] As a result, Pienaar sought to have the assessment of SARS dated 13 December 2011 declared invalid, and requested the court to set it aside. After an in-depth analysis of the question of retrospective legislative amendments and the constitutional aspects of such an amendment, the court dismissed the application of Pienaar and made no order as to costs.[21]

4 Commentary: Background, STC, and dividends tax

A distribution of after tax profits earned by a company is usually paid as a dividend to the shareholders of a company or it can also be paid as a return of capital, which is sourced from a capital account of the company.[22] In order for STC or dividends tax to be payable, a payment must comply with the definition of a dividend as it applied at the time of the transaction.

Prior to 1 April 2012 all dividends declared by South African companies were subject to secondary tax on companies, which was a company-level tax payable by the company when a dividend was declared and prior to the distribution of the dividend to its shareholders.[23] The amount of the liability for STC was calculated by subtracting the amount of the dividends that had

18 *Pienaar* case para 12.
19 *Pienaar* case para 7.
20 *Pienaar* case para 14.
21 *Pienaar* case para 113.
22 Croome *Tax Law* 402; Van der Linde 2009 *TSAR* 484-487.
23 Mazansky 2003 *BIFD* 145; Van Blerck 2003 *BIFD* 570-571; Van Blerck 1993 *BIFD* 701-703.

accrued to a company from the amount of the dividends which that company declared within a certain dividend cycle (time period). Besides the lengthy and complex legislative provisions, the difficult terminology and the complicated definition of a dividend, the payment of STC often resulted in a reduction of the accounting profits of the company, which placed a South African company at a disadvantage when compared to foreign companies. This could affect the neutrality of investment decisions by foreign investors and deter investment in South African companies.[24]

In the context of cross-border trade, the application of certain articles of double-tax treaties (or a double tax agreement - "DTA") in transactions which involved STC became problematic. This sometimes resulted in double taxation or non-taxation. This was because STC was unique to South Africa. Furthermore, the differences between taxes levied in other states (that were party to such agreements) and STC was too significant. This made it very difficult to reconcile STC with such taxes or to determine the allocation of tax liability in terms of the articles of such double tax agreements.[25] In *Volkswagen of South Africa (Pty) Ltd v CSARS*,[26] the court denied the claiming of a refund in respect of a deemed dividend based on a provision in the tax treaty between South Africa and Germany which contained a lower rate of tax for dividends.[27] The court stated that the structure of STC did not correspond with the taxes mentioned in the treaty as it was irreconcilable with the definition of a dividend as contained in this specific treaty.[28] The differences that caused problems in the attempts to reconcile STC with its foreign counterparts were mostly caused by the difference in the tax base. STC was a tax on the difference in dividends of a company which declared the distribution, as opposed to dividend tax, which was levied on the recipient of the dividend or the shareholder.[29] The wording in the article of this specific DTA granted relief to the recipient of

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24 SARS *Explanatory Memorandum 2008* 24; Hattingh 2009 *BIT* 442; Stiglingh *et al Silke South African Income Tax Vol I* 562; SARS *Quick Guide to Dividends Tax* 1; Oguttu 2011 *SAYIL* 77. For further reading on STC see Meyerowitz *Meyerowitz on Income Tax* paras 17.40-17.51.

25 SARS *Explanatory Memorandum 2008* 24.

26 *Volkswagen of South Africa (Pty) Ltd v CSARS* 70 SATC 195 2008 (T) (hereafter the *Volkswagen* case)

27 *Volkswagen case* 199D.

28 *Volkswagen case* 204A-C. See also Editorial Comment 2008 *International Tax Law Reports* 772; Hattingh 2009 *BIT* 446.

29 *Volkswagen* case 203C, 293G; Editorial Comment 2008 *International Tax Law Reports* 772; Hattingh 2009 *BIT* 445; SARS *Explanatory Memorandum 2008* 31.

the dividend and not the company declaring the dividend. In the main, this is why the court denied the relief in favour of the company.[30]

Before a transaction could be subject to STC it had to comply with the definition of a dividend. For the purposes of this analysis it is not necessary to quote the lengthy definition again save to mention that the transaction in the *Pienaar*-case did not comply with the definition of a dividend. This is so because the amount in question had been transferred from the share premium account of the company. As mentioned above, paragraph (f) of the definition of a dividend specifically excluded distributions from a share premium account from the ambit of the definition of a dividend. Thus, based on normal principles, this transaction could not, for STC purposes be taxable in the hands of Pienaar. This was common cause between the parties.

It is not unusual to exclude amounts paid from a capital account from the definition of a dividend. However, the rules differ depending on the jurisdiction concerned. In Australia, for example, amounts paid from or debited against a company's share capital account are expressly excluded from the definition of a dividend and excluded from the Australian dividends tax regime and dividend imputation system.[31] In contrast with the South African and Australian position, the Canadian definition of a dividend does not contain specific exclusions from the definition of a dividend in its tax legislation.[32] The Canadian *Income Tax Act* 1985, however, defines the term "taxable dividend" in a manner which excludes a capital dividend, which is treated as exempt in terms of section 83(2) of the *Income Tax Act* 1985. The Act contains a separate regime for the taxation of capital dividends.[33]

It was announced in the 2007 Budget Speech that the STC provisions in the *Income Tax Act* would be amended and a dividends tax system enacted to align the South African tax on dividends with international trends. This was so as to attract more foreign direct investment to South Africa.[34] The

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30 *Volkswagen* case 204D-F; Editorial Comment 2008 *International Tax Law Reports* 772.

31 Section 6(1) definition of the term "dividend" part (d) read with s 6(4) of the Australian *Income Tax Assessment Act*, 1936; Deutsch *et al Australian Tax Handbook* 815.

32 Friedlander *Taxation of Corporate Finance* para 5.1.1.1; Duff and Loomer *Taxation of Business Organizations* 233, 609; Loomer "Canada" 473; s 248(1) of the Canadian *Income Tax Act*, 1985, definition of "dividend"; CCH *Canadian Master Tax Guide* 569, 575; Tobias *Taxation of Corporations, Partnerships and Trusts* 210.

33 Section 89(1) of the Canadian *Income Tax Act*, 1985; Duff and Loomer *Taxation of Business Organizations* 233.

34 SARS *Explanatory Memorandum 2008* 24; Hattingh 2009 *BIT* 442.

necessary amendments were drafted and eventually came into force on 1 April 2012 after many amendments of the initial proposed legislation. From this date, the distribution of a dividend paid by a South African resident company has been subject to dividend withholding tax, currently levied at a rate of twenty per cent, for which the beneficial owner is liable.[35]

It is rather peculiar that the commissioner, in the *Pienaar* case, sought to enforce a tax which he knew would be phased out literally a few months prior to the demise of STC (the assessment was dated 13 December 2011, while STC was gradually repealed from 1 April 2012). The transaction clearly did not fall within the ambit of the definition of dividend. The fact that certain capital transfers were excluded from the definition of "dividend" did not mean that those distributions would not be taxable at all. The capital gains tax ("CGT") provisions may still have found application.

Throughout the proposed amendments to the dividends tax provisions, the exclusion of amounts paid from certain capital accounts from the definition of a dividend was retained.[36] This approach is similar to the position under Australian tax law, which excludes amounts distributed from share capital from the definition of a dividend. If it had at any time been the intention of the legislature to tax distributions from capital accounts, this would surely have been included in the legislative amendments which were drafted prior to the time of the Pienaar assessment.

At the time of the proposed changes to the dividends tax regime in the *Income Tax Act*, the *Companies Act*[37] was also promulgated. This Act abolished the requirement that it was compulsory for all companies to keep record of their share capital and share premium accounts.[38] The removal of the requirement to keep a record of the capital in those accounts could have had disastrous consequences for income tax calculation purposes had it not been for the introduction of the concept of contributed tax capital into the *Income Tax Act*.

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35 Clegg and Stretch *Income Tax* para 12.17.1; Stiglingh *et al Silke South African Income Tax Vol I* 562; SARS *Budget Tax Guide* 18; SARS *Quick Guide to Dividends Tax* 2; De Koker, Koekemoer and Williams *Silke on South African Income Tax* para 9.37; Haupt *Notes on South African Income Tax 2013* 397.

36 See the definition of "dividend" in s 1 of the *Income Tax Act* 1962, which excludes payments sourced from contributed tax capital from the dividend definition.

37 *Companies Act* 71 of 2008.

38 Sections 76 and 77 of the *Companies Act* 61 of 1973 contained the requirements for the stated capital and share premiums accounts, while the *Companies Act* 71 of 2008, which came into effect on 1 May 2011, contains no such requirements.

5 Commentary: Share premium, share capital, and contributed tax capital

The concept contributed tax capital was introduced in the *Income Tax Act* to ensure that all companies keep a separate account of their "contributed tax capital" ("CTC") in their accounting records in accordance with the requirements of this definition in section 1 of the *Income Tax Act*.[39] In this separate account the notional amount (as it was on 11 January 2011),[40] which reflects the value of the contributions received by the company from its shareholders for the issue of shares, is recorded separately per share per class. The value of the total share capital (excluding amounts that constitute dividends or other distributions to shareholders) of the specific company should be reflected in this account, as well as the value of the amounts that were contributed to the company after this date in exchange for the issue of shares.[41] This definition was amended several times before the eventual implementation of the new dividends tax. The same amendment act also inserted the new definition of a dividend, the new dividends tax regime, and transitional arrangements for the phasing out of STC with the effective date 1 April 2012.[42] The balance reflected in the CTC account should reflect all the previous share capital account, share premium account, and stated capital account balances, and the values contained in this account may be used for future capital gains tax calculations to determine the tax liability of the company or shareholder, where applicable.[43]

As was confirmed in *Commissioner for Inland Revenue v Bobat,*[44] payments from a share premium or share capital account were mostly not subject to STC. In this case, a payment was made by a company from the share premium account to its shareholders as part of the restructuring of the company and a reduction of capital. As the payment did not constitute a dividend as defined, the court found this payment to be exempt from tax

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39 Stiglingh *et al Silke South African Income Tax Vol I* 554.

40 The starting CTC.

41 Section 1 of the *Income Tax Act* definition of "contributed tax capital"; Stiglingh *et al Silke South African Income Tax Vol I* 554-555; SARS *Explanatory Memorandum 2008* 24; s 4(1)(b) of the *Revenue Laws Amendment Act* 60 of 2008 inserted the new definition of CTC into s 1 of the *Income Tax Act*.

42 Louw 2011 *Moneyweb's Tax Breaks* 7-8. For more detail on CTC see Anon 2009 *Taxgram* 3. Also see s 1 of the *Income Tax Act* definition of "contributed tax capital"; Stiglingh *et al Silke South African Income Tax Vol I* 558; Clegg and Stretch *Income Tax* para 12.2.2.

43 Stiglingh *et al Silke South African Income Tax Vol I* 554-555.

44 *Commissioner for Inland Revenue v Bobat* 2005 67 SATC 47 (NPD) (hereafter the *Bobat* case).

(this was prior to the introduction of CTC).[45] Interestingly, the Supreme Court of Appeal gave a contrary judgment in the case of *Liberty Investors Ltd (in members voluntary liquidation) v Commissioner South African Revenue Services.*[46] In this matter, amounts were received from a subsidiary as dividends by a holding company, which were revenue in nature and capitalised in the accounting records of the company by adding these amounts to the share capital and share premium accounts of the company.[47] After the holding company was placed into liquidation, it declared a dividend which the commissioner sought to assess as dividends upon which STC would be payable. The company objected, claiming that the distributions were capital in nature and as part of the liquidation process had been exempt.[48] At the time, section 64B(5)(c) of the *Income Tax Act* 1962 provided that dividends paid in the course of liquidation that were of a capital nature were exempt from STC if paid in the course of the liquidation of the company.[49] Both the court *a quo* and the Supreme Court of Appeal found that dividends were inherently income in nature, and that the manner in which the amounts were reflected in the accounting records of the company did not alter the nature of the payments, which originally had been dividends.[50]

Although the law which regulates distributions paid from capital accounts has been amended in many ways recently, and specific principles apply to liquidation distributions, the principle has remained the same, namely that distributions made out of a capital account (whether paid from the previous share capital account or the share premium account or the current contributed tax capital account) of the company is usually not subject to STC or dividends tax.[51] The *Bobat* case in our view represents a correct interpretation of the law in this regard.

It does not appear to have been the intention of the legislature to regard returns paid from either share premium or share capital accounts (both of which were included in the definition of the concept contributed tax capital)

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45 *Bobat* case 49.

46 *Liberty Investors Ltd (in members voluntary liquidation) v Commissioner South African Revenue Services* 2005 2 SA 313 (SCA) (hereafter the *Liberty Investors* case)

47 *Liberty Investors* case 314G-H.

48 *Liberty Investors* case 314G-H

49 *Liberty Investors case* 314I-J.

50 *Liberty Investors* case 315E-316E.

51 See para (f) of the previous definition of "dividend"; Stiglingh *et al Silke South African Income Tax Vol I* 554-558. Also see the current definition of "dividend" in s 1 of the *Income Tax Act*, which specifically excludes amounts paid from contributed tax capital from the definition of a dividend.

as taxable for the purposes of STC or dividend tax. This is evident from the retention of the exclusion from the definition of a dividend of payments made from the contributed tax capital account as the law currently stands. This is also what the law stated in respect of share premium accounts at the time of the amalgamation transactions, assessment, and averred dividend cycle, the completion of the distribution, and the hearing of the *Pienaar* case. The amounts in dispute in this matter were therefore a payment from the share premium account and thus not taxable as a dividend to which STC could apply at any relevant point in time. It seems very clear that were it not for the insertion of section 44(9A) and the retroactive effect of the amendment, this transaction would not be subject to STC. This was also argued by Pienaar.[52]

It is further rather strange that a deemed dividend provision was inserted in the part of the *Income Tax Act* which regulates corporate roll-over relief, and not in the section dealing with deemed dividends. Rules of interpretation require that a provision be interpreted by attempting to determine the intention of the legislature in a manner consistent with the purpose and context of a provision within the context of the place where that provision is located in the Act itself, without allowing for the fragmentation of the legislation as a whole.[53] This was further confirmed in *Standard General Insurance Co Ltd v Commissioner for Customs and Excise*,[54] where the court stated that words should be given the meaning which "takes its colour, like a chameleon, from its setting and surrounds in the Act".[55]

Although the interpretation of section 44(9A) was not in dispute in this matter, it is our view that this section did not fit into the scheme of the Act at the setting and surrounds where it was placed. The entire part deals with relief from tax liability during amalgamation transactions. As the normal rules that apply to all company distributions could be applied to such a transaction, it is our view that it is not proper to insert deemed dividend provisions in this part of the Act. This odd placing of the amendment supports the argument that the amendment was drafted, promulgated, and implemented in haste to recover alleged lost taxes.

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52 *Pienaar* case para 109.

53 Legwaila and Ngwenya 2013 *De Jure* 1069-1072; *CSARS v Airworld CC* 2008 3 SA 335 (A) 345I-J. Also see *Glen Anil Development v SIR* 1975 4 SA 715 (A) 727; *CIR v Delfos* 1933 AD 242.

54 *Standard General Insurance Co Ltd v Commissioner for Customs and Excise* 2005 2 SA 166 (SCA) (hereafter the *Standard General Insurance* case).

55 *Standard General Insurance* case 174H-175A.

An additional strange occurrence was the repeal of this section with effective date 1 January 2011 within such a relatively short period of time after its insertion on 8 August 2007, which was effective from 21 February 2007.[56] This section literally applied to a select few transactions. It is of concern that the very section upon which the commissioner relied in this matter was repealed on 1 January 2011 prior to the assessment of Pienaar.[57] This creates the unfortunate impression that a mere hunt for money was embarked upon by SARS and National Treasury through this absurd amendment.

Section 44(9), which was in force at the time of the distribution of the amount from the share premium account to the shareholder, exempted the distribution of shares as part of an amalgamation transaction to the shareholders of the amalgamated company.[58] The law as it applied during the 2007 year of assessment also specifically excluded from the definition of a dividend the value of any asset given to a shareholder to the extent that such an asset constituted a reduction of the share premium account of a company.[59] The parties agreed that the combined effect of the application of these provisions to the facts in the *Pienaar* case, as it then was, would have the result that this distribution of shares would not be subject to STC.

The only reason for the possible application of STC to the transaction was therefore that the provisions of section 44(9A) caught it within the deeming provision. Although the parties were in agreement that the provisions of section 44(9) applied to the distribution, this view is not necessarily shared. Section 44(9) granted exemption from tax for shares that were distributed during the amalgamation transaction, while the amount which formed the subject of the dispute in the *Pienaar* case was described in the law report as "an amount" of R29 500 000 which was paid from the share premium account. It would have been interesting to see how the court would have interpreted section 44(9) if it had been placed before the court for adjudication. As the amount in question did not constitute shares, it does not necessarily follow that this section formed the basis of arguing that the transaction would have been tax exempt had it not been for the retrospective insertion of section 44(9A). It is conceded that the court could not interpret an issue which was not raised before it as the parties did not

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56 Section 44(9A) was deleted by s 63(1)(b) of the *Taxation Laws Amendment Act* 7 of 2010 with effect from 1 January 2011.

57 Pienaar was issued with an assessment on 13 December 2011.

58 Huxham and Haupt *Notes on South African Income Tax 2007* 250.

59 Paragraph (f) of the definition of a dividend in s 1 of the *Income Tax Act*; Huxham and Haupt *Notes on South African Income Tax 2007* 266.

require judicial interpretation of this section in their application or in the opposition to the application.

A further factual difference between the protection or relief provided for and the transaction in dispute is the timing of the distribution. Section 44(9) provides relief for transactions that are part of amalgamation transactions. This was not what occurred on the facts of the *Pienaar* case. The distribution *in casu* was made after the amalgamation had been completed and, in our view, rendered the application of the corporate roll over relief rules irrelevant.

If the exclusion of a distribution paid from the share premium account from the dividend definition prohibits the taxation of the return as a dividend for the purposes of STC, the question remains how such a return should have been assessed in the absence of section 44(9A).

6 Commentary: Capital gains tax

A return of capital is not necessarily without tax consequences. Capital gains tax rules may apply to certain company distributions.[60]

Before capital gains tax was introduced in 2001, a return of capital (which at the time was a reduction of the share premium account of the company) was considered a tax-free return in the hands of the shareholder. This was subject to the condition that such a shareholder held the shares as a capital asset and did not speculate or trade in shares. It was a popular trend for companies to make a distribution of capital to their shareholders and by doing so avoid STC. This type of distribution resulted in a reduction of the total tax liability of the company, while shareholders, depending on the circumstances, received a tax-free capital distribution.[61]

The *Income Tax Act* contains specific rules that are applicable when a company distributes cash or assets of a capital nature that are linked to shares.[62] These rules are contained in part XI of the 8th Schedule to the *Income Tax Act* and apply to both cash dividends and dividends *in specie* that are capital in nature.[63] Paragraphs 75 and 76 of the 8th Schedule to the

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60 Stiglingh *et al Silke: South African Income Tax Vol II* 858.

61 Mazansky 2012 *BIT* 172. Also see Williams *CGT - A Practitioner's Manual* 229-239 for the rules that applied historically when CGT was introduced for the first time in 2001.

62 Stiglingh *et al Silke: South African Income Tax Vol II* 950.

63 Williams *CGT - A Practitioner's Manual* 229-239; Stiglingh *et al Silke: South African Income Tax Vol II* 950.

Income Tax Act contain rules that apply to dividends *in specie* and returns of capital as defined. However, the remainder of the possible capital distributions which do not comply with the specific requirements and definitions, and could be made by a company to its shareholders, are taxable under the general principles that apply to the taxation of capital gains. CGT is mostly levied upon the realisation of CGT assets. That said, certain exceptions to this general rule are contained in the deemed capital gain provisions and the specific rules that were enacted that apply to company distributions. A distribution of an asset by a company to a holder of shares is also specifically included in the list of disposal events listed in the 8th Schedule to the *Income Tax Act,* to which the general CGT rules apply.[64]

It is our view that the distribution *in casu* would at the time have amounted to a "capital distribution", which was defined in paragraph 74 of the 8th Schedule to the *Income Tax Act* 1962 as "any distribution (or part thereof) by a company that (a) does not constitute a dividend" or is an exempt dividend in terms of section 65B(5(c) of the *Income Tax Act* as it then applied.[65] The distribution *in casu* did not constitute a dividend as defined as was explained above, and the law as it applied in 2007 when the transaction took place included this definition of a capital distribution.[66] The definition of the term “distribution” included cash or assets *in specie* that were transferred to a shareholder.[67]

Under the normal CGT rules that applied at the time of the transaction, if a company distributed an asset to a shareholder, which was not subject to STC, the shareholder would treat this receipt as proceeds for CGT purposes due to the application of paragraphs 74, 75 and 76 of the 8th Schedule to the *Income Tax Act*.[68] Paragraph 76 (as it applied during 2007) stated that if a capital distribution of cash or an asset *in specie* had accrued to a shareholder, and it happened before the valuation date (1 October 2001), the base cost (referred to as allowable expenditure) would have to be

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64 Paragraph 11(1)(e) of the 8th Schedule to the *Income Tax Act*; Stiglingh *et al Silke: South African Income Tax Vol II* 868.

65 Paragraph 74 of the 8th Schedule to the *Income Tax Act* definition of "capital distribution", as it applied in 2007 prior to its deletion by s 117(1)(a) of the *Taxation Laws Amendment Act* 24 of 2011 with effect from 1 April 2012. Also see Meyerowitz *Meyerowitz on Income Tax* para 17A.26.

66 Meyerowitz *Meyerowitz on Income Tax* para 39.11.2.

67 Paragraph 74 of the 8th Schedule to the *Income Tax Act* definition of "distribution", as it applied in 2007 prior to its deletion by s 117(1)(a) of the *Taxation Laws Amendment Act* 24 of 2011 with effect from 1 April 2012.

68 Also see Huxham and Haupt *Notes on South African Income Tax 2007* 685.

reduced by the amount of the distribution.[69] This could ultimately result in a larger capital gain in certain cases, depending on the other aspects that are taken into account for the purposes of the calculation. If the capital distributions took place after the valuation date , the shareholder must include the proceeds of the share upon the eventual disposal of the share in the amount of the capital distribution so received and reduce the base cost by the amount of the distributions.[70]

According to the judgment the distribution would have been treated as a part disposal of a share for CGT purposes.[71] As the legislation which applied to company distributions was amended several times during this time, this interpretation would depend on the specific version of the *Income Tax Act* 58 of 1962 which was applied at a specific time. The exact definitions which the court considered applicable in this case were not analysed in the judgment, as the merits were not a question before the court.

The implications of these provisions for the *Pienaar* case would be that deferral of a tax liability would have been allowed until the shares were disposed of. A value determination had to be done at the time of distribution to determine the amount to be added to the proceeds of the shares for such a future disposal. This would result in a lesser amount of tax payable at the time of distribution, yet a potentially larger capital gain upon the disposal of the shares. This may be an undesirable consequence for the commissioner in this instance perhaps, but it did not constitute a permanent escape or erosion of the tax base in respect of the shares that would eventually be disposed of. For the purposes of CGT, the collection of the full amount of tax is postponed until disposal. However, the application of section 44(9A) prevented the normal tax consequences from applying and deemed the distribution to be profit which was not of a capital nature. Disappointingly, the court explained the law relating to CGT in brief, but did not address the arguments of the applicant in this regard.[72] It remains our view that upon a proper interpretation of the facts in the absence of the retroactivity of section 44(9A), CGT would have been the appropriate tax to levy.

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69 Paragraph 76 of the 8th Schedule to the *Income Tax Act* as it applied in 2007 prior to the amendment thereof. Also see Meyerowitz *Meyerowitz on Income Tax* para 39.11.2.

70 Paragraph 76 of the 8th Schedule to the *Income Tax Act* as it applied in 2007 prior to the amendment thereof. Also see Huxham and Haupt *Notes on South African Income Tax 2007* 685, 689.

71 *Pienaar* case para 23.

72 *Pienaar* case para 23.

7 The application of a general anti-avoidance provision

It is stated in the *Pienaar* judgment that it had come to the government's attention that certain stakeholders were engaging in tax avoidance transactions by using section 44(9) of the *Income Tax Act* and that the insertion of section 44(9A) was necessary to cure a problem.[73] That said, it was common cause between the parties that the transactions in question had a commercial rationale.[74] The insertion of section 44(9A) can be classified as a specific anti-avoidance provision to target specific transactions. *In casu,* the commissioner did not rely on the general anti avoidance provisions (GAAR) as set out in section 80A-L of the *Income Tax Act* to attack the transactions. This is despite the general statement that taxpayers were abusing section 44(9) to enter into tax avoidance schemes.

For the commissioner to rely on a GAAR successfully, it is required that there must be an arrangement in terms of which the sole or main purpose is to obtain a tax benefit and the transaction must ultimately result in such a tax benefit. An arrangement is defined to include a transaction, operation, scheme, agreement, enforceable and unenforceable understanding, or any such listed arrangements, which include the alienation of property.[75] Furthermore, any steps taken in order to execute an arrangement as alluded to in section 80L are deemed included as an arrangement so defined.[76] The definition of a tax benefit includes "the avoidance, postponement, or reduction of any liability for tax".[77] In this sense, "tax" refers to any tax, duty or levy which is levied in terms of the *Income Tax Act* 1962 or any other Act which is administered by the commissioner.[78] As CGT could have been levied in the absence of the deeming provision in section 44(9A) (see discussion above), it would be difficult for the commissioner to prove that there had been a reduction of tax. However, it can be argued that the tax liability under CGT is significantly lower than the tax liability for STC. Accordingly, a reduction in tax occurred.

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73 *Pienaar* case para 99.

74 *Pienaar* case para 7.4.

75 Section 80L of the *Income Tax Act*, definition of "arrangement". Also see Stiglingh *et al Silke: South African Income Tax Vol II* 799; Oguttu *International Tax Law* 110-113.

76 Section 80H of the *Income Tax Act* read with s 80L of the *Income Tax Act*, definition of "arrangement".

77 Section 1 of the *Income Tax Act* definition of "tax benefit". This definition now applies to all sections in the entire *Income Tax Act* and was repealed from the definitions which applied only to the GAAR contained in s 80L of the *Income Tax Act* by the promulgation of s 77 of the *Taxation Laws Amendment Act* 7 of 2010.

78 Section 80L of the *Income Tax Act* definition of "tax"; Stiglingh *et al Silke: South African Income Tax Vol II* 799; Oguttu *International Tax Law* 113.

Where a tax avoidance arrangement is made in the context of business, it must either lack commercial substance, or make use of means that are not normally utilised, or create rights or obligations which are not normally created, or result in a misuse or abuse[79] of the provisions of the *Income Tax Act*.[80] It is clear in the *Pienaar* case that the transactions were carried out in the ordinary course of business, and there appears to have been no misuse of the Act. In addition, on the facts nothing indicates that Pienaar took any steps or means that are not normally utilised, or that the transactions lack commercial substance.

When the requirements of section 80A are met, the commissioner may disregard the arrangement itself or steps or parts of the arrangement for tax purposes and he may determine the tax consequences of the transaction in a manner which he deems fit to decrease the effect of the said tax benefit.[81]

The courts have interpreted some of the core concepts, although with reference to a previous version of the GAAR. In *CIR v Conhage (Pty) Limited*[82] a scheme was devised to arrange for the tax-free return of capital profit at a time when CGT was not yet applicable in South Africa. The court

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79 The phrase "misuse or abuse of the act" is not defined in the *Income Tax Act* and it is unclear how the courts will interpret these provisions. The Canadian court has stated that if a taxpayer takes advantage of the express wording of the act which differs from the effect of a transaction this constitutes misuse of the act (see *McNichol v Canada* 1997 2 CTC 2088 97 DTC 111 TCC; Duff and Loomer *Taxation of Business Organizations* 644-658, 673; Bleiwas, Hutson and Kellough *Taxation of Private Corporations* paras 19.92-16. Also see *RMM Canadian Enterprises Inc et al v The Queen* 1997 TCJ No 302, 1998 1 CTC 2300, 97 DTC 302 (TCC), where the court found that the *Income Tax Act*, 1985 prevents surplus stripping and that if the taxpayer is in contravention of the general purpose of the act to prevent such surplus stripping, the actions of the taxpayers amounted to a misuse of the act. In Canada a contextual purposive interpretation of the act itself is required to determine whether a scheme applicable to corporate distributions applied. In this regard see *Collins & Aikman Products Co v Canada* 2009 TCJ No 225, 2009 TCC 299, 2009 DTC 1179 (TCC) aff'd 2010 FCJ No 1232, 2011 1 CTC 250, 2010 DTC 5164 (FCA)).

80 Section 80A(a)(i)(ii) read with ss 80A(c)(i)-(ii) of the *Income Tax Act*. The phrase "means that are not normally utilised" refers to rights and obligations that would normally not be created between people dealing at arm's length. The meaning of the phrase "in the context of business" refers to transactions or arrangements which are carried out in the normal course of business and only one of these four requirements needs to be met for a transaction in the normal course of business to be considered an avoidance arrangement. Also see Oguttu *International Tax Law* 115-119, 120-122; Stiglingh *et al Silke: South African Income Tax Vol II* 799-800. For a detailed comparative analysis of the misuse and abuse provisions, see Kujinga 2012 *CILSA* 42-63, where he warns that the purposive interpretation and the approach of Canada is not necessarily appropriate for South Africa to follow. Also see Cilliers 2008 Part One *The Taxpayer* 85-92; Cilliers 2008 Part Two *The Taxpayer* 103-110.

81 Section 80B(1)(a)-(e) of the *Income Tax Act*. Also see Stiglingh *et al Silke: South African Income Tax Vol II* 803-804.

82 *CIR v Conhage (Pty) Limited* 1999 4 SA 1149 (SCA) (hereafter the *Conhage* case).

held that the sole or main purpose of this transaction had not been tax avoidance but to raise additional funds to expand the taxpayer's business and that the taxpayer had no motivation to reduce its tax burden.[83] Mazansky points out that this case weakened the GAAR significantly as the court failed to apply the GAAR to a part or step of a complex series of transactions in this matter and was satisfied that the overall purpose of the transaction as a whole had to be one which was motivated by a commercial purpose, and not tax reasons.[84] It seems that the approach of the courts are that tax saving is permissible, but where a transaction had been entered into blatantly for tax avoidance purposes the courts would most likely find in favour of SARS.[85] In the *Pienaar* case there was no evidence of a blatant tax avoidance purpose. As was confirmed in the *Bobat* case*,* not only must there be this tax avoidance purpose, but the sole or only purpose of an arrangement must be to obtain a tax benefit.[86] In this matter, an arrangement which had a dual purpose, namely the reduction of capital which was done as part of the restructuring of a company and also had the reduction of estate duty was found not to be subject to the GAAR, because the sole purpose of the transaction had not been to avoid estate duty.[87] As a result of the lack of judgments, it is not certain how section 80A-L of the *Income Tax Act* will be applied. Some jurists are of the opinion that the unfamiliar concepts in the GAAR will take decades to be properly applied and defined by the courts.[88] The overall guideline seems to be that as long as the transactions are executed within the confines of normal commercial arrangements no further investigation to determine the sole or main purpose of the arrangement is required.[89] The nature of the purpose requirement seems to have remained unchanged after the introduction of the new GAAR.[90] The facts in *Pienaar* indicate that the intention of the taxpayer was to amalgamate two companies, enhance the BEE status of the business, and continue with its operations while making a return of capital to its shareholders. The sole reason for the distribution and other transactions was not to avoid or postpone tax liability. Considering the uncertainty of how the courts will interpret the new GAAR, it is not surprising that the commissioner did not attempt to rely on section 80A in the *Pienaar* case. As

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83 *Conhage* case 1155I-1156C.
84 Mazansky 2007 *BIT* 160.
85 Mazansky 2007 *BIT* 159-162.
86 It must be noted that this judgment was based on an earlier version of the GAAR contained in s 103 of the *Income Tax Act* 58 of 1962.
87 *Bobat* case 52G-53G, 59D.
88 Mazansky 2007 *BIT* 163; Cassidy 2012 *Stell LR* 351.
89 Mazansky 2007 *BIT* 163.
90 Kujinga 2014 *CILSA* 458-459.

it is clear that the transaction had a commercial rationale and was not entered into with the sole or main purpose of obtaining a tax benefit, any reliance on the GAAR would thus in all probability have failed.

8 Commentary: The retro-activity of amendments, the taxpayer's rights, and the Constitution

It is a well-established principle in international tax law that a taxpayer has a legal right to reduce the amount of what would constitute his taxes, or altogether avoid them, by any means within the ambit of the law.[91] Where a transaction was concluded for the purposes of business efficacy, the associated desire to structure the transaction to reduce a tax liability or to escape it altogether is irrelevant.[92] In *Duke of Westminster v IRC*[93] Lord Tomlin aptly remarked that "Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be." As pointed out above, the difference between a legitimate arrangement to reduce taxes and an impermissible scheme of tax avoidance is a fine line. *In casu* Pienaar structured the amalgamation transaction within the legal parameters of the *Income Tax Act* as it applied when the transactions were entered into so as to obtain the best commercial structure to include a BEE partner. As pointed out above, the absence of any intention to deliberately avoid paying taxes clearly indicates the commercial soundness of the transaction. There is no doubt that the amalgamation transaction falls within the parameters of a legal transaction structured to the best tax advantage as envisaged by Lord Tomlin in *Duke of Westminster v IRC*.[94]

The taxpayer's right to arrange his affairs to arrive at the best tax advantage is interconnected with the taxpayer's right to certainty. Adam Smith advocates that every taxpayer has the right to certainty as to the taxes payable by him and that the taxes due are not arbitrarily determined.[95] This translates into the statement that the time of tax, the method of tax, and the

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91 *Gregory v Helvering* 293 US 465 (1935); *Jones v Helvering* 71 F 2d 214 (1934).

92 *Superior Oil Co v State of Mississippi* 280 US 390 (1930).

93 *Duke of Westminster v IRC* 1936 19 TC 490; Also see Gibson 2017 http://www.internationallawoffice.com/Newsletters/Corporate-Tax/South-Africa/Cliffe-Dekker-Hofmeyr/BEPS-effect-has-Lord-Tomlins-famous-dictum-become-obsolete?utm_source=ILO+Newsletter&utm_medium=email&utm_content=Newsletter+2017-10-20&utm_campaign=Corporate+Tax+Newsletter; Mazansky 2005 *BIFD* 116-120; Tooma *Legislating against Tax Avoidance* 214-215.

94 Also see *Ayrshire Pullman Motor Services & Ritchie v CIR* 1929 14 TC 754.

95 Smith *Wealth of Nations* 426. Also see Von Justi *Natur und Wesen* 250, where he notes that the taxpayer's tax liability must be transparently clear to everyone.

amount of tax must be certain to the taxpayer and to every other person.[96] This certainty involves that the taxation laws must be clear and unambiguous as to the taxpayer's tax liability.[97] Furthermore, the taxpayer must have peace of mind that the tax laws will not be amended arbitrarily, or retrospectively, and with the effect that the taxpayer's tax or economic position is affected negatively.[98] Accordingly, the taxpayer may enter into transactions within the parameters of the law to arrive at the best tax advantage with the comfort and confidence that the tax position will not be altered negatively by an amendment with retrospective effect.[99] This right entails that the taxpayer can either arrange his affairs to circumvent the statutory provisions or to bring them within the ambit of the statutory provisions in order to obtain a tax benefit.[100] In the *Pienaar* case the taxpayer arranged the transactions within the ambit of the provisions of the *Income Tax Act*. This right, however, does not entail that where a lacuna in law exists that leads to base erosion, no amendments may be promulgated. Furthermore, the right does not prevent the retro-activity of amendments altogether. Apart from criminal law, there is no rule in the South African law that prevents the legislator from promulgating legislation with retroactive application. The legislator may still – and has a legal duty to – amend existing legislation so as to protect the tax base. That said, amendments may not be structured with retrospective effect to target specific transactions in order to collect lost taxes.[101] This is so because the legislator cannot create a tax with retrospective effect to tax completed transactions.[102] It is important to note that rapid and frequent changes to revenue laws result in a lack of tax certainty.[103] Backhaus and Wagner correctly point out that modern states fail to follow Smith's canons of taxation; instead, they resort to extreme measures to take revenue from any possible source.[104] This behaviour is clearly evident from the repeal of section 44(9) and the insertion of section 44(9A) with retrospective effect. Interestingly, section 44(9A) was repealed with effect from 1 January 2011, when the new Dividend Tax

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96 Smith *Wealth of Nations* 426.

97 Vanistandael "Legal Framework for Taxation" 24-27.

98 Das *Exposition to Economics* 336; Frecknall-Hughes *Theory, Principles and Management of Taxation* 25-26.

99 Vanistandael "Legal Framework for Taxation" 24-27.

100 Gibson 2017 http://www.internationallawoffice.com/Newsletters/Corporate-Tax/South-Africa/Cliffe-Dekker-Hofmeyr/BEPS-effect-has-Lord-Tomlins-famous-dictum-become-obsolete?utm_source=ILO+Newsletter&utm_medium=email&utm_content=Newsletter+2017-10-20&utm_campaign=Corporate+Tax+Newsletter.

101 Vanistandael "Legal Framework for Taxation" 27.

102 Jain *et al Macro Economics* 398; Jain *Public Finance and International Trade* 40.

103 Jurinsky *Tax Reform* 15.

104 Backhaus and Wagner *Handbook of Public Finance* 195.

dispensation replaced the STC rules. No similar provision existed for many years under the Dividend Tax dispensation. Thus, it is clear that section 44(9A) was promulgated with retroactive effect purely to target specific legitimate transactions in order to collect lost taxes.

Generally, and unless the contrary appears by express or necessary implication, legislation and amendments to legislation apply with prospective effect only.[105] In the *Curtis* case Innes CJ ruled that legislation applies prospectively specifically so that vested rights are not taken away.[106] In *Kruger v President Insurance Co Ltd*[107] it was held that a court is more likely to rule in favour of retroactivity where vested rights are not affected negatively by the retrospective operation, or where the purpose of the legislation is to grant a benefit or to ensure equity in the operation of law. *In casu*, apart from granting the commissioner the ability to tax very specific transactions, it cannot be said that the retroactivity of section 44(9A) ensures equity in the operation of law. Importantly, the retroactivity negatively affects Pienaar's vested rights. Having regard to the judgment in *Curtis*, where a vested right is negatively affected, an amendment cannot apply retrospectively. This is irrespective of the retroactivity that applies by express provision or by implication. However, in *Burt v Shield Insurance Co Ltd*[108] Watermeyer J ruled that the presumption against removing accrued or vested rights must yield to clear and unambiguous language of enactment.[109] This is so, even where the consequence of the retrospectivity appears to be unjust.[110] Even so, transactions which have been completed before the enactment belong to the past and cannot be affected by the retroactivity of the legislation.[111] *In casu* the transactions were completed before the promulgation of the amendment which enacted section 44(9A)

105 *Transnet Ltd v Ngcezula* 1995 3 SA 538 (A); *S v Venter* (CCT109/10) 2011 ZACC 22 (14 June 2011); *National Director of Public Prosecutions v Carolus* 2000 1 SA 1127 (SCA); *Bareki v Gencor Ltd* 2006 1 SA 432 (T); *S v Koukoulas* 1970 2 SA 477 (T); *Curtis v Johannesburg Municipality* 1906 TS 308 (hereafter the *Curtis* case)

106 *Curtis* case 311. Also see *Transvaal Investment Co v Springs Municipality* 1922 AD 337; *Shaboodien v Sekretrais van Binnelandse Sake* 1971 3 SA 684 (C).

107 *Kruger v President Insurance Co Ltd* 1994 2 SA 495 (D).

108 *Burt v Shield Insurance Co Ltd* 1975 4 SA 133 (A).

109 Also see *Soja (Pty) Ltd v Tuckers Land and Development Corporation (Pty) Ltd* 1981 3 SA 314 (AD); *Caterers & Entertainers Ltd v City of Salisbury* 1974 4 SA 515 (R).

110 See *R v Ah Koon* 1927 TPD 966; *Browne v Incorporated Law Society of Natal* 1968 3 SA 535 (N).

111 *Du Plessis v Raubenheimer* 1917 OPD 104; *Bell v Voorsitter van die Rasseklassifikasieraad* 1968 2 SA 678 (A); *Thom v Moulder* 1974 4 SA 894 (A); *Bellairs v Hodnett* 1978 1 SA 1109 (A); *Juddor (Pty) Ltd v Kingsburgh Borough Town Council* 1982 3 SA 611 (D); *Industrial Council for Furniture Manufacturing Industry, Natal v Minister of Manpower* 1984 2 SA 238 (D); Du Plessis *Interpretation of Statutes* 98-99; Devenish *Interpretation of Statutes* 189; Du Plessis *Re-interpretation of Statutes* 182-187.

took effect. Importantly, section 12(2)(c) of the *Interpretation Act* 33 of 1957 specifically provides that where a law repeals another law, then unless the contrary intention appears the repeal shall not affect any right, privilege, obligation or liability acquired, accrued or incurred under any law so repealed. In *Cape Town Municipality v Bethnal Investments (Pty) Ltd*[112] Watermeyer J ruled that the presumption against interference with vested rights is not limited to property rights or rights in terms of contract, but that it extends to rights acquired in terms of a statute. This, in a constitutional state, includes rights vested in terms of the *Constitution*. It can further be argued that rights vested in statute include a taxpayer's tax position that he acquired as a result of the application of tax statutes that existed when he entered into certain transactions. The taxpayer's right to tax certainty and his right to manage his affairs to ensure the best tax or commercial advantage are negatively affected by the retroactivity of the amendment which inserted section 44(9A). In addition, the retroactivity of section 44(9A) infringes on the taxpayer's constitutional right to property. Section 25 of the *Constitution* provides that:

> (1) No one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property.
> (2) Property may be expropriated only in terms of law of general application
> (a) for public purpose or in the public interest; and
> (b) subject to compensation, the amount of which and the time and manner of payment of which have either been agreed to by those affected or decided or approved by a court.

It is well known that the *Income Tax Act* is law of general application. The deprivation of property which is a consequence of the liability to pay taxes, albeit involuntary, is not unconstitutional.[113] Freedom from tax is not a fundamental right.[114] While the imposition of taxes is acceptable in an open and democratic society, they must be imposed subject to the safeguards contained in the Bill of Rights.[115] Thus, an amendment that applies retrospectively may not arbitrarily deprive the taxpayer of property. Croome notes that the retrospective application of amendments to tax legislation – which impose a tax liability – constitutes a confiscation of property held by the taxpayer.[116] The retroactivity of an amendment to tax legislation is justifiable in cases where it corrects or evens out past prejudice towards the

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112 *Cape Town Municipality v Bethnal Investments (Pty) Ltd* 1972 4 SA 153 (C).
113 *First National Bank of SA Ltd t/a Westbank v Commissioner, South African Revenue Services* 2001 3 SA 310 (C); *First National Bank of SA Ltd t/a Westbank v Commissioner, South African Revenue Services* 2002 4 SA 768 (CC).
114 Also see *Krok v Commissioner, South African Revenue Services* 2015 6 SA 317 (SCA).
115 Croome *Taxpayer's Rights* 20.
116 Croome *Taxpayer's Rights* 63.

taxpayer, confers benefits to the taxpayer, or corrects errors in previous versions of legislation.[117] Croome believes that it would be difficult to show that tax legislation with retroactive effect is arbitrary where it applies to taxpayers in general.[118] This is especially so in the light of the limitations clause in section 36 of the *Constitution*. Given the limited scope of section 44(9A) it cannot be said that it applies to taxpayers in general. Instead, it applies to specific transactions and a specific class of taxpayers only. Can it be said then that the retroactivity of section 44(9A) deprives the specific class of taxpayers from property arbitrarily?

The word “arbitrary” originates in the Latin *arbitrārius,* which refers to something that is uncertain. In modern English, an arbitrary rule or action is founded on or subject to personal whims, prejudices or, in the case of a penalty or punishment, not laid down by statute or within the court's discretion.[119] Accordingly, where an amendment to legislation is envisaged that would impact negatively on a taxpayer's right to tax certainty and the constitutional right to property, the taxpayer must be afforded an opportunity to arrange his affairs before the promulgation of such an amendment so as not to be deprived of his rights arbitrarily. Pienaar therefore correctly argued that "unless there was adequate warning of the intention to implement the change retrospectively, such that the taxpayer cannot be said to have been entitled to rely on the law continuing to apply, a retroactive amendment could *never*[120] pass constitutional muster."[121] In addition, the warning must relate to the actual amendment. It does not serve as a warning where a politician or the commissioner makes statements in the media hinting at possible amendments and where the final amendment differs essentially from the media statement or parliamentary discussions or announcements. Similarly, where an amendment in a draft bill differs essentially from the final version it cannot be said that the taxpayer was adequately warned. Instead, such uncertainty constitutes an arbitrary amendment - especially where the amendment applies with retrospective effect. As section 44(9A) applies to a limited number of transactions and to a specific group of taxpayers only, the argument that the retrospective effect of the amendment serves a public purpose or that it is in the public interest is flawed. This is so, because the transaction entered into by Pienaar was for reasons of business efficacy,

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117 Bentley *Taxpayer's Rights* 38. Also see Eiselen and Van Zyl 2016 *TSAR* 569-571, 575.

118 Croome *Taxpayer's Rights* 67.

119 Collins Online Dictionary 2017 https://www.collinsdictionary.com/dictionary/english/arbitrary.

120 Our emphasis.

121 *Pienaar* case 49.

especially to introduce a BEE business partner. Fabricius J ruled that there is no authority or legislative provision that provides that a fairly precise warning needs to be given before the legislature can pass retrospective legislation.[122] While this is so, the retrospective effect of legislation or amendments to legislation must still be subject to the safeguards in the Bill of Rights. Fabricius J further ruled that if the tax statute is rationally connected to a legitimate purpose, no precise warning is required, if one at all.[123] As we have pointed out above, the rationality of the retroactivity of section 44(9A) or the legitimate purpose thereof is questionable. The fact that a loophole in the Act may result in a flood of amalgamation transactions that would ultimately be to the detriment of the fiscus does not rationalise a retroactive amendment where such an amendment is promulgated without adequate warning. Surely, where a loophole is exploited to obtain a tax benefit, the transaction must in principle be set-aside in terms of section 80A-L. Accordingly, when he became aware of the loophole the commissioner was not entirely without remedy. The fact that reliance on the GAAR may not have been successful is irrelevant. Therefore, the argument that a prospective amendment would have encouraged taxpayers to exploit the loophole in the last few months before the loophole was closed cannot stand. While there might be room for avoidance action between the announcement of the amendment and the promulgation, the avoidance transactions must, in our view, be captured by a GAAR or specific anti-avoidance provisions which are clear and certain, and which applied at the time of the transaction. In the current case, Pienaar did not show the intention to obtain a tax benefit. The transaction was *bona fide* entered into for the purposes of business efficacy. As a result, it cannot be said that Pienaar exploited the loophole. As the commissioner was not entirely without remedy, the retroactivity without precise warning constitutes an arbitrary deprivation of the taxpayer's property. More importantly, the significant differences in the announcement by the minister, the draft bill, and the final amendment negatively affected the taxpayer's right to certainty.

9 Conclusion

It is a pity that the court did not have the opportunity to consider the merits of the matter and that it found that section 44(9A) did apply *in casu.* The argument of Pienaar that the commissioner would not have been able to levy STC, were it not for the application of the retrospective amendment of section 44(9A), is valid in our view. Without this amendment, and upon a

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122 *Pienaar* case 63.
123 *Pienaar* case 63.

consideration of the merits, CGT liability would be deferred until a later stage while the calculation of certain values would have had to be done at the time of the distribution of the amount out of the share premium account. This would amount to the same treatment as applied to all other returns of capital to shareholders at the time. This falls squarely within the parameters of the law as it applied at the time of the transaction. The sole intention of the transactions was of a commercial nature. No avoidance intention was evident, which means that the requirements of the GAAR could not be fulfilled. It seems that the taxpayer in this case exercised his right to arrange his affairs in the most effective manner in accordance with the law as it applied at the time, a principle which is well established in tax jurisprudence. This did not leave the *fiscus* without a remedy, as the value of this distribution would be taken into account upon the disposal of the shares for CGT or income tax purposes depending on the situation of the shareholders who disposed of the shares. Accordingly, it cannot be said that there would be base erosion or a loss of tax revenue.

The part of the judgment that deals with the retroactivity of the amendment is unsatisfactory. The court did not consider the taxpayer's right to property with reference to the right to tax certainty. In addition, the court failed to consider that the commissioner is not entirely without remedy where a loophole in tax legislation exists. As a result, the conclusion that the retroactivity of the amendment is rational, and as a result of this rationality, constitutional, is incorrect. The fact remains that retroactivity cannot affect vested rights, specifically rights vested in completed transactions. Moreover, amendments to tax legislation cannot be applied retrospectively to collect lost taxes. In the case of completed transactions, the commissioner must stand or fall by the provisions of the act as they applied when the taxpayer entered into the transactions. An amendment intended to close a loophole must be accompanied by a warning to taxpayers that is relatively certain. Media statements by the minister of finance of proposed amendments that may apply with retrospective effect do not constitute a warning that creates tax certainty. While retroactivity may prevent a scurry of avoidance transactions entered into before the amendment takes effect, the retroactivity may apply without warning only in cases where the commissioner is otherwise without remedy. This, in our view, is the only just, legitimate, and constitutional circumstance under which retroactive amendments that affect the vested rights of a taxpayer negatively (in the case of completed contracts) may be implemented.

We have it on good authority that leave for appeal was granted. We can only hope that the Supreme Court of Appeal will interpret and apply the law correctly and that the values of the Constitution will be upheld.

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List of Abbreviations

BEE	Black Economic Empowerment
BIFD	Bulletin for International Fiscal Documentation
BIT	Bulletin for International Taxation
CGT	Capital Gains Tax
CILSA	Comparative and International Law Journal of Southern Africa
CTC	Contributed Tax Capital
DTA	Double Tax Agreement

GAAR	General Anti Avoidance Regulations
NPC	National Planning Commission
SARS	South African Revenue Service
SAYIL	South African Yearbook on International Law
STC	Secondary Taxes on Companies
Stell LR	Stellenbosch Law Review
TSAR	Tydskrif vir Suid Afrikaanse Reg