

76/90

Case No 532/88

IN THE SUPREME COURT OF SOUTH AFRICA
(APPELLATE DIVISION)

In the matter of

THE COMMISSIONER FOR INLAND REVENUE... Appellant

and

S A MUTUAL UNIT TRUST MANAGEMENT
COMPANY LTD..... Respondent

CORAM: CORBETT CJ, VAN HEERDEN, KUMLEBEN, JJA, NICHOLAS
et GOLDSTONE, AJJA.

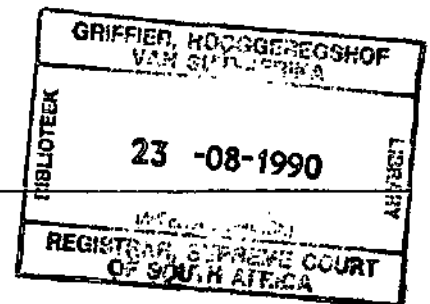
DATE OF HEARING: 15 May 1990

DATE OF JUDGMENT: 23 August 1990

J U D G M E N T

CORBETT CJ:

The respondent is a public company, which carries on business as the management company of a unit trust scheme known as the Old Mutual Unit Trust. In the course of its business respondent deals in shares. During the 1981 income



tax year respondent entered into two share transactions which have given rise to a dispute between respondent and appellant, the Commissioner for Inland Revenue ("the Commissioner"), as to how respondent should properly be assessed to income tax for that tax year. This dispute was resolved in favour of respondent by the Cape Income Tax Special Court, against whose decision appellant now appeals (with the necessary leave) directly to this Court.

One of these transactions related to shares in a public company called Tollgate Holdings Limited ("Tollgate"), which is listed on the Johannesburg Stock Exchange ("JSE"). In February 1981 and for reasons which need not be canvassed the directors of Tollgate conceived and announced a scheme which was designed to return to shareholders surplus cash in the coffers of the company. The scheme involved the surrender by Tollgate shareholders of each of their existing ordinary shares in exchange for

one new ordinary share and one "A" ordinary share, each of no par value (such surrender to commence as from 6 March 1981); the listing of the new and "A" ordinary shares on the JSE (as from 9 March 1981); the declaration on 2 April 1981 of a dividend of 220 cents per share to the holders of "A" ordinary shares registered as such on 24 April 1981; the automatic conversion of the "A" ordinary shares into "A" redeemable preference shares, also on 24 April 1981; the redemption forthwith of the "A" redeemable preference shares at 50 cents per share; the delisting of the "A" ordinary shares; and on 30 April 1981 the payment to shareholders of the dividend-plus-redemption moneys of 270 cents per "A" ordinary share against surrender of the share certificates. This scheme was approved by shareholders at a general meeting held on 4 March 1981.

Over the period 9 - 12 March 1981 respondent purchased 651 200 Tolgate "A" ordinary shares on the JSE;

and on 22 April 1981 respondent acquired another 223 280 such shares by way of a private deal. The total outlay for the 874 480 shares was R2 413 677. In implementation of the scheme respondent in due course received a total dividend of R1 923 856 on its "A" ordinary shares and in addition was paid an amount of R437 240 in redemption of the shares, of which an amount of R197 632 (22,6 cents per share) was classified by appellant in terms of the Income Tax Act 58 of 1962 ("the Act") as dividend. The total dividend thus amounted to R2 121 488 and the balance of the proceeds of the redemption to R239 608.

The other transaction related to another public company, Natal Anthracite Collieries Limited ("Anthracite"), also listed on the JSE. On 25 November 1981 respondent acquired 100 000 stock units (for convenience I shall refer to them as shares), 70 000 of these on the stock exchange and 30 000 by way of a private transaction, for a total

outlay of R2 080 685.' The entire issued capital of Anthracite was acquired by Anglo American Coal Corporation Ltd and in terms of proposals adopted by the members of Anthracite on 9 February 1982 shareholders were afforded certain options regarding the take-over of their shares. One of these was to receive a special dividend of 850 cents per share, plus a capital payment of 1050 cents per share. Respondent chose this option and on 27 February 1982 surrendered its shares against payment of a dividend of R850 000 and a capital payment of R1 050 000.

The dividends received by respondent from Tollgate and Anthracite in this way were exempt from income tax in terms of sec 10(1)(k) of the Act. In its return of income (together with annual accounts) submitted under the Act for the 1981 tax year (which ended on 30 June) respondent showed a loss on the sale of investments amounting to R3 204 754. This figure was made up as follows:

<u>Shares</u>	<u>Cost of Acquisition</u>	<u>Proceeds on Sale</u>	<u>Loss</u>
874 480 Tollgate	R2 413 677	R239 608	R2 174 069
100 000 Anthracite	R2 080 685	R1 050 000	R1 030 685
		Total:	<u>R3 204 754</u>

Respondent considered that, as a dealer in shares, this loss should be taken into account in the computation of its taxable income and it framed its return accordingly. This resulted in a computed assessed loss for the year of R2 430 577.

In a commercial sense, of course, there was no loss of such dimensions, for in the case of each company respondent received on its shares substantial dividends. It was only the non-taxability of the dividends under the Act that, according to respondent, created a loss for tax purposes. But for such exemption, respondent would have been obliged to bring the dividends into account as income.

and this would largely have off-set the loss.

On about 1 April 1982 appellant issued respondent with an income tax assessment for the 1981 tax year. This assessment ^{was based on} accepted the correctness of respondent's return and reflected, in respect of taxable income, a loss of R2 430 577 and a nil assessment for tax payable. This loss was carried through into respondent's assessment for the 1982 tax year, which was issued on about 1 June 1983, and resulted, after setting off income amounting to R897 759, in a loss in that year, for income tax purposes, of R1 532 818.

On about 1 November 1983 appellant issued to respondent revised assessments in regard to the 1981 and 1982 tax years. In the 1981 revised assessment appellant disallowed the loss of R3 204 754 claimed in respect of the Tollgate and Anthracite transactions, with the result that a taxable income of R774 177 was assessed for that year. The consequential revision of the 1982 assessment (there being

no loss to be carried forward) resulted in a taxable income for that year of R897 759.

In its return for the 1983 tax year the respondent sought to bring forward an assessed loss of R1 532 818 from the 1982 tax year. In assessing respondent (the notice was issued on about 1 March 1984) appellant disregarded this alleged assessed loss and determined a taxable income of R1 832 566.

Respondent objected to the revised assessments for 1981 and 1982 and the assessment for 1983 broadly on the ground that, since it was a dealer in shares, the losses in 1981 on the Tollgate and Anthracite^N transactions were incurred in the production of the income and were not of a capital nature; that consequently they should have been allowed as a deduction from income in terms of sec 11(a) of the Act in the 1981 assessment; and that had this been done an assessed loss would have resulted, which would have been

carried through into the 1982 and 1983 tax assessments. I pause here to observe that it would have been more accurate to say, with reference to the Tollgate and Anthracite transactions, that the proceeds of the shares (amounting to R239 608 and R1 050 000 respectively) constituted income, from which the taxpayer claimed to be entitled to deduct in terms of sec 11(a) the full cost of acquisition (R2 413 677 in the one instance and R2 080 685 in the other), resulting in the combined loss of R3 204 754.

Subsequently, with appellant's consent, respondent amplified its grounds to include the following alternative grounds:

- (1) that portions of the expenditure incurred in the cost of acquisition of the shares in Tollgate and Anthracite should have been allowed as a deduction in terms of sec 11(a); and
- (2) that appellant's allowance in full, in his

original assessment for 1981, of respondent's claim to be entitled to deduct the full cost price of the shares was in accordance with the practice generally prevailing at the date of issue of this assessment and that in the circumstances appellant was precluded by proviso (iii) to sec 79(1) of the Act from re-opening the assessment and issuing a revised assessment.

Appellant having disallowed these objections, the case came on appeal to the Cape Income Tax Special Court. At the hearing (presided over by Berman J) only the second alternative objection was pursued by the respondent. It was upheld by the Special Court and the appeal was allowed, but respondent was ordered to pay wasted costs incurred as a result of a postponement of the hearing ordered at the instance of the respondent. In addition to the appeal by appellant against the order of the Special Court upholding

the appeal to it against the assessments, respondent cross-appealed against the costs order. Prior to the hearing before this Court, however, appellant notified the respondent that it abandoned the costs order in its favour and tendered to pay respondent's wasted costs of cross-appeal up to the date of the notification. It is consequently not necessary to consider or make any order in regard to the cross-appeal.

Before discussing the merits of the appeal it is appropriate to make reference to a factor which looms largely in this case, viz the decision of this Court in the case of Commissioner for Inland Revenue v Nemojim (Pty) Ltd 1983 (4) SA 935 (A). That case dealt with a commercial operation known as "dividend stripping". The facts were that the taxpayer, a one-man private company, embarked upon a business of purchasing the shares in dormant companies with, as their only assets, substantial cash reserves

available for distribution by way of dividend; of stripping the companies of their assets by way of dividend declarations comprising their cash reserves; and of selling the shares in the remaining "shell" companies (there being a ready market in such companies). In each case the dividend and the resale price of the shares constituted the commercial proceeds of the transaction, the dividend being by far the major component thereof. In terms of sec 10(1)(k) of the Act, however, the dividends were exempt from tax, and only the resale proceeds of the shares constituted income from these transactions in the taxpayer's hands. The taxpayer nevertheless sought to deduct the full purchase price of the shares, as being expenditure incurred in the production of the income, in terms of sec 11(a) of the Act. Because the income earned from resale was relatively small the effect of such deduction was to produce large losses, which were carried forward into subsequent years of

assessment. This was in contrast to the actual commercial results of the dividend stripping business, which were to show an annual profit.

This Court held that the expenditure incurred by the taxpayer in the acquisition of the shares in these dormant companies had a dual purpose, viz (a) the receipt of moneys on resale which constituted income in the taxpayer's hands and (b) the receipt of dividends which were exempt income in the taxpayer's hands; that in so far as the expenditure related to the receipt of the dividends it was not incurred in the production of the income (in terms of sec 11(a)) and it was incurred in respect of amounts received which do not constitute income (in terms of sec 23(f)); and that in the circumstances, and following the precedent of Commissioner for Inland Revenue v Rand Selections Corporation Ltd 1956 (3) SA 124 (A), the expenditure should be split up and apportioned according to

a formula which took account of this dual purpose.

It is of some importance to note some of the relevant facts and dates pertaining to the Nemojim case. The taxpayer conducted its dividend stripping business during the 1977 and 1978 tax years. In those years the taxpayer reflected losses, which were carried forward into the 1979 and 1980 tax years. These losses were initially allowed by the Commissioner in assessments issued (for the four years) between 1 December 1977 and 1 November 1980. On 28 November 1980, however, the Commissioner, having had second thoughts on the matter, issued additional assessments in which he allowed as a deduction that portion of the purchase price of the shares which was equivalent to the actual proceeds of the shares when sold by the taxpayer. This was, in effect, an apportionment not dissimilar to that adopted by this Court. After the usual objections and disallowance thereof the matter came before the Natal Income

Tax Special Court which gave judgment in favour of the taxpayer on 25 June 1981. The Commissioner appealed and the matter was heard by this Court on 15 August 1983. This Court gave judgment on 23 September 1983.

The respondent's decision not to pursue the original ground of objection in the Court a quo was evidently motivated by the belief that it was legally precluded from doing so by the decision of this Court in Nemojim's case; and, in addition, the application of the apportionment system laid down by Nemojim's case appeared to render superfluous the first alternative ground of objection. This left the second alternative objection.

The general rule is that where no objection has been made to an assessment it becomes final and conclusive as regards both the taxpayer and the Commissioner (see sec 81(5) of the Act and Silke on South African Income Tax 11th ed, par 18.23 and the cases cited in note 106). Sec 79(1),

79(1), however, gives the Commissioner the power to re-open an assessment and raise an additional or revised assessment, notwithstanding the provisions of sec 81(5), where, inter alia, an amount which was subject to tax and should have been assessed to tax under the Act, has not been so assessed to tax. This power to re-open is, however, circumscribed by a proviso to sec 79(1), the relevant portion of which reads:

"Provided that the Commissioner shall not raise an assessment under this subsection -

- (i) after the expiration of three years from the date of the assessment (if any) in terms of which any amount which should have been assessed to tax under such assessment was not so assessed or in terms of which the amount of tax assessed was less than the amount of such tax which was properly chargeable, unless the Commissioner is satisfied that the fact that the amount which should have been assessed to tax was not so assessed or the fact that the

full amount of tax chargeable was not assessed, was due to fraud or misrepresentation or non-disclosure of material facts; or

.....

- (iii) if the amount which should have been assessed to tax under the assessment referred to in paragraph (i) of this proviso was, in accordance with the practice generally prevailing at the date of the assessment, not assessed to tax, or the full amount of tax which should have been assessed under such assessment was, in accordance with such practice, not assessed;.....".

Respondent's second alternative objection assumes and accepts that in the light of the decision of this Court in Nemojim's case, the original assessment for 1981 failed to assess to tax an amount which should have been so assessed. This came about because of the Commissioner's initial acceptance of the deduction of the full cost of the Tollgate and Anthracite shares with the result that a loss,

and no income subject to tax, was assessed; whereas, as the revised assessment for 1981 indicates, if the Nemojim principle had been applied, the loss would have been far less and there would have been income subject to tax. The revised assessment does not, of course, apply the apportionment principle, but even so without making precise calculations it is clear from the figures which I have already quoted that the amounts which, in accordance with the Nemojim principle, would have been allowed by way of deduction would have left a substantial taxable income.

Respondent's objection is based upon the proposition that the non-assessment to tax in 1981 of the amount referred to was

"in accordance with the practice generally prevailing at the date of assessment"

and that consequently in terms of proviso (iii) the appellant was precluded from raising a revised assessment in

regard thereto. The soundness of this objection depends upon the meaning to be attached to the words "practice generally prevailing" and upon the evidence as to whether or not a relevant practice generally prevailed at the time of the original assessment, ie on or about 1 April 1982.

In his judgment in the Court a quo Berman J held (relying upon Silke on South African Income Tax 10th ed, par 18.34) that the words "practice generally prevailing" related to

".... a practice which is both known to the Commissioner and which he has authorised for application by the various Receivers of Revenue in the Republic.....".

(This interpretation was followed by Howie J in Income Tax Case No 1459 51 SATC 142, at 148.) The reference to Silke, supra, is to a paragraph in the book dealing with sec 102(1)

of the Act, which concerns the power of the Commissioner to authorize a refund to a taxpayer of tax overpaid and contains the same phrase, "practice generally prevailing", in a proviso. The full text of Silke's comment on this proviso (which has been retained in the 11th edition) reads as follows:

"The 'practice generally prevailing' at the time, it is submitted, is the practice known to and applied by the Commissioner, whether it is founded on his own interpretation of the law or upon the then existing judicial interpretation of the law. Furthermore, it is considered that the 'practice generally prevailing' is one that has been authorized by the Commissioner and is being applied throughout the country."

It seems to me, with respect, that what was stated by Berman J, as set forth above, places insufficient emphasis upon what is actually done in the different offices of the Department of Inland Revenue in the assessment of taxpayers.

I also am of the view that it may be misleading to suggest as a requisite personal knowledge and approval of the practice on the part of the Commissioner. Although in terms of sec 2(1) of the Act the Commissioner is the official responsible for carrying out the provisions of the Act, under sec 3(1) the powers and duties thereby imposed upon him may be exercised or performed by him personally or by any officer engaged in carrying out the provisions of the Act.

"... under the control, direction or supervision of the Commissioner".

At all events, a practice "generally prevailing" is one which is applied generally in the different offices of the Department in the assessment of taxpayers and in seeking to establish such a practice in regard to a particular aspect of tax assessment it would not be sufficient to show that the practice was applied in merely one or two offices.

Moreover, the word "practice", in this context, means "a habitual way or mode of acting" (see Oxford English Dictionary, meaning 2.c.); and consequently, in general, it would also not be sufficient to show that, in regard to an aspect of assessment, a certain attitude had been adopted by the assessors concerned only in some instances.

In the Court a quo it was held that the burden of proving such a "practice generally prevailing" rested upon the taxpayer and that in the present case there rested an onus on the respondent

"...to prove, on a preponderance of probabilities, that a practice generally prevailed at the time of (respondent's) 1981 assessment allowing for losses such as that claimed by (respondent) as a legitimate deduction".

The question of onus, an issue in the Court a quo, was also debated before us.

Sec 82 of the Act provides as follows:

"82. The burden of proof that any amount is exempt from or not liable to any tax chargeable under this Act or is subject to any deduction, abatement or set-off in terms of this Act, shall be upon the person claiming such exemption, non-liability, deduction, abatement or set-off, and upon the hearing of any appeal from any decision of the Commissioner, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong."

In Income Tax Case No 1233, 37 SATC 179, which was concerned with the taxability of profits made on the sale of shares, the question arose as to whether the three year period prescribed by proviso (i) to sec 79(1) had elapsed or not. The assessment in question had been issued in terms of sec 79(1) and it was common cause that there had been no such fraud, misrepresentation or non-disclosure of material facts as in the referred to proviso (i). The President of the

Special Court, Colman J, held that the onus was on the appellant taxpayer. He reasoned as follows (at pp 184-5):

"It was argued on behalf of the appellant that, for that reason, the appeal should succeed, inasmuch as the Secretary for Inland Revenue had failed to produce evidence on matters peculiarly within his knowledge, to show that the additional assessment was raised within the three-year period. But that argument, in my view, is in conflict with the provisions of s 82 of the Act. In quoting the terms of that section I shall, to facilitate later reference, divide it into two parts which I shall letter (a) and (b).. With these amendments the section reads thus:

- (a) 'The burden of proof that any amount is exempt from or not liable to any tax chargeable under this Act or is subject to any deduction, abatement or set-off in terms of this Act, shall be upon the person claiming such exemption, non-liability, deduction, abatement or set-off';

and

- (b) 'upon the hearing of any appeal from any decision of the Secretary, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong'.

It is argued, perhaps correctly, that the language in the part of the section which I have lettered (a) does not cover the ground of appeal under consideration; the contention is not that the share profits were exempt from, or not liable to taxation; it is that the Secretary for Inland Revenue is barred by effluxion of time from recovering the tax thereon.

The language of the part of the section which I have lettered (b) is, however, much wider, and in my view it covers a contention such as the one raised in this appeal against the additional assessment for the 1968 tax year.

It was argued that part (b) of the section should be read restrictively, and interpreted to apply only to reversals or alterations on the grounds listed in part (a), or grounds of a like nature. It is in effect the noscitur a sociis rule which counsel is seeking to have applied. But, as was pointed out in such cases as Rex v Jones 1925 AD 117 at 129, Director of Education, Transvaal v McCagie & others 1918 AD 616 at 623, and Grobbelaar v Van de Vyver 1954 (1) SA 248 at 254-5, the rule is not automatically applied to every statutory provision in which particular words are followed by general ones. It is always the duty of the court to seek the true intention of the legislature; and proper weight must be given to the presumption against tautology.

If the legislature had not wished to add anything to what it had provided in that part of s 82 which I have lettered (a), it would presumably not have enacted the part which I

have lettered (b). What did it wish to add? The answer is to be sought in part (b), which is wide enough to cover all possible attacks on the correctness of a decision by the Secretary. If that language had not been intended to have the wide operation which its natural meaning indicates, the legislature would surely have given guidance as to the intended ambit of that part of the section. And if there had been issues which could be raised in an appeal but which were not intended to be covered by the language of part (a) or (b) of s 82, one would have expected the legislature to say on whom onus of proof would lie in respect of such issues.

It is, therefore, my view that in respect of the issue under discussion, the onus was on the appellant."

This decision was followed by Grosskopf J in Income Tax Case No 1303, 42 SATC 95, at 98, and, with respect, it seems to me to be correct and to apply equally to proviso (iii) to sec 79(1). It was argued by respondent's counsel that the

portion of sec 82 labelled (b) by Colman J was designed to apply to the many provisions elsewhere in the Act where the Commissioner is given a power of decision. This is no doubt correct, but I can find no reason why the correctness of a decision of the Commissioner to re-open an assessment in terms of sec 79 and whether or not he was precluded from doing so by proviso (iii) should not also fall within the purview of portion (b).

The present appeal must, therefore, be approached on the basis that the onus was upon the respondent to show on a preponderance of probability that the original 1981 assessment allowing the deduction in full of the cost of the Tollgate and Anthracite shares was in accordance with a practice generally prevailing at the time of assessment, ie on 1 April 1982.

In the Court below respondent called three witnesses and appellant one. Respondent's first witness

was Mr W B Cronje, a practising chartered accountant, who specializes in taxation. He told the Court that prior to the decision of the Appellate Division in the Nemojim case it was "well-known in fact amongst tax practitioners" that "such losses" (meaning evidently losses resulting from the deduction of the full purchase price of shares acquired by a company for dividend stripping operations) were allowed by the Receiver; and that this was an issue discussed amongst tax practitioners. In this connection he referred to dividend stripping operations alleged to have been conducted on a large scale by two companies, National Acceptances Limited ("NA") and Barclays National Merchant Bank Limited ("Barname"). In the course of Cronje's testimony, particularly under cross-examination, it appeared that his evidence was based entirely on hearsay. He had no personal knowledge or experience of what I shall, for the sake of brevity, call "dividend stripping losses" being allowed by

the Revenue Department: he was merely retailing what he had heard from other tax practitioners in the course of discussion. Barname was a client of Cronje's firm and Cronje claimed to have "some knowledge of what they were doing as they are clients of ours", but he also seemed to concede under cross-examination that the facts pertaining to the actual cases of dividend stripping were not within his knowledge.

In my view, Cronje's evidence is wholly inadmissible and ought not to have been relied upon (as it was) by the Court a quo. The factum probandum was whether in the assessment of taxpayers who had carried on dividend stripping operations there was a generally prevailing practice, in the sense described above, that dividend stripping losses be allowed. The existence of such a practice could be established by showing that the Commissioner, or someone in the Department with the

necessary authority, had issued a departmental directive to that effect and that this directive was being followed generally in the assessment of taxpayers; or by showing that in the general process of assessment dividend stripping losses were consistently allowed in a sufficient number of cases to lead to the inference that such a practice was authorized and generally prevailed. These are factual matters to be decided by the Court; and they are not matters in respect of which assistance may be derived from expert evidence as such. Cronje's evidence in regard to actual cases of the allowance of dividend stripping losses being pure hearsay, there is, in my view, no basis upon which it could be held to be acceptable in law.

It is true that the appellant's representative in the Court a quo did not formally object to Cronje's evidence when it was first led, but he did later expose its hearsay character in cross-examination and there is no question of

any waiver or consent by the appellant. This Court must accordingly disregard the evidence of Cronje and determine on the admissible evidence on record whether the decision of the Court a quo was correct or not (see Estate Lala v Mahomed 1944 AD 324, at 330; Radus & Mindel v Plaza Outfitters 1945 TPD 350, at 352).

Respondent's second witness was Mr H G Howes, the group taxation manager of Barclays National Bank (as it was then known). He assumed this position in February 1979. He stated that as from that time he was aware of the fact that dividend stripping losses incurred by Barname had been allowed by the appellant in the assessment of that company's income tax for the 1979, 1981 and 1983 tax years. In substantiation of this he referred to various transactions entered into by Barname and produced Barname's income tax returns and its assessments for the three years in question in order to show how the transactions had been reflected in

the returns and what the reaction of the appellant had been.

The first such transaction related to a company known as Edworks (1936) Limited ("Edworks") which approached Barname for assistance in regard to an internal problem concerning dividend policy. It was decided that this could only be resolved by "taking out" the minority shareholders. This was to be achieved by converting the minority shares, under a scheme of arrangement, into redeemable preference shares which would then be redeemed by using the proceeds of a fresh issue of redeemable preference shares of 10 cents each to be issued to Barname at a premium of 90 cents. In terms of the scheme Edworks was obliged to redeem the Barname shares over a five year period (1979 - 1983), as to 10 cents per share out of capital and as to 90 cents per share out of distributable reserves. For tax purposes the 90 cents per share constituted a dividend in Barname's hands. In its return of income for 1979 Barname showed, in respect of

Edworks shares redeemed, an amount representing 90 cents per share as a non-taxable "deemed dividend", an amount representing 10 cents per share as income and the full cost of the shares (ie R1 per share) as a deduction. This obviously resulted in a loss for tax purposes on this transaction. A similar transaction took place at about the same time in regard to a company called East London Daily Dispatch (Pty) Limited ("ELDD") and the proceeds of redemption received during the 1979 tax year were treated in the same way as the proceeds of the Edworks shares, resulting again in a loss for tax purposes. In each case the full facts were disclosed in Barname's income tax return, which was dated 28 February 1980. The assessment issued on about 1 July accepted these losses.

In the 1981 tax year there were further redemptions of Edworks and ELDD shares and in terms of a similar transaction (entered into during the 1981 tax year)

involving the issue of redeemable preference shares in a company known as HMB Industries (Pty) Ltd ("HMB"). And in the 1983 tax year, according to the returns placed before the Court, there were redemptions of Edworks shares and further redemptions in terms of the two further transactions entered into during that year and involving NDUMU Limited "Ndumu") and Trescon Holdings (Pty) Limited ("TH"). Assessments for the 1981 and 1983 tax years were issued respectively on about 1 August 1982 and on about 1 July 1984. In both assessments the losses claimed by Barname by reason of these various transactions were not queried.

The legitimacy of the claimed losses in these three years was first questioned in terms of a letter dated 4 January 1985, in which, with reference thereto, the Receiver of Revenue, Johannesburg wrote:

"In my opinion these items are not allowable as deductions for tax purposes as they are

not in production of income. (Please refer to CIR vs Nemojim 1983 (4) SA 935 (A) where the principles involved are essentially similar to the case at hand). Please forward reasons, if any, why these items should be allowed as deductions for tax purposes."

Under cross-examination of Mr Howes it transpired that Barname was approached to participate in the Tollgate scheme, to which reference has already been made. On 3 March 1981 Barname wrote to the appellant describing the scheme, indicating that it proposed to purchase 1,1m Tollgate "A" ordinary shares cum dividend and seeking his confirmation (i) that, in the event of Barname purchasing these shares, the dividends received of 242,6 cents per share would constitute exempt income under sec 10(1)(k); (ii) that the 27,4 cents per share, representing the balance of the redemption payment, would be treated as gross income in Barname's hands; and (iii) that the total cost of the

shares would be treated as a deductible expense in terms of sec 11(a) of the Act. To this the appellant replied:

"I write to inform you that it is not possible to give you the assurances which you are seeking".

Partly because of this reply Barname decided not to take up the Tollgate shares.

The third witness called by the respondent was Mr S V C Richardson, the tax partner in a large firm of accountants. NA was a client of his firm. From about the middle of 1983 he dealt directly with NA's tax affairs. In 1980 NA commenced dividend stripping and it did so on an extensive scale during the 1981 and 1982 tax years. Dividend stripping was, however, "phased out" during 1983. In its income tax return for 1981 NA included a schedule headed "Purchase and sale of unlisted investments/subsidiaries". The schedule is divided into

five columns reflecting (1) name of company, (2) cost, (3) sale proceeds, (4) loss and (5) dividend declared. The schedule reflects over 80 share transactions. In almost every case the sale proceeds constitute a small proportion of the cost of the shares. In every case a loss is shown and this loss is generally matched or exceeded by the dividend declared. A simple calculation shows that the loss in each case is the difference between the cost and the sale proceeds of the shares in question. In aggregate the schedule reflects a loss of R24 167 158 and dividends declared of R24 712 814. This loss is brought into account in computing NA's taxable income, with the result that a tax loss of nearly R25m is shown in the return. It is not clear when this return was submitted. On about 1 May 1982 an assessment was issued reflecting a loss in exactly the same amount as that claimed in the return.

The 1982 return and assessment followed the same

pattern. The return contained a similar schedule of some 27 share transactions, in which losses totalling R15 985 850 were incurred and dividends totalling R16 305 179 were received. These losses were brought into account in computing NA's taxable income in its return. The result was a loss for the year of R15 797 126, which together with the assessed loss for 1981 resulted in a total loss of R40 705 007. The return was submitted on 30 November 1982. The assessment, issued on about 1 March 1983, accepted these figures.

At an early stage and with reference to the 1980 year of assessment NA received from the Receiver of Revenue, Johannesburg a written enquiry dated 13 August 1981, the opening paragraph of which read -

"It has come to my notice that National Acceptances (Pty) Ltd is buying shares of companies for purposes of dividend stripping."

The enquiry went on to request schedules reflecting certain details concerning "all companies acquired for this purpose". The query had to be answered within 21 days. NA replied, asking for an extension of time within which to supply the information. Thereafter from Mr Richardson's point of view the trail runs cold; and for various reasons he was unable to say what response, if any, there had been to this enquiry.

On 28 June 1983 the Receiver of Revenue, Johannesburg, initiated a further series of enquiries concerning, inter alia, NA's 1981 and 1982 returns. It is clear that the schedules which formed part of NA's 1981 and 1982 tax returns reflected its dividend stripping operations. These enquiries did not, however, at first mention dividend stripping. This matter was first raised by the Receiver in a letter dated 28 November 1983, which contains the following comment:

" 5) Dividend stripping losses will not be allowed."

This was followed by a letter dated 18 January 1984 stating,
inter alia,

"Kindly note that the company's taxable income will be adjusted according to the judgment handed down in CIR v Nemojim (Pty) Ltd 45 SATC 241."

Additional assessments disallowing these losses in 1981 and 1982 followed in due course.

The witness called by appellant in the Court à quo was Mr W P Coetzee, presently a member of the Law Interpretation section in the office of the Commissioner. His section advises the Commissioner in tax matters. He explained how a practice becomes established in the Department. When Receivers experience a problem in assessment it is referred to the Commissioner's office. The

Law Interpretation section then evaluates the problem and advises the Receivers what approach to adopt. This is done by circular minutes distributed to Receivers throughout the country. Subsequently the point is included in the official income tax handbook, distributed within the Department. The handbook is not available to the public. Receivers are not permitted to establish practices on their own.

Mr Coetzee stated that the practice of the Department was not to allow losses incurred in dividend stripping operations. In regard to redeemable preference shares the position was as follows:

".....The Department will particularly look at the preference shares and determine for what purpose the shares were taken up and investigate in detail what the purpose behind the acquisition of preference shares was.

Would you say that in some instances losses could become allowable?-- In some

instances losses might become allowable."

Mr Coetzee pointed out that there was a standing instruction in the handbook referring to the situation of dividend stripping where a company is being liquidated. This took the form of a section in the handbook summarizing the facts and decision in the Rand Selections case, supra.

With reference to the instances, referred to in the evidence of Messrs Howes and Richardson, where dividend stripping losses had been allowed by the Revenue Department, Mr Coetzee pointed to two factors. The first was that from 1978 onwards the Department had adopted a new system of assessment, referred to as the "auditing system". In terms thereof a taxpayer's return is initially accepted at its face value and an assessment is issued accordingly. Thereafter, during the ensuing three years, the Receiver concerned will reconsider the return and assessment, make a more thorough investigation and determine whether the

original assessment fully accounts for the taxpayer's tax liability. (Hence the term "audit".) The object behind this system is to expedite tax assessments. This has various advantages. The second factor was that some assessors are new and inexperienced and mistakes are made. These, however, should be picked up and corrected at the time of the three-year audit.

Specifically with regard to NA, Mr Coetzee pointed out that he had been the author of the enquiry dated 13 August 1981, referred to above. Later, towards the end of the 1981 tax year someone from NA brought to him a list of all the companies and the required details relating to NA's dividend stripping operations. Mr Coetzee then, on 8 April 1982, submitted an internal memorandum to his senior recommending that the matter be referred to head office for instructions. He stated that his own attitude was that the dividend stripping losses should not be allowed.

With reference to Barname's approach to the Commissioner, by way of the letter of 3 March 1981 (referred to above), Mr Coetzee stated that the letter was referred to one of the senior officers on the staff of the Receiver of Revenue, Johannesburg. In an internal memorandum he expressed the view that

"..... as was the case of C I R v Rand Selection Corp. Ltd (20 SATC 390) the amount which will accrue to the Bank as a result of the expenditure to be incurred, will consist of (1) a return of floating capital and (2) dividends. Thus the expenditure, to my mind, will have to be apportioned between the taxable and exempt income on the income basis."

He accordingly concluded that

"The Department cannot be party to these transactions and we cannot give the assurance that the losses will be allowed. In my view the losses should be disallowed."

Then there is a further note on file, dated 3 April 1981, containing the following instruction

"The loss which will be incurred by the Company must not under any circumstances be allowed without the authority of the Assistant Receiver, Companies."

Mr Coetzee further deposed to having scrutinized the files of a number of Tollgate shareholders (taken at random) in the Cape Town office to ascertain whether any losses from the Tollgate shares had been allowed. He found that they were not, for various reasons; in some cases because of the fact that it was a dividend stripping operation.

The Court a quo held that the evidence given by respondent's three witnesses made out "a prima facie case for the Commissioner to answer"; and that the evidence of Mr Coetzee did not constitute an acceptable answer thereto.

In this connection the Court emphasized that the Commissioner himself did not testify.

Appellant's counsel criticized the general approach of the Court a quo as constituting a "piecemeal process of reasoning" and he referred in this regard to R v Sacco 1958 (2) SA 349 (N), at 352 E-H and Arthur v Bezuidenhout & Mieny 1962 (2) SA 566 (A), at 574 A-B. I think there is substance in this criticism and that the correct approach is to ask oneself whether on a consideration of all the evidence placed before the Court (about which there is virtually no dispute) respondent discharged the onus of showing that as at the time of assessment (1 April 1982) there was a practice generally prevailing whereby the Commissioner allowed what I have termed dividend stripping losses. Moreover, I do not attach any significance to the failure of the Commissioner himself to give evidence.

In my opinion, respondent failed to discharge this onus. The general impression created by the evidence is that there was a measure of uncertainty in the Department, or in certain sectors of the Department, about the general question of the taxation of dividend stripping operations, but that at the same time there are indications that the policy was to disallow tax losses incurred by companies in this way. There is certainly not proof, in my view, of a consistent and generally prevailing practice to allow dividend stripping losses.

To begin with, there is the Nemojim case itself. As I have indicated, in that case the additional assessments disallowing the dividend stripping losses were issued on 28 November 1980; and on 1 September 1981 the Commissioner appealed against the adverse judgment of the Special Court, which had been delivered on 25 June 1981. (I have ascertained these latter dates from the original record.)

This was all well before the critical date in this case and tends to refute the respondent's case.

It is true that initially the extensive tax losses from dividend stripping operations claimed by NA and the similar losses claimed by Barname in respect of the Edworks, ELDD, HMB, Ndumu and TH transactions were allowed by the Revenue Department. But this evidence loses much of its force when viewed against the background of the audit system of assessment. Moreover, the negative response received by Barname from the Department in regard to its enquiry concerning a possible purchase of Tollgate "A" ordinary shares, and the evidence as to internal departmental exchanges on the subject, point the other way. So does the evidence relating to the enquiry dated 13 August 1981 directed to NA and the internal memoranda in regard thereto. On the other hand the handbook itself does not appear to take the matter much further.

In respondent's own case the Receiver of Revenue, Cape Town, on 20 August 1982 raised queries concerning the Tollgate and Anthracite transactions and asked respondent, inter alia, to state why the losses should be allowed for tax purposes. Although the revised assessments were issued only on about 1 November 1983, respondent was notified on 7 September 1983 that these losses were to be disallowed.

Then there is the further factor that whilst there are some thirty Receivers offices in the country the admissible evidence led by the respondent related to the allowance of such losses by only one such office, viz the Johannesburg office.

Respondent's counsel emphasized the fact that the Nemojim case was concerned with shares in private companies, whereas the transactions involved in respondent's case related to shares in public companies; and argued that

because of this difference the disallowance of the deduction in the Nemojim case in November 1980 did not run contrary to the existence (alleged by respondent) of a generally prevailing practice to allow dividend stripping losses in regard to public companies. In support of this proposition counsel made reference to secs 8C and 8D of the Act, which apply only to shares in private companies. This argument cannot succeed. I can see no logical reason why a distinction should be drawn between the case where a taxpayer buys shares in a private company in order to receive a large dividend and thereafter sell his shares and the case where he does the same thing in regard to shares in a public company. And the evidence does not indicate that in practice the Department drew any such distinction. In fact such indications as there are tend to the contrary. Furthermore, I cannot see upon what basis secs 8C and 8D can be used to show factually what the practice was at the

relevant time.

For these reasons I hold that it has not been shown that the original assessment for the 1981 tax year was made in accordance with a practice generally prevailing at the time; and that consequently the appellant was not precluded by sec 79(1), proviso (iii), from issuing a revised assessment for that year. That disposes of the issue upon which the appeal was fought both in this Court and in the Court a quo. It would seem, however, that the revised assessment for 1981 does not apply the Nemojim formula and that it (and consequently those for 1982 and 1983) should be referred back to the appellant for reassessment. This would be in accordance with respondent's first alternative ground of objection.

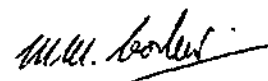
It is accordingly ordered that :-

(1) The appeal be allowed with costs, such costs

to include the costs of two counsel.

- (2) The order of the Special Court be set aside and there be substituted therefor the following:

"The revised assessments for 1981 and 1982 and the assessment for 1983 be referred back to the Commissioner for reassessment, applying to the 1981 assessment the formula laid down in C I R v Nemojim (Pty) Ltd 1983 (4) SA 935 (A)".


M M CORBETT

VAN HEERDEN JA)
KUMLEBEN JA)
NICHOLAS AJA)
GOLDSTONE AJA)

CONCUR