

A warning by press release that the retrospective application of legislation to completed transactions will be applied: A case analysis of the Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and Another (2017)

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ABSTRACT

Pienaar Brothers (Pty) Ltd was an amalgamated company who sought to introduce a BEE element of ownership into its company in a tax efficient manner. Upon consulting their legal experts they were advised that the best manner in which they could achieve this objective was to enter into an amalgamation agreement in terms of section 44 of the ITA. At this particular time, the law was structured in a way in which it was possible to achieve this objective in a tax efficient matter, particularly because any distribution made by parties to the amalgamation transaction would be tax free. The problem however was that the tax collecting agency never intended the section 44 of the ITA amalgamation process to be STC free, and instead intended a temporary deferral thereof. To address this, the taxing authorities accordingly started putting mechanisms in place to limit the loss of such STC. On the 10 January 2007, SARS issued a public announcement stating that they planned to investigate certain corporate entities which had elaborate corporate structures that led to an impermissible loss of tax. On the 21 February 2007, the Minister of Finance stated that section 44 of the ITA, as it stood, allowed for a loss of STC as opposed to a deferral thereof, and that the taxing authorities intended on withdrawing such STC exemption in order to align it with their initial intention, and to further make such amendment retrospective to the date of such announcement. This was then once again cemented in the form of a press release on the part of SARS on that same day. Thereafter, this proposed amendment was submitted to Parliament in the Draft Taxation Laws Amendment Bill on 27 February 2007, and in May 2007, the Taxpayer completed its amalgamation transaction and achieved its BEE objective into its ownership. On the 7th June 2007 the Taxation Laws Amendment Bill was published together with an Explanatory memorandum which however no longer proposed the withdrawal of the STC exemption contained in section 44 of the ITA, but instead introduced a new addition into section 44 of the ITA. This provision now targeted a resultant company's equity share capital and share premium, instead of the distribution of company income at the amalgamated company's level. This new insertion was then promulgated into law on 8 August 2007 as section 44(9A) of the ITA. In complete difference to the initial proposal contained in the forewarning, the practical consequence

of section 44(9A) of the ITA was that the income which rolled over from the amalgamated company to the Taxpayer (the resultant company) had in the process changed its nature from revenue to capital which was caught up in the share premium account of the Taxpayer. Section 44(9A) of the ITA accordingly targeted any distribution made by the resultant company of this share premium. The Taxpayer's problem in the present matter arose in 2011 when SARS sought to tax the Taxpayer on its May 2007 completed transaction, particularly its distribution of its share premium at the time. In addition to this assessment, SARS furthermore also levied interest on such outstanding STC payment from 8 August 2007, the date on which the final enactment was promulgated into law. This was that which accordingly prompted the Taxpayer to bring its matter before the High Court. Here, the prime relief sought by the Taxpayer was an order of constitutional invalidity, while the second order, couched as an alternative to the first was an interpretational argument which had the effect that section 44(9A) of the ITA did not apply to Taxpayer's distribution when it was made because it was a completed transaction. The gist of the Taxpayer's constitutional issue requested of the court to declare that the provision did not pass constitutional muster to the extent of its retrospectivity. The court however dismissed the Taxpayer's claims and held in favour of SARS. The paper seeks to analyse this case alongside the values of legal certainty, as espoused in the Rule of Law, and to consider the probability of success on the part of the Taxpayer if they opted to take the matter on appeal.

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CHAPTER ONE

1.1. **Background and Context:**

Secondary Tax on Companies (hereinafter referred to as “STC”) was a tax introduced by section 64B and section 64C of the Income Tax Act¹ (hereinafter referred to as the “ITA” or “the Act”), and applied in South Africa until 1 April 2012. It was aimed at taxing the net dividends of a company, that is, a company’s distribution of its profits to its shareholders. Such sections were however not aimed at taxing a company’s capital distributions, that is, the income the company derived from the sale of its assets at a value higher than the original amount it purchased such assets for.² On this basis, para (f) of the definition of ‘dividend’ in section 1 of the ITA specifically excluded any distribution made by a company which represented a *‘reduction of a share premium account of a company’*, as such ‘share premium’ was constituted of company capital, and not of company income.

A further important section for the purposes of this paper is section 44 of the ITA. This is the ‘the group restructure provision’ or ‘the amalgamation transaction’ provision, which provides for roll over relief in the case of amalgamation transactions.³ Here amalgamation transactions are defined as being transactions

¹Act 58 of 1962.

²Brink, J and Brincker, E ‘Important Judgment on the Constitutionality of Retrospective Legislation’ 2017 *Tax and Exchange Control Alert* 3.

³Botha, H and Marupen, C ‘Retrospective legislation: The Pienaar Brothers Case’ 2017 *Siber Ink* 11.

through which a company (the amalgamated company) disposes of all its assets to another company (the resultant company), with the end result being that the amalgamated company ceases to exist.⁴

Section 44(9) of the ITA then takes this a step further to deal specifically ‘*with amalgamation transactions where the resultant company issued shares to the amalgamated company, which shares the amalgamated company then distributed to its shareholders as a dividend in specie*’.⁵ Ordinarily, in such a case, such dividend would have attracted STC, but because section 44(9) of the Act deems such distribution not to be a dividend for the purposes of STC, the distribution is exempted from STC.⁶

In this regard, the Legislature intended the purpose of the exemption to render amalgamation transactions as STC neutral. Their reasoning behind such exemption was based on the assumption that the distributable income which was initially held by the amalgamated company would not attract STC, and merely be rolled over into the new resultant company, and then at a later stage if and when the resultant company chose to declare dividends on this income, would such distribution attract STC.⁷ The Legislature however overlooked the possibility of such ‘rolled over’ distributable income changing its character in the new resultant company and becoming share premium, which share premium would then avoid STC again if a distribution of it was made.⁸ This was exactly what happened in the present Pienaar

⁴*Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and Another* 2017 (6) SA 443 (GP) at 7.

⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 26.

⁶*Pienaar Brothers (Pty) Ltd* supra note 4.

⁷*Pienaar Brothers (Pty) Ltd* supra note 4.

⁸*Pienaar Brothers (Pty) Ltd* supra note 4.

Brothers' transaction, where the resultant company issued shares to the amalgamated company, which the latter then distributed to its shareholders as a dividend *in specie*.⁹

Practically, the way this so-called 'loophole' worked was that the amalgamated company would surrender its distributable income to the resultant company, in exchange for Newco shares being issued from the resultant company to the amalgamated company. Once such Newco shares were distributed to the amalgamated company's shareholders would such distribution constitute a dividend, but be exempt from STC by virtue of section 44(9) of the Act.¹⁰ The resultant company would at this point have received the assets from the amalgamated company, but in its hands, the income would have changed its character from distributable income in the amalgamated company to share premium in the resultant company.¹¹ If and when the resultant company decided to distribute from this share premium to its shareholders, would it constitute a capital distribution, and not a dividend, which would once again avoid STC as such distribution would not be a dividend as defined. Such amalgamation provision therefore allows a permanent loss of STC which would otherwise have been payable by the amalgamated company on its distributable income.¹² This was exactly what happened in the present case.

1.2. Introduction:

⁹*Pienaar Brothers (Pty) Ltd* supra note 4.

¹⁰*Pienaar Brothers (Pty) Ltd* supra note 4.

¹¹*Pienaar Brothers (Pty) Ltd* supra note 4.

¹²*Pienaar Brothers (Pty) Ltd* supra note 4.

Pienaar Brothers (Pty) Ltd, an operating company, and also the Taxpayer in the present matter, entered into an amalgamation transaction in terms of section 44(9) of the ITA, with the *bona fide* intention of introducing a BEE element of ownership into its company in a tax efficient manner. At the time they entered into this amalgamation transaction, section 44(9) of the ITA contained a so-called ‘loophole’ that permitted a permanent loss of STC, as opposed to a mere deferral thereof, as intended by Legislature when drafting such legislation.¹³ However, a few months after their transaction was completed, the law was formally amended to close this so-called ‘loophole’. The problem in this particular matter however was that the content of this final amendment was considerably different to that was initially warned of in the prior warnings, which amendment was made retrospective to 21 February 2007, the date on which the Minister of Finance announced his intention to close such so-called ‘loophole’ in his Budget speech, and thereafter in a press release statement again.¹⁴ In 2011 the South African Revenue Service (hereinafter referred to as “SARS”), the tax collecting authority in the present matter, sought to use this retrospective amendment to levy STC against the Taxpayer for making use of such so-called ‘loophole’ in its May 2007 transaction.¹⁵ This ultimately prompted the Taxpayer’s application to the High Court. In this regard, South African law distinguishes between two types of retrospective legislation; retroactive legislation and retrospective legislation, which is explained as follows:

[L]egislation is retroactive if it changes the law from what it was at a date in the past, typically if it provides that from a past date the new law will be deemed to have been in operation. Legislation is retrospective if it imposes new results in respect of a past event that is, if it operates forwards but looks backwards in that it attaches new

¹³*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

¹⁴*Pienaar Brothers (Pty) Ltd* supra note 4 at 444.

¹⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 446.

consequences for the future of an event that took place before the legislation was imposed.¹⁶

In the present case, the court, per Fabricius J, ruled that the retrospective legislative amendment was constitutional in that it was not a violation of the Rule of Law. The court further ruled that the retrospective amendment applied to transactions completed before the promulgation of the legislative amendment, and that there was no requirement that the Taxpayer ought to be given prior warning of the retrospective nature of the amendment – even though supposed ample warning had been afforded in this case. The judgment will be analysed in further detail in the chapters below.

At this juncture it is important to understand the Rule of Law doctrine, and the values it proposes. In *Fedsure Life Assurance Ltd v Greater Johannesburg Transitional Metropolitan Council*,¹⁷ the Constitutional court stated that the Rule of Law doctrine places limitations on the manner in which the state exercises the powers that has been conferred upon it. In *President of the RSA v Hugo*¹⁸ the Constitutional court also used the doctrine to hold that legislation may not be applied retrospectively, and in *Affordable Medicines Trust v Minister of Health of RSA*¹⁹ the Constitutional court held that that legislation must be expressed in a clear, accessible and a reasonably precise manner. Taking this further, in the case of *Zondi v MEC for Traditional and Local Government Affairs*,²⁰ the Constitutional court also stated that disputes should be adjudicated in accordance with the confines of the law and that judges must be

¹⁶*Unitrans Passenger (Pty) Ltd t/a Greyhound Coach Lines v Chairman, National Transport Commission and Others* 1999 (4) SA 1 (SCA) at 7C.

¹⁷ 1998 12 BCLR 1458 (CC).

¹⁸ 1997 6 BCLR 708 (CC).

¹⁹ 2005 6 BCLR 529 (CC).

²⁰ 2005 4 BCLR 347 (CC).

accountable and not act arbitrarily. To summarise this, South Africa is a democratic state founded on the supremacy of the Constitution and the Rule of law,²¹ where the

[P]urpose [thereof] is to protect basic individual rights by requiring the government to act in accordance with pre-announced, clear and general rules that are enforced by impartial courts in accordance with fair procedures. This requires state institutions to act in accordance with the law which means two things. The first is that the various organs of state must obey. The second is that the state cannot exercise power over anyone unless the law permits it to do so. This means that there must be a law authorising everything the state does. If it acts without legal authority it is acting lawlessly, something that a constitutional democracy cannot permit.²²

The principle of legality, on the other hand, is the more sophisticated version of the rule of law, as it adds the procedural requirements to the exercise of state power that is absent on the principle of authority's version stated above.²³ *"In this respect the principle of formal legality provides that the law must be general in nature; that it must be prospective and not retrospective; that it must be clear, open and relatively stable; and that it must be enforced by independent courts following fair procedures."*²⁴

A further important term that needs to be understood from the outset is the concept of a 'loophole', which is referred to by both SARS and the Taxpayer in formulating their arguments either for or against the retrospective application of legislation throughout the case.²⁵ For this reason, and in order to effectively engage and analyse the case, I will, as a start, need to define what is meant by the term, as well as my

²¹ Section 1(c) of the Constitution of 1996 .

²² Currie I & De Waal J *The Bill of Rights Handbook* 6ed (2013) at 10.

²³ *President of the Republic of South Africa and Another v Hugo* 1997 (6) BCLR 708 (CC).

²⁴ *Kruger Potchefstroom Electronic Law Journal* (2010) 468 475.

²⁵ *Pienaar Brothers (Pty) Ltd* supra note 4 at 435.

understanding of the use of the term in this particular case. From a legal perspective, one definition of the term ‘loophole’ is as follows:

[I]t is an ambiguity or inadequacy in a system, such as law..., which can be used to circumvent or otherwise avoid the purpose, implied or explicitly stated, of the system. In a loophole, a law addressing a certain issue exists, but can be legally circumvented due to a technical defect in the law.²⁶

Another definition of the term is that it is *‘an opportunity to legally avoid an unpleasant responsibility, usually because of a mistake in the way the rules or laws have been written’*.²⁷ A further legal definition of the term is that it is *‘a mistake in a law or set of rules that allow the rules to be broken’*²⁸.

Furthermore, I believe that in trying to understand what is meant by the concept of a ‘loophole’ in tax law, it is important to consider the term alongside the tax avoidance/ tax evasion distinction.

[T]he former is generally taken to connote the lawful process of protecting one’s income and assets from erosion by taxation through measures which are within the bounds of the law, whereas the latter connotes the use of illegal means to escape, reduce or postpone tax for which penalties are prescribed under the Tax Administration Act²⁹ or stratagems which fall foul of one or more of the anti-avoidance provisions of the Income Tax Act.³⁰

²⁶“Loophole”. Revolvly. 2019. Available at <https://www.revolvly.com/page/Loophole>, accessed on 23 March 2019.

²⁷“Loophole”. Cambridge dictionary. 2018. Available at <https://dictionary.cambridge.org/dictionary/english/loophole>, accessed on 15 May 2018.

²⁸“Loophole”. IdioMeanings. 2018. Available at <http://www.idiomeanings.com/loophole/>, accessed on 15 May 2018.

²⁹Act 28 of 2011.

³⁰“Tax avoidance and evasion”. LexisNexis South Africa. 2018. Available at <https://www-mylexisnexis-co-za.ezproxy.uct.ac.za/Index.aspx>, accessed on 16 May 2018.

On this basis, I am of the view that a ‘loophole’ is not a mistake in law which allows the law to be broken. Instead, where the legal system has addressed a certain issue by formulating particular laws and rules regarding such issue, but where, despite such regulation, an ambiguity or inadequacy exists which results in the possibility that the implied or explicitly stated purpose of the provision can be avoided, then the taking advantage of such inadequacy is more alligned to the lawful tax avoidance principle, as opposed to the unlawful tax evasion principle. Planning one’s affairs to make effective use of such lawful tax avoidance mechanisms in order to pay the least amount of tax possible is every taxpayer’s right, and in accordance with the principle of legality and certainty as espoused under the Rule of Law doctrine.³¹ Such doctrine lies at the heart of our constitutional dispensation, and requires that the law be certain, clear and stable at all times.³² This furthermore affords taxpayers the right to rely on the laws remaining what it was when they entered into a transaction, and that where new laws come into existence, that such laws will only be made prospective in its application.³³ This view accords with Emslie’s perspective that if taxpayers were required to take into account the Legislature’s actual intention, as opposed to merely what the legislation states, that it would in effect mean that taxpayers would be required to guess what statutes intended rather than what it actually stipulated. The further result of this would be that taxpayers would be required to base the structuring of their affairs on a hypothetical situation of such legislation being brought in line with that which the Legislature actually intended.³⁴

³¹*Pienaar Brothers (Pty) Ltd* supra note 4 at 435.

³²*Pienaar Brothers (Pty) Ltd* supra note 4 at 435.

³³*Pienaar Brothers (Pty) Ltd* supra note 4 at 435.

³⁴Trevor Emslie ‘Constitutionality of the Application of Retroactive Legislation to Completed Transactions’ 66 (2017) April May *The Taxpayer* at 61.

Such an approach could never be in conformance with the values espoused by the Rule of Law doctrine.

On the facts of the case, we can accordingly see that at the time the Taxpayer completed its transaction in May 2007 it was not liable for the payment of STC because section 44(9) of the ITA was formulated in a clear way that allowed a permanent loss of STC as opposed to a mere deferral thereof.³⁵ At this time, the provisions regulating amalgamation transactions allowed taxpayers the lawful opportunity to bypass the payment of STC, and as such, the opportunity was not strictly speaking a ‘gap’ or ‘loophole’ in the law, it was the law. Similarly, the Taxpayer cannot be said to have acted in bad faith and that it took advantage of the existing law at the time as it was within the lawful bounds of what the law allowed at the time. Instead, the Taxpayer’s business affairs required it to use the existing law to plan and structure its affairs in a manner which attracted the least amount of tax possible, and which achieved its ultimate BEE ownership objective, which was exactly what the Taxpayer did.³⁶

1.3. Outline and scope:

This paper will consider the probability of success of the Taxpayer’s case if it had taken the matter on appeal to the Constitutional Court. In doing so, only the issues concerning the constitutionality of the retrospective amendment will be considered.

³⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 452.

³⁶*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

Accordingly, this paper is divided into four Chapters. Chapter one sets out the background and context relevant to understanding the facts of case, while Chapter two sets out such relevant facts of the case, the relevant announcement by the taxing authorities and the research issue.

Chapter three then sets out my analysis of the court's interpretational and constitutional issues, while Chapter four contains my conclusion.

CHAPTER TWO

2.1. Factual Background:

Pienaar Brothers (Pty) Ltd (the amalgamated company) was an operating company who needed to introduce a BEE element of ownership into its company in a tax efficient manner. However, in order to achieve this, their balance sheet statement needed to be slim so as to ensure that the share price was low and affordable for the prospective BEE owners to buy into.³⁷ With this objective in mind, Pienaar Brothers (Pty) Ltd (the amalgamated company), acting upon legal advice, entered into an amalgamation agreement with Serurubele Trading 15 (Pty) Ltd in accordance with section 44 of the ITA (also referred to as ‘the group restructure provision’ or ‘the amalgamation transaction’). In terms of this amalgamation

³⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 442.

agreement, Serurubele Trading 15 (Pty) Ltd acquired all the assets of Pienaar Brothers (Pty) Ltd (the amalgamated company) as a going concern on 16 March 2007, which acquisition was effectively backdated to 1 March 2007 in accordance with the Sale of Business Agreement between the parties.³⁸ Once Pienaar Brothers (Pty) Ltd (the amalgamated company) disposed of its shares, being its only asset, to its shareholders, as a dividend *in specie*, it was liquidated in accordance with the requirements of the ‘amalgamation transaction’ provisions set out in the Act. Normally this distribution would have attracted STC, but because of the STC exemption espoused in section 44(9) of the ITA at the time, Pienaar Brothers (Pty) Ltd (the amalgamated company) was not liable for the payment of STC on such distribution.³⁹ Once such distribution was effected, Serurubele Trading 15 (Pty) Ltd thereafter changed its name to Pienaar Brothers (Pty) Ltd (the Taxpayer), which for all intents and purposes was the resultant company of the whole amalgamation and the ‘*vehicle for the envisaged amalgamation transaction*’.⁴⁰

Furthermore, one of the conditions of the above mentioned amalgamation was that in partial settlement of the purchase price, the Taxpayer would issue shares to Pienaar Brothers (Pty) Ltd (the amalgamated company) to an amount equal to the equity consideration of the assets sold to it.⁴¹ On this basis the Taxpayer’s share premium account was then further credited with the equity consideration less the face value of those shares, which amounted to R29 500 000.00 (the capital distribution). At this point, when we consider Pienaar Brothers’ (Pty) Ltd (the

³⁸Pienaar Brothers (Pty) Ltd supra note 4 at 443.

³⁹Pienaar Brothers (Pty) Ltd supra note 4 at 443.

⁴⁰Pienaar Brothers (Pty) Ltd supra note 4 at 443.

⁴¹Pienaar Brothers (Pty) Ltd supra note 4 at 443.

amalgamated company) initial objective of introducing a BEE element into its ownership, we see that although the structure was as it needed to be, the share price in the Taxpayer was still far too high for the prospective BEE buyers to afford as the Taxpayer, at this point, had all the assets and income of Pienaar Brothers (Pty) Ltd (the amalgamated company). Thus, in order to accordingly make the share price affordable, the Board of Directors of the Taxpayer resolved in terms of the relevant legislation to make a distribution of this R29 500 000.00 in its share premium account to its shareholders *pro rata* according to their shareholding, which distribution was made on 3 May 2007.⁴² This distribution was effected in terms of section 90 of the old Companies Act⁴³, read with article 21A of the company's Articles of Association.⁴⁴

At this point, the Taxpayer achieved a slimmed down balance sheet and its existing shareholders acted in unison and sold 25.1% of its issued share capital to the BEE buyer, Naha Properties (Pty) Ltd, whereby the desired BEE ownership objective into the Taxpayer was achieved. This transfer of shares was confirmed by the Taxpayer's directors on 7 May 2007.⁴⁵

As alluded to above, on 7 May 2007, when the distribution was effected and finalised, para (f) of the definition of 'dividend' in section 1 of the ITA excluded any amount distributed from the share premium account of a company (not being

⁴²*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

⁴³Act 61 of 1973.

⁴⁴*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

⁴⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

profits previously capitalised to the share premium account).⁴⁶ Section 44(9) of the Act further cemented and confirmed that this exemption applied to distributions in terms of an amalgamation transactions. Such dividend would ordinarily have attracted STC, but section 44(9) of the ITA exempted it from STC by deeming the provision not to be a dividend for income tax purposes. In this regard, the Taxpayer averred that on the 3 May 2007 when the distribution was made, the distribution was not a dividend as defined in the Act, and thus no STC was due and payable by it on the distribution. This was due to the fact that the distribution was made out of the Taxpayer's share premium account, which share premium arose from the issue of ordinary shares at a premium over their par value.⁴⁷

The problem that led to the present matter arose when SARS imposed STC on the Taxpayer's R29 500 000.00 distribution to its shareholders by retrospectively applying an amendment of the ITA, which in effect meant that SARS denied the exemption provided for in para (f) of the definition of 'dividend' at the time. SARS argument was that during the Budget speech of 20 February 2007, the Minister of Finance made known his intention to pass retrospective legislation to specifically deal with anti-avoidance arrangements relating to STC, particularly the loophole provided for by section 44 of the Act, which exemption permitted a permanent loss of STC instead of a deferral of tax, which was the reason behind the amalgamation provisions exception in the first place.⁴⁸ This intention was further reinforced by SARS on the 21 February 2007 when it issued a press release in which the STC

⁴⁶*Pienaar Brothers (Pty) Ltd* supra note 4 at 444.

⁴⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

⁴⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 446.

exemption for amalgamation transactions contained in section 44(9) of the ITA was withdrawn with immediate effect.⁴⁹

In the context of the definition of a 'dividend' in terms of section 1 of the ITA, the applicable law on 3 May 2007 at the time the Taxpayer's distribution was made, such distribution did not constitute a dividend as defined, and therefore no STC should have been due and payable by it on such distribution. Such distribution was instead made out of the share premium of the Taxpayer, which share premium arose from the issue of ordinary shares at a premium over the par value.⁵⁰

2.2. Announcements by the Minister of Finance and SARS of the prospective change in closing the so-called 'loophole' created by section 44 of the ITA:

As mentioned above, the net effect of the definition of 'dividend' in relation to distributions made out of a company's share premium account and section 44(9) of the ITA was that no STC was triggered in consequence of the application of the amalgamation provisions of section 44 of the ITA. This was completely unacceptable to the SARS. To address this, a general warning was contained in the first public statement of the 10 January 2007, which warned taxpayers that the Treasury intended to close the so-called loophole in the ITA, and that '*certain corporate transactions were structured in such a way that they show complete and reckless disregard for tax morality and South African Tax Law*'.⁵¹ It gave notice

⁴⁹Pienaar Brothers (Pty) Ltd supra note 4 at 453.

⁵⁰Pienaar Brothers (Pty) Ltd supra note 4 at 442.

⁵¹South African Revenue Service 'Aggressive tax structuring' Press statement 2007, available at <https://www.ftomasek.com/archive/p100107a.html>, accessed on 30 May 2007.

that it was *'to carefully examine these transactions in order to ensure that no impermissible tax loss occurs'*, and that it should be noted that *'the architects of certain tax aggressive structures will not be permitted to abuse South African tax provisions in ways clearly unintended by the legislature'*.⁵²

Thereafter, on the 21 February 2007, the Minister of Finance in the 2007 Budget Speech made reference in general terms to an intention to pass retrospective legislation to deal with the loophole created by section 44 of the ITA, particularly relating to the loss of STC. At this point, no other specifics were provided.⁵³

Taking the Minister of Finance's announcement further, on 21 February 2007, the Commissioner for SARS issued a press release in terms of which he withdrew the STC exemption for amalgamation transactions contained in section 44(9) of the ITA with immediate effect as it created a permanent loss of STC instead of a deferral of tax. The particular statement read as follows:

[2]1 February 2007': The STC exemption for amalgamation transactions contained in section 44(9) of the Income Tax Act, 1962, is withdrawn. This exemption permits a permanent loss of STC, rather than a deferral of tax, which is the intent of the amalgamation provisions.⁵⁴

In accordance with this proposed amendment, the compulsory distribution made by Pienaar Brothers (Pty) Ltd (amalgamated company) would have been subjected

⁵²Ibid.

⁵³*Pienaar Brothers (Pty) Ltd* supra note 4 at 453.

⁵⁴South African Revenue Service 'Explanatory Note: STC Reforms' Press statement 2007, available at <https://www.ftomasek.com/archive/p210207a.html>, accessed on 30 May 2007.

to the payment of STC, and not the voluntary distributions made by the resultant company, the Taxpayer in the present matter.⁵⁵

On 27 February 2007, SARS and the National Treasury released the Draft Taxation Laws Amendment Bill of 2007 for public comment, which in keeping with the press release of 21 February 2007, such Bill proposed the amendment of section 44 of the ITA by the deletion of section 44(9) and (10) thereof, which amendments would have been deemed to come into operation on 21 February 2007, and which would apply in respect of any disposal of an equity share, or any deemed declaration of a dividend, by an amalgamated company (the amalgamated company) on or after the date.⁵⁶

It was at this point in early May 2007 that the amalgamation transaction, the distribution and the introduction of the BEE partner of the Taxpayer was completed.⁵⁷

Then, on the 7 June 2007, the Taxation Laws Amendment Bill was published together with an explanatory memorandum. This Bill no longer proposed the deletion of sections 44(9) and (10) of the ITA, but instead proposed the insertion of section 44(9A) into the ITA, and that such amendment was to be made retrospective to 21 February 2007.⁵⁸ The Explanatory memorandum relating to this insertion explained that section 44 amalgamations was meant to act as a deferral mechanism where all the assets and tax attributes from the amalgamated

⁵⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 468.

⁵⁶*Pienaar Brothers (Pty) Ltd* supra note 4 at 444.

⁵⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 445.

⁵⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 445.

company was to roll over to the resultant company, and that such resultant company should not only enjoy the tax benefits of the amalgamated company but also carry its tax burdens.⁵⁹ The same theory was also to apply to STC. The distribution of acquiring company shares in an amalgamation transaction was accordingly free from STC. However, the profits of the amalgamated company did not roll over to the resultant company, and the net effect was that there was a complete STC exemption when the resultant company made a distribution of the former amalgamated company assets. On this basis, the effect of ‘*section 44(9A) was that the amalgamated company’s profits are effectively rolled over to the resultant company, so that STC remains payable when the resultant company makes [a] subsequent distribution*’.⁶⁰

Section 34(1)(c) of the Taxation Laws Amendment Act⁶¹ (hereinafter referred to as “the Amendment Act”) was then promulgated into law on 8 August 2007, which inserted the new section 44(9A) into the already existing section 44 of the ITA. As explained in the Explanatory memorandum of the Taxation Laws Amendment Bill, this new insertion closed the existing loophole by deeming the resultant company’s equity share capital and share premium arising from any of section 44 amalgamation transactions to ‘*be profits not of a capital nature available for distribution to shareholders to the extent of any profits distributed by the amalgamated company ito subsection (9)*’.⁶² The practical effect of this new amendment was that the amalgamated company’s profits would be rolled over into the resultant company so that STC would not affect the amalgamated company, as

⁵⁹*Pienaar Brothers (Pty) Ltd* supra note 4 at 445.

⁶⁰*Pienaar Brothers (Pty) Ltd* supra note 4 at 445.

⁶¹Act 8 of 2007.

⁶²Taxation Laws Amendment Act supra note 61.

initially intended, but instead roll over to Taxpayer, the resultant company, if and when it makes a subsequent voluntary distribution.

More importantly for our purposes, however, was that:

[S]ection 34(2) of the Amending Act provided that section 44(9A) was deemed to have come into operation on the 21 February 2007 and that it would be applicable ‘to any reduction or redemption of the share capital or share premium of the resultant company of its shares.’⁶³

2.3. Issues before the Court:

The issue that led to the above dispute between the Taxpayer and the taxing authorities, the Commissioner of SARS and the Minister of Finance, was based on the STC assessment raised by SARS in an amount of R3 687 500.00 on the distribution of R29 500 000.00 of the Taxpayer out of its share premium account, made on 3 May 2007.⁶⁴ At this time, such distribution did not constitute a dividend for the purposes of STC, but because the legislature not only amended section 44 of the ITA on 8 August 2007 to close this so-called ‘loophole’ which caused a permanent loss of STC, and also backdated such amendment retrospectively to 21 February 2007, the Commissioner was now able to raise an assessment on the distribution effected by the Taxpayer on 3 May 2007.⁶⁵

⁶³Taxation Laws Amendment Act supra note 61.

⁶⁴*Pienaar Brothers (Pty) Ltd* supra note 4 at 446.

⁶⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 446.

The Commissioner justified such assessment on the basis of the amended amalgamation provision, and the fact that prior to such distribution the Minister of Finance and SARS had generally indicated their intention to close the loophole created by section 44 of the ITA. The Taxpayer objected to such assessment, but such objection was disallowed by SARS. The Taxpayer's application to the High Court was accordingly based on its disputing such STC assessment, where the court had to consider two main arguments the Taxpayer placed before it. The prime relief sought by the Taxpayer was an order of constitutional invalidity, while the second order, couched as an alternative to the first was an interpretational argument which had the effect that section 44(9A) did not apply to Taxpayer's distribution when it was made.⁶⁶ To be more precise, these arguments were as follows:

1. The Constitutional issue- That section 34(2) of the subsequently enacted Taxation Laws Amendment Act, which introduced section 44(9) retrospectively to 21 February 2007, should to be declared inconsistent with the Constitution and invalid; or alternatively;⁶⁷
2. The Interpretational issue- that the provisions of section 44(9A) of the ITA did not apply to the distribution made by the Taxpayer on 3 May 2007, or to its registered shareholders at that date *pro rata* according to their shareholding, of an amount of R29 500 000.00 out of the Taxpayer's share premium account.⁶⁸

⁶⁶*Pienaar Brothers (Pty) Ltd* supra note 4 at 447.

⁶⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 459.

⁶⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 447.

For the purposes of convenience however, the court found it convenient to deal with the interpretational issue first.⁶⁹

CHAPTER THREE

3.1. Analysis of the Interpretational Issue:

With regards to the interpretational issue, I am of the opinion that the court correctly dismissed this leg of the Taxpayer's claim, and that the relevant provision should be read as applying to 'any transaction', without any exceptions.

Despite the Taxpayer correctly citing the existence of a general presumption against retrospectivity in our law, the wording of section 34(2) of the Amendment Act⁷⁰ expressly states that the provision should be applied retrospectively from the 21 February 2007. In this regard, despite the starting point in the process of interpretation being the wording of a provision, such interpretation does not stop at the perceived literal meaning of the words.⁷¹ Instead, to uncover the true meaning of the provision, and the intention of the legislature when drafting such legislation, the Purposive Approach requires us to consider the provision's literal wording in

⁶⁹*Pienaar Brothers (Pty) Ltd* supra note 4 at 447.

⁷⁰Taxation Laws Amendment Act supra note 61.

⁷¹*Pienaar Brothers (Pty) Ltd* supra note 4 at 450.

conjunction with all the relevant and admissible context in which it operates, as well as the circumstances upon which the document came into being.⁷² Here, the express wording of the provision in line with the proposed purpose for which SARS sought to close the so-called loophole in the first place,⁷³ the supposed numerous warnings given to taxpayers prior to the promulgation of section 34(2) of the Amendment Act, and SARS's contentions that if they did not push for the so-called loophole to be closed that '*there would be a real risk that the national fiscus would suffer extensive and permanent harm*'⁷⁴ should be taking into account. From this, it becomes clear that the court had no choice but to reach the conclusion that the amendment applied to any and all transactions, including completed transactions. This was so regardless of whether or not the retrospective application of legislation seemed unfair, as the court concluded that tax laws are not fair.⁷⁵ On this basis, I am of the view that if the Taxpayer had to take the matter on appeal, the grounds for success on this interpretational leg would not be any more different to the initial outcome in the High Court.

At this point however, it is important to point out that the subjective intention of the legislator when drafting such provision is what needed to be uncovered when attempting to interpret section 34(2) of the Amendment Act, alongside the relevant context and existing circumstances that brought the legislation into existence.⁷⁶ As mentioned above, in support of the courts conclusion that the legislature intended the amendment to apply retrospectively to any and all transactions, the supposed

⁷²*Pienaar Brothers (Pty) Ltd* supra note 4 at 450.

⁷³*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

⁷⁴*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

⁷⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 458.

⁷⁶*Pienaar Brothers (Pty) Ltd* supra note 4 at 450.

numerous warnings provided to taxpayers prior to the final addition of section 44(9A) of the ITA was mentioned as well as the belief that if they did not push for such amendment that there would be ‘*a real risk that the national fiscus would suffer extensive and permanent harm*’.⁷⁷ Here, despite the legislator subjectively intending the provision to apply retrospectively to any and all transactions because of these prior warnings, when we objectively consider this factor in analysing the case, it becomes clear that there was considerable distance between the supposed prior warnings and that which was finally enacted.⁷⁸ While the warnings contained in the Budget Speech and the subsequent press release statement of 21 February 2007 proposed the withdrawal of the exemption contained in section 44 of the ITA, the actual amendment retained this exemption and instead inserted a new section 44(9) into the ITA.⁷⁹

On this basis, the content and specificity of these warnings becomes important. Hattingh believes that the ‘*challenge [in this matter] arose because of the generality and non-specific nature of the measure indicated in [the] public announcement and media release*’.⁸⁰ I, however, believe that despite the fact that SARS’s announcement of the 10 January 2007 was of a very general and non-specific nature in that it referred to certain corporate transactions which were to be ‘*carefully examined in order to ensure that no impermissible tax loss occurred*’,⁸¹ the Budget Speech and press release statement of 21 February 2007 was very specific and limited to the withdrawal of the exemption in section 44(9) of the ITA because it

⁷⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

⁷⁸Johann Hattingh ‘*Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and Another*’ (2017) 20 *ITLR* 284 at 288.

⁷⁹*Ibid.*

⁸⁰*Ibid.*

⁸¹South African Revenue Service op cit note 51.

permitted a loss of STC as opposed to a mere deferral thereof.⁸² As mentioned above, the withdrawal of this exemption would nonetheless have made sense and would have been expected, since but for this exemption, compulsory distributions made by amalgamated companies constitutes a dividend as defined, and would accordingly have attracted STC.⁸³

However, when the final amendment was tabled, taxpayers discovered that something completely different to what was initially warned of in the press release statement had been promulgated into law. Instead of this mere withdrawal of the section 44(9) of the ITA exemption, the amendment inserted a new section 44(9A) into the ITA with a complete different purpose.⁸⁴ This new provision now targeted any subsequent voluntary distribution of resultant companies' share premium (which was of a capital nature), and which share premium was now deemed to be a dividend for income tax purposes. The result of deeming such share premium to be a dividend for income tax purposes was that tax became payable thereon when a resultant company decided to make a distribution thereof.⁸⁵

Moreover, I believe that while the first warning contained in the public announcement of 10 January 2007 that warned taxpayers that SARS was planning on investigating certain corporate entities which had 'elaborate structures' that led to impermissible tax losses was of a general nature,⁸⁶ both the warnings contained in

⁸²South African Revenue Service op cit note 54.

⁸³Johan Hattingh op cit note 78 at 289.

⁸⁴*Pienaar Brothers (Pty) Ltd* supra note 4 at 445.

⁸⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 445.

⁸⁶South African Revenue Service op cit note 51.

the Budget Speech and the subsequent press release statement of 21 February 2007 was of a more specific nature.⁸⁷ I am of the view that these specific warnings could be argued to have given taxpayers the impression that SARS had narrowed down their general warning of 10 January 2007 to the loss of dividend tax occasioned by the STC exemption contained in section 44(9) of the ITA.⁸⁸ This would be a reasonable conclusion to reach on the part of taxpayer, particularly when a general statement is followed by a specific one, the latter can be construed as being a specific clarification of the first general statement.⁸⁹ I further believe that the withdrawing of such exemption would furthermore have been the logical and reasonable response to the loss occasioned by section 44(9) of the ITA, and it was an action that both taxpayers and their legal advisors expected. At this point, if we liken this to the South African law of interpretation of statutes when trying to reason through legislation to uncover its true purpose, we are guided by the general context of legislation as a whole, the subject matter and the broad objects of the statute,⁹⁰ and that when a general intention is followed by a specific intention, that this specific intention is paramount importance in indicating what is meant by the legislation.⁹¹ In this case, a general intention to curb ‘impermissible tax loss’ followed by a warning that the section 44 of the ITA created a permanent loss of STC, gives taxpayers the impression that this specific section was the problem which SARS was looking into when they warned of ‘impermissible tax loss’ in the context of elaborate corporate structures.

⁸⁷South African Revenue Service op cit note 54.

⁸⁸ Ibid.

⁸⁹Botha C. *Statutory Interpretation: An introduction for students* 4 ed (2010).

⁹⁰*Pienaar Brothers (Pty) Ltd* supra note 4 at 450.

⁹¹Botha C. *Statutory Interpretation: An introduction for students* op cit note 89.

From this it becomes clear that the supposed prior warnings that needed to be taken into account when uncovering the true intention of the legislator when drafting such legislation, from an objective perspective, in no way gave taxpayers any proper warning that any subsequent voluntary distribution made by the resultant company of share premium would have been affected.⁹² This distribution was in any event of a capital nature, it was not a dividend as defined, and it rarely occurred. The only reason it occurred in the present matter was because the amalgamated company needed to achieve a slimmed down balance sheet so that the share price could be affordable for the prospective BEE buyers to buy into the Taxpayer.⁹³ This affordable share price could furthermore only be achieved if the share premium of the Taxpayer was accordingly distributed to its pre-existing shareholders.

Moreover, the second factor used in support of the court's conclusion that section 34(2) of the Amendment Act should be interpreted to apply to all transactions, including completed transactions, was the contention on the part of the that if the so-called loophole was not closed that there would have been '*a real risk that the national fiscus would have suffered extensive and permanent harm*'.⁹⁴ Here, we again see that although the legislature subjectively based its decision to make section 34(2) of the Amendment Act applicable to all transactions retrospectively on its belief that if this was not done that it would result in a real risk to the national fiscus as the so-called 'loophole' allowed companies to avoid paying STC; when we objectively consider this factor we discover that this was not necessarily the case.

⁹²*Pienaar Brothers (Pty) Ltd* supra note 4 at 467.

⁹³Johan Hattingh op cit note 78 at 289.

⁹⁴*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

According to Hattingh, such contention was not backed by empirical data and instead based on hearsay.⁹⁵ Fabricuis J also found it questionable that the existing law containing the so-called ‘loophole’ created ‘extensive and permanent harm’ to the fiscus, since the use of the term ‘harm’ presupposed ‘the loss of something already held’ and suggested that the fiscus was entitled to more tax than the law provided for at the time. He went further to state that this principle could not be applied to tax law as the fiscus was not entitled to more tax than what the law provided for at the time.⁹⁶ In line with Hattingh and Emslie’s argument, Fabricuis J stated that even if harm was a legitimate consideration, that there was no suggestion that in the five years since the enactment of section 44 of the ITA that any taxpayer had used it or that the fiscus suffered any loss.⁹⁷ If as SARS contended, the Shoprite/Brait transaction in late 2006 was the primary driver for the amendment, no actual loss of STC took place, and no such prejudice to the fiscus existed anymore.⁹⁸ Also, there was no concrete evidence of any other amalgamation transaction took place in the period between February 2007, the date of the initial formal warning, and August 2007, the date of the final enactment, nor that there was any ‘flood of section 44 amalgamation transactions’ during this time.⁹⁹

Taking this argument further, Emslie and Hattingh’s commentaries are quite relevant here. Hattingh questions whether the Rule of Law could really mean and allow organs of state who draft legislation to act on hearsay to enact overbroad measures to achieve their objectives, and whether this is a rational response by the legislature

⁹⁵Johan Hattingh op cit note 78 at 290.

⁹⁶*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

⁹⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

⁹⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 481.

⁹⁹*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

at all.¹⁰⁰ He further questions whether this could mean that as soon as members of the legislature are able to make such reasonable inferences based on hearsay (with no empirical data to support their assumptions), that the Rule of Law no longer had any constraining effect on the decision to enact retrospective law; and whether this meant that the Rule of bad law is possible as long as the organ of state drafting the law is able to show a thin basis for rationality in the decision to draft the law, however ill-informed.¹⁰¹ In this regard, and although I do agree with Hattingh's contention that the anticipated tax avoidance that brought about the use of such retrospective amendment never in fact materialised, and that such tax avoidance concerns were brought about by hearsay, I do not believe that the legislature should always need to prove an actual financial loss supported by empirical data to be able to address loopholes in the law.¹⁰² In justification for this point, I rely on contentions put forward by SARS and accepted by Fabricius J that '*parliament is not required to wait for iron-clad evidence before it enacts to prevent damage to the fiscus*' and that it would be perfectly appropriate for parliament to act proactively to avoid any such damage feared.¹⁰³ To expect the opposite, would be too rigid a route to comply with the flexibility needed by parliament to govern effectively and to ensure the effective running of South Africa. In any event, the problem in this particular case was not the fact that the legislature chose to amend section 44 of the ITA without empirical data, but rather that they were allowed to do so in a manner which violated the highly held principle of legal certainty.

¹⁰⁰Johan Hattingh op cit note 78 at 289.

¹⁰¹Ibid.

¹⁰²Ibid.

¹⁰³*Pienaar Brothers (Pty) Ltd* supra note 4 at 481.

In *CSARS v NWK Ltd*¹⁰⁴ the court set out this constitutional right to legal certainty in the law and that it would be prejudicial and unfair to taxpayers to impose tax *ex post facto* on completed transactions, ‘*since taxpayers have a well-established right to know what the law proposes and then to arrange their affairs in a manner that would attract the least amount of tax possible*’.¹⁰⁵ On this basis, Emslie similarly provides compelling criticisms of Fabricius J’s judgment of the case, where he disagrees with the court’s reasoning and decision. He began such criticism by stating that the application of retrospective legislation to completed transactions displayed a clear disregard of the taxpayer’s rights under the Constitution, particularly the principle of the Rule of Law, and that such disregard signifies and embodies an absence of tax morality.¹⁰⁶ According to Emslie, tax authorities are quick to complain about the absence of tax morality on the part of taxpayers, but forget that the same principle applies where such tax authorities argue for the retrospective application of legislation to completed transactions.¹⁰⁷ On this basis and in line with both Hattingh and Emslie’s commentary, it cannot be a reasonable response on the part of the legislature, in a constitutional democracy such as South Africa, that the organs of state responsible for drafting legislation is allowed to violate the principle of legality by enacting retrospective legislation based on a supposed warning which did not actually warn taxpayers of that which was finally enacted. Why were overbroad measures used to achieve the objective of closing the so-called loophole contained in section 44 of the ITA retrospectively when the problem could have been addressed prospectively instead? This latter route would have been more in conformance with the values espoused in the Rule of Law, and would have afforded

¹⁰⁴2011 (2) SA 67 (SCA) para 42.

¹⁰⁵*CSARS v NWK Ltd* supra note 104 at 42.

¹⁰⁶Trevor Emslie op cit note 34 at 62.

¹⁰⁷*Ibid* at 62.

taxpayers the opportunity to know what the law proposed, and then be able to arrange their affairs accordingly.

In line with this argument and Fabricius J's reasoning in the case, Hattingh criticises the approach taken by the relevant taxing authorities as SARS made no mention of the possibility of assessing the Taxpayer's transaction on the basis of using the anti-avoidance measures already provided for the ITA, such as the statutory GAAR, nor was the feasibility into such an approach even inquired into by the relevant Parliamentary bodies.¹⁰⁸ On the basis, I agree with Hattingh when he questions whether it would it would not be more rational to have first inquired into the feasibility of this route, and then to wait and see if the revenue administration was at all capable of using its already wide powers provided for under the statutory general anti avoidance rule to address actual tax avoidance arrangements, or was such an option not considered at all because it was common cause that the factual background suggested that the completed transactions were *bona fide*, and was entered into merely to introduce BEE into its ownership, and not to evade tax.¹⁰⁹ As mentioned above, I believe this criticism to hold much relevance, particularly because of the general nonconformist and unsophisticated manner in which the court dealt with the pivotal constitutional value of the Rule of Law. I believe that the relevant authorities should perhaps have looked into the feasibility of using the anti-avoidance provisions already provided for, prior to just opting for the extreme approach of making the amendment retrospective. I say this because from the *Pienaar Bros* case it becomes clear that there was no other amalgamation

¹⁰⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

¹⁰⁹Trevor Emslie op cit note 34 at 62.

transactions that took place between the period of the press release warning and the formal amendment on 8 August 2007, and that if it was possible for the relevant tax authorities to ‘catch’ the Taxpayer by using already existing anti-avoidance provisions, then this should rather have been the starting point. No such attempt or inquiry into this route was even made. These possible alternative routes becomes even more important in the light of the already existent problem of tax morality in South Africa, as indicated by Emslie in his critique of the case.¹¹⁰ Having researched this concept further, and based on Emslie’s correct criticism statement that SARS is always quick to use tax morality to further their agenda, I agree that taxpayers need to be given hope in the system again, and that the retrospective application of legislation could have been avoided altogether if the statutory anti-avoidance provisions had been considered. Tax morality is an obvious concern and a concept that has gained much popularity lately, and was even mentioned by our current President Ramaphosa in his 2018 State of the nation address.¹¹¹ The Commissioner of SARS is also in particular is known to have referred our courts to the concept on numerous occasions, an example of which was in the case of *Hindry v Nedcor Bank and another*¹¹² where the Commissioner stated that:

[T]he (Income Tax) Act provides, to a great extent, for a system of self-assessment insofar as the South African Revenue Service has to rely on taxpayers for information on which final assessments are based. The necessity, therefore, of a high tax morality is obvious.

¹¹⁰Ibid.

¹¹¹“Tax morality”. Fin24.2018. Available at <https://www.fin24.com/Budget/treasury-to-focus-on-tax-morality-administration-as-income-tax-is-left-largely-unchanged-20180221>, accessed on 18 May 2018.

¹¹²[1999] 2 All SA 38 (W).

Furthermore, while I do believe that it is the mandate of SARS to collect as much tax as legally possible for the effective running of South Africa, in accordance with Hattingh's commentary,¹¹³ as with any organ of state, I believe that accountability and transparency is very important to ensure that there is no use of arbitrary power. In a taxation context, the Rule of Law acts as the fundamental constraint against the abuse of state power, and it is given practical effect by regulating how the state uses its coercive power to raise funds from its citizens.¹¹⁴ On this basis, I believe that if the taxing authorities had been made aware of the fact that section 44(9) of the ITA allowed for a permanent loss of STC as opposed to a mere deferral thereof through the Shoprite/Brait transaction in late 2006, that they then had ample time to thoroughly investigate the different ways that this loss of tax could occur, and to develop effective means in which such possibilities could be addressed. If this had been done, would it have been possible for the taxing authorities to announce a well-thought through warning (general or specific) in order to properly put taxpayers on guard for perhaps an 'impermissible' loss of tax occasioned by section 44 amalgamation transaction provision generally. If this were the case, would I be more inclined to entertain SARS's contention that the Taxpayer should have taken heed of such warnings when planning its affairs, and that they should retrospectively be held liable for the tax imposed *ex post facto* on its completed transaction.

However, despite the fact that no organ of state's power is unrestrained, the *Pienaar Bros* case makes it appear as if SARS is conveniently allowed to make any general and specific public statements, without having thoroughly investigated an issue at

¹¹³Johan Hattingh op cit note 78 at 289.

¹¹⁴*Ibid.*

hand, and regardless of whether or not the effect of such warning would conflict with the principle of legal certainty. It appears further as if SARS will then receive favourable treatment from the courts because of the assumption that the loss of tax would result in a real risk that the national *fiscus* would suffer extensive and permanent harm. Also, I do agree with Hattingh's comment that the judgment creates the perception that the '*Rule of Law in the context of the case exists to protect the state against corporate citizens under the heading 'Retrospective legislation, a necessary tool for modern government'*'.¹¹⁵

Surely, this cannot be true in a democratic state such as South Africa. Surely representatives of the taxing authorities' should be responsible and accountable for their actions. If SARS was concerned with the 'impermissible tax loss' when they made the statement on 10 January 2007, and then on the 21 February 2007 they narrowed down such concern to the loss of STC occasioned by section 44 of the ITA and that they intended on remedying it by withdrawing the exemption contained in section 44(9) of ITA, then they should be held to the warning they gave.

Having said this however, while I do acknowledge the need for flexibility to allow for the true inclusion of recommendations attained through the process of public participation, I believe that if the press release and Budget Speech warnings were thoroughly thought through, that the amendment in the present case could have been giving effect to without violating the principle of the Rule of Law. Also, I believe that if the court on this occasion took the strict approach and afforded the Taxpayer protection under the Rule of Law and the principle of legal certainty that it would

¹¹⁵Johan Hattingh op cit note 78 at 290.

act as a warning to SARS to act responsibly and accountably to the decisions they make, particularly when it comes to something as serious as making laws retrospective based on warnings given in a press release statements. As mentioned above, I agree with Emslie's contention that taxpayers need to be given hope in the system again, particularly because of the already existent problem of tax morality.¹¹⁶ This concept is in any event based on the social contract between taxpayers and the state, where the state depends on the obedience and conformity of the taxpayers to pay their taxes and to act in accordance with the law, so that the state can govern effectively.¹¹⁷ Here, *'taxpayers and citizens are generally allowed to claim the protection of the Rule of Law principle because they accept this undisputed authority of the state'*.¹¹⁸

As discussed above, another point which I found very interesting was the contention by Emslie that the judgment espoused an absence of tax morality, a concept that seemed to have gained much popularity lately. This concept of 'tax morality', and the absence thereof, can also be viewed in accordance with that which Emslie highlighted in this commentary, particularly the manner in which taxpayers who made use of the so called 'loophole' were described as being 'unscrupulous taxpayers'.¹¹⁹ In this regard, I agree with Emslie's contention that the fault does not lie with taxpayers when they are well within their rights to arrange their affairs in such a way that they pay the least amount of tax possible. Tax avoidance in this regard is not unlawful, and the Taxpayer did not 'exploit' or 'undermine' the ITA and its provisions by acting within the boundaries set by law. In such an instance,

¹¹⁶Trevor Emslie op cit note 34 at 62.

¹¹⁷ Johan Hattingh op cit note 78 at 290.

¹¹⁸Johan Hattingh op cit note 78 at 290.

¹¹⁹Trevor Emslie op cit note 34 at 62.

one would think it reasonable for taxpayers to complain if the tax authorities decided to ‘take remedial action’ against their lawful conduct. Also, Fabricius J also commented in a similar vein to the SARS’s argument that if the legislation was not made retrospective, that the fiscus would suffer ‘extensive and permanent harm’, by stating that ‘harm’ in this sense *‘presupposes the loss of something already held, [and this] suggests that the fiscus is in fact entitled to more tax than the law provides’*.¹²⁰ This can never be true. Furthermore, reference can be made to the first public statement of the 10 January 2007 which warned taxpayers that the Treasury intended to close the loophole in the ITA, and that *‘certain corporate transactions were structured in such a way that they show complete and reckless disregard for tax morality and South African Tax Law’*.¹²¹ It gave notice that it was *‘to carefully examine these transactions in order to ensure that no impermissible tax loss occurs’*, and that it should be noted that *‘the architects of certain tax aggressive structures will not be permitted to abuse South African tax provisions in ways clearly unintended by the legislature’*.¹²²

Here, and in accordance with Emslie’s contentions, the use of the concept of ‘tax morality’ was conveniently cited by the taxing authorities as supporting their claim, and the ‘loss’ referred to is described as being ‘impermissible’, which regardless of whether or not the initial section 44 of the ITA was intended to result in a tax loss, such loss, in terms of the bounds of the law, can never be impermissible. Tax avoidance in this regard is always the lawful option.¹²³ From this, I completely agree

¹²⁰*Pienaar Brothers (Pty) Ltd* supra note 4 at 471.

¹²¹South African Revenue Service op cit note 51.

¹²²*Ibid.*

¹²³“Tax avoidance and evasion” op cit note 30.

with Emslie’s statement above, as it seems as if all those who are on the side of the relevant taxing authorities, need to be reminded that they too are bound by the Rule of Law and that their actions should also embody the necessary ‘tax morality’ they so often advocate.

Furthermore, in trying to make sense of the Fabricuis J’s unorthodox application of the Rule of law in the present matter, Hattingh provided a further interesting interpretation thereof and suggested that the judgment could be read as implying that ‘*a special approach applies in perceived tax avoidance cases that exonerates the state from the confines of the rule of law to permit the use of retroactive taxing measures*’, of which there would be several obvious concerns with.¹²⁴ As a start, he explains that such retroactive taxing measures should only be used as an exceptional measure, and the conditions for its invocation needs to be clearly stipulated and explained. To Hattingh, this would arguably require a development in the law ‘*which is reserved only for the highest courts pursuant to the rule of precedent*’.¹²⁵ This argument is accordingly of particular importance against the problematic reality of tax morality and the importance of the principle of legal certainty. This understanding would also be more in conformance with the right to legal certainty as it would provide taxpayers with the knowledge of what the law proposed prior to them planning their affairs.

3.2. Analysis of the Constitutional Issue:

¹²⁴Johan Hattingh op cit note 78 at 291.

¹²⁵Ibid.

With regards to the Taxpayer's constitutional issue, I am of the opinion that the court incorrectly dismissed this leg of the Taxpayer's claim, and that on the facts of this particular case, that section 34(2) of the Amendment Act, to the extent of its retrospectivity, is invalid on the grounds that it is inconsistent with the Rule of law.

The starting point of this leg of the analysis was that section 1(c) of the Constitution,¹²⁶ read with section 2 thereof, makes the Rule of Law one of the foundational values of our Constitution, and that any law inconsistent with it is invalid.¹²⁷ Here the Taxpayer argued that the Rule of Law obliges government to act in accordance with laws that are reasonably clear, accessible and prospective in their operation, and that laws should not be structured in wide terms, but rather be precise and clear, otherwise a decision by discretion is imported.¹²⁸ This is particularly the case because in line with the case authority postulated in *Dawood*,¹²⁹ taxpayers have no fair chance of knowing and predicting their rights and the manner in which they would need to regulate their affairs to pay the least amount of tax possible if laws are applied retrospectively to the disadvantage of people. Hattingh similarly uses this important component of the Rule of Law doctrine, the right to legal certainty, in his argument and defines it as follows:

[L]egal certainty is essential to an ordered society and manifest in several ways. It impacts the content of laws so that legislators are required by the rule of law to design legislation that enables citizens to know and to predict their rights on an upfront basis with precision. Further, certainty under the rule of law suggests that laws should take effect for the future, otherwise citizens will not be able to know what their rights are or how to plan their conduct.¹³⁰

¹²⁶The Constitution of the Republic of South Africa of 1996.

¹²⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 472.

¹²⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 472.

¹²⁹*Dawood and Another v Minister of Home Affairs* 2000 (2) SA 936 (CC) at para. 47.

¹³⁰Johan Hattingh op cit note 78 at 288.

However, as mentioned above despite the starting point being the inquiry of whether or not the retrospectivity would amount to the contravention of the Rule of Law principle itself, Fabricius J correctly qualified this general principle to state that the court was nevertheless entitled to investigate into the substance, nature and form of the transaction, which would not conflict with the Rule of Law values at all.¹³¹ In addition to this, the contextual circumstances that surrounded the statute and the facts that gave rise to it needed to be taken into account as well. This furthermore accords with the view espoused by both Fabricius J and Davis J who expressed that such context is everything in legal disputes.¹³² For Davis J while a vaguely drafted press release could in one context be argued to be not to be justified, the same press release could under different circumstances, be justified. This is of particular importance against the backdrop of fluidity and flexibility generally demanded by our economic circumstances.¹³³

At this point, I need to stress that I share some of the concerns highlighted by Hattingh and Emslie relating to the court's unusual reasoning and nonconformist approach to the very highly held Rule of Law doctrine espoused within our Constitution and the lack of tax morality therein.¹³⁴ Here, Hattingh's first criticism of the case was the non-conformist approach to the Rule of Law taken by the court.¹³⁵ In this regard, I agree with Hattingh when he states that the case made it appear as if

¹³¹*Pienaar Brothers (Pty) Ltd* supra note 4 at 460.

¹³²Dennis Martin Davis 'Retroactive legislation and completed transactions- another view' (2017) June 2017 *The Taxpayer* at 102.

¹³³Dennis Martin Davis op cit note 132.

¹³⁴Johan Hattingh op cit note 78 at 289; Trevor Emslie op cit note 34 at 62.

¹³⁵*Ibid.*

the Rule of Law had a completely different role to play than that of acting as a regulator of the uneven power relationship between citizens and the state, which principle is ultimately that which should prioritize a standard of order and fairness between the two.¹³⁶ Hattingh takes this perception further and states that the judgement makes it appear that the Rule of Law, in a tax context, is there to protect the state against the corporate citizens, and that such protection is different depending on whether it is a weaker natural person claiming its protection or a stronger corporate entity.¹³⁷

I furthermore also agree with Hattingh that another unusual feature of the judgement relates to the manner in which the court applied the review standard in trying to establish whether the Rule of Law principle was infringed and that it was as if the court assumed that public interests outweighed the private interest in this case.¹³⁸ Similarly to Dicey et al, as mentioned by Hattingh, I was left with the impression that the Rule of Law was a mere adornment, and that it needed to squirmed into whatever was needed to protect the ‘fiscus’ and the public interest.¹³⁹ This can be seen through statements made by Fabricuis J such as ‘*there is nothing internal in the rule of law which renders retrospective legislation per se unconstitutional*’ (at [102]), which directly contradict orthodox articulations by courts of the rule of law,¹⁴⁰ as in *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG*¹⁴¹ for instance, where it was stated as follows:

¹³⁶Ibid.

¹³⁷Ibid.

¹³⁸Ibid.

¹³⁹Ibid.

¹⁴⁰Ibid.

¹⁴¹[1975] 1 All ER 810 at 836, [1975] AC 591 at 638.

[L]ord Diplock said the following about the rule of law under the constitution of the United Kingdom: ‘The acceptance of the rule of law as a constitutional principle requires that a citizen, before committing himself to any course of action, should be able to know in advance what are the legal consequences that will flow from it.’ The late Lord Bingham wrote in his twilight years that ‘[...] the core of the existing principle of the rule of law: that all persons and authorities within the state, whether public or private, should be bound by and entitled to the benefit of laws publically made, taking effect generally in the future and publically administered in the courts’ (T Bingham, *The Rule of Law* (London 2010) 37) and the South African Constitutional Court has held that: ‘A person should be able to know of the law, and be able to conform his or her conduct to the law’ (*President of the Republic of South Africa v Hugo* 1997 (6) BCLR 708 (CC), 1997 (4) SA 1 (CC), para [102]).¹⁴²

Similarly, after having analysed the case I was also shocked by the bold approach taken by Fabricius J in stating that no warning needs to be given by the state to citizens of the possibility of retroactive tax legislation.¹⁴³ From my point of view, this ‘warning’, or the absence of thereof, was that which formed the most important determinant of whether or not the Rule of Law doctrine was breached in the present case. In disagreeing with Fabricius J, I am of the view that to state that no warning needs to be given to citizens of the possibility of retroactive tax legislation is unfair, as it is not just law that was unknown to the taxpayer but also law that was not in existence at the time the Taxpayer in question undertook the action.¹⁴⁴ Based on the very high value given to the principle of the Rule of Law, I could understand the need for flexibility and having a rebuttable presumption against retroactive legislation, but to state that no warning whatsoever needed to be given to warn taxpayers that they should anticipate a change clearly goes against the right to legal certainty.

¹⁴²Johan Hattingh op cit note 78 at 290.

¹⁴³Ibid.

¹⁴⁴Ibid.

With this principle in mind, Emslie similarly criticises the judgment and states that the application of the retroactive tax laws are in breach of the Rule of Law doctrine and that it disregards taxpayers' rights under such doctrine, particularly the right to legal certainty.¹⁴⁵ He goes further to state that this breach of the Rule of Law doctrine is even more serious when a warning given by press release that a 'loophole' in the law will be closed, as it falls short of the high standards espoused in our Constitution.¹⁴⁶ Davis J however criticizes these contentions as very strong criticisms, particularly the latter one.¹⁴⁷

In considering these opposing contentions, my stance is one that lies in between these two views. While I do agree with Emslie that the retrospective application of legislation in this particular case constituted a breach of the rights afforded to Taxpayer under the Rule of Law,¹⁴⁸ I do not extend my view to generally state that warnings given by press release that 'loopholes' will be closed retrospectively will always contravene the Rule of Law principle.¹⁴⁹ Here, I agree with Fabricuis J that the contextual circumstances that surrounded the statute and the facts that gave rise to it, as well as the substance, nature and form of the transaction needed to be taken into consideration when considering whether the Rule of Law had been breached.¹⁵⁰ Taking this further, I am of the view that in addition to these considerations, that future matters should be decided on a case-

¹⁴⁵Trevor Emslie op cit note 34 at 61.

¹⁴⁶*Ibid.*

¹⁴⁷Dennis Martin Davis op cit note 132.

¹⁴⁸Trevor Emslie op cit note 34 at 61.

¹⁴⁹*Ibid.*

¹⁵⁰*Pienaar Brothers (Pty) Ltd* supra note 4 at 467.

to-case basis so as to ensure that our courts do not act blindly and merely apply existing precedents which do not necessarily conform with the values espoused by the Rule of Law doctrine. With having said this though, I do acknowledge the principle of *stare decisis*, and the issues which applying future matters on a case-to-case basis could bring. Also, I agree with both Fabricuis J and Davis J that our economic circumstances generally demand a degree of fluidity.¹⁵¹

Here, in agreeing with the Taxpayer's contentions before the court and taking into account this demand for fluidity and flexibility, I am of the view that while the Rule of Law does lead us to a strong presumption that retrospective tax statutes are constitutionally invalid, that there could exist exceptions to this rule that would not necessarily attract constitutional sanction.¹⁵² In disagreement with Emslie's strict approach, I am accordingly of the opinion that warnings given by press release that so-called 'loopholes' will be closed retrospectively will not always violate the Rule of Law principle *per se*. There could exist exceptions which will not infringe on taxpayers' right to legal certainty. In this regard, I found Davis J's contentions that the context is everything in legal disputes relevant.¹⁵³ Here he found it difficult to understand why retroactive legislation '*which falls within the scope of a clearly worded press release and a draft Bill*' cannot be justified under the circumstances of the case.¹⁵⁴ This was especially problematic if there exists a so-called loophole in our tax legislation which would result in great economic loss to our fiscus if left open, and which would provide

¹⁵¹Dennis Martin Davis op cit note 132.

¹⁵²*Pienaar Brothers (Pty) Ltd* supra note 4 at 466.

¹⁵³Dennis Martin Davis op cit note 132.

¹⁵⁴*Ibid.*

taxpayers with the opportunity to abuse the existing ‘loophole’ if it was not closed retrospectively.¹⁵⁵ According to Davis J this could result in the government falling short of the amount of revenue it budgeted for and would force government to borrow more money. This would have a jeopardising long-term effect on the economy, as well as detrimental consequences on the society at large. On this basis, while I do agree with Davis J’s contention that a carefully drafted press release warning given to taxpayers that an existing ‘loophole’ in the law would be closed retrospectively (to the date of such warning) could in certain circumstances still pass legal muster, I do not believe that on the facts of this particular case, that this was the case. Unlike Davis J, I do not believe that a fair balance was struck in the present case, particularly because of the considerable difference between the initial warning and final enactment.¹⁵⁶

On the facts of this particular case however, I am of the view that if in accordance with SARS press release of 10 January 2007,¹⁵⁷ SARS public announcement in the Minister’s Budget Speech and the subsequent press release statement of 21 February 2007 continued to warn taxpayers that SARS was concerned with a general loss of tax occasioned by elaborate corporate structures which was unintended by the legislature, and narrowed down this to consideration of section 44 of the ITA generally (and the actual objective of the legislature in the first place), that I would have been more inclined to side with the taxing officials that the Taxpayer should be held liable for the loss of tax allowed through the use of

¹⁵⁵Ibid.

¹⁵⁶Ibid.

¹⁵⁷South African Revenue Service op cit note 51.

section 44 of the ITA, regardless of whether or not the income had changed its nature and been converted into capital. In my opinion, such a warning would have sufficiently put taxpayers on guard that the taxing officials were intending to align this section with the legislature's actual intention when drafting the provision, that is, to provide a deferral of STC as opposed to a loss of STC. In my opinion, such a warning would be both specific enough to cover any loss of tax occasioned by section 44 of the ITA, and general enough to catch this change in nature from income to capital. If such a warning was given, the Taxpayer's right to legal certainty would not have been infringed, and the Taxpayer's expensive legal advisors would have advised it of the risk of its distribution being subjected to tax.¹⁵⁸

As a side point however, I have to point out that it is unfortunate that in the present matter, the Taxpayer's objective was to achieve a *bona fide* BEE element into its ownership.¹⁵⁹ The only way that this could be possible in the present matter was if the share price was affordable to the prospective BEE buyers, which could only be done if the Taxpayer (the resultant company after the amalgamation transaction) distributed the income tied up in its share premium account.¹⁶⁰ It is truly unfortunate that STC was levied on this distribution, since the distribution was aimed at enabling the empowerment of vulnerable and needy black South Africans.

¹⁵⁸Dennis Martin Davis op cit note 132.

¹⁵⁹*Pienaar Brothers (Pty) Ltd* supra note 4 at 448.

¹⁶⁰Johan Hattingh op cit note 78 at 290.

Moreover, when considering the considerable distance between the initial warning proposing the withdrawal of section 44(9) of the ITA, as opposed to the actual final enactment, which inserted a new section 44(9A), Fabricius J reasoned through his decision to hold the Taxpayer *ex post facto* liable for STC on its voluntary distribution by stating that if SARS had nevertheless implemented its original plan of withdrawing section 44(9) of the ITA, that the amalgamated company's distribution of the consideration shares to its shareholders would in any event have been subjected to STC.¹⁶¹ Fabricius J went further to state that the net effect of the actual change on the other hand was merely that the amalgamated company would no longer be held liable for STC on its consideration shares, but rather that the Taxpayer (the resultant company) now became liable on the distribution of its newly acquired share premium.¹⁶² To me, this reasoning completely misses the point.

The right to legal certainty enables citizens generally to know and to predict their rights on an upfront basis with precision in order for them to know and understand what the law prescribes, and how to plan their conduct accordingly to attract the least amount of tax possible.¹⁶³ In line with this principle, if the final enactment maintained the exemption of section 44(9) in the ITA, as initially proposed in the Budget Speech and press release statement of 21 February 2007, would the Taxpayer's right to legality certainty have been upheld, as it would have been given ample warning of the prospective change being implemented

¹⁶¹*Pienaar Brothers (Pty) Ltd* supra note 4 at 482.

¹⁶²*Pienaar Brothers (Pty) Ltd* supra note 4 at 482.

¹⁶³*Pienaar Brothers (Pty) Ltd* supra note 4 at 460.

retrospectively. In accordance with Davis J's commentary, the Taxpayer's 'expensive legal advisors' would in this regard have advised it that regardless of it acting *bona fide* to achieve a BEE ownership objective, that their distribution would most definitely have been *ex post facto* subjected to STC.¹⁶⁴ Here, I would have agreed that the Taxpayer would have been given ample notice of the prospective change and that it should have been held liable for the payment of STC on the distribution of its consideration shares. However, when we consider values under the right to legal certainty, we cannot justify holding the Taxpayer liable for STC under section 44(9A) of the ITA merely because it would in any event have been liable for STC if the initial withdrawal of section 44(9) of the ITA had been given effect to. While the latter was that which was warned of in the forewarnings, and that which accordingly upheld the values espoused in the Rule of Law, the former amendment was not warned of, and did accordingly not comply with the values espoused by the Rule of law.

Furthermore, in relation to the extensive foreign law authorities cited as persuasive authority as guidance for the court, I was left flabbergasted as to how Fabricius J just randomly cited foreign cases that clearly disregarded the Rule of Law.¹⁶⁵ An example hereof was in his consideration of the Taxpayer's interpretational argument, where he cited the Supreme Court of Canada where it was stated as follows:

[N]o one has a vested right to continuance of the law as it stood in the past; in tax law it is imperative that legislation conform to changing social needs and governmental

¹⁶⁴Dennis Martin Davis op cit note 132.

¹⁶⁵Johan Hattingh op cit note 78 at 289.

policy. A taxpayer may plan his financial affairs in reliance on the tax laws remaining the same; he takes the risk that the legislation may be changed.¹⁶⁶

As if this wasn't bold enough, Fabricuis J took this idea further and condoned a similar principle from the American Supreme Court where Justice Blackmun stated that '*tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code*'.¹⁶⁷ In this regard, it was stated that retrospective changes may seem to be unfair to certain persons or institutions, but that in the context of tax statutes specifically, that the fiscus needed to be flexible to be able to function effectively by taking into account changing demands of society.¹⁶⁸ This clearly gives one the impression that the Rule of Law seems to be applied differently depending on the person claiming its protection.

Taking this argument further, the proposition put forward by Hattingh was that while there was an extensive list of cited authorities from all around the globe, there was no general rule that prohibited tax legislation, and that any authority was cited regardless of whether it undermined our Rule of Law principle or not.¹⁶⁹ Furthermore, I agree with his contention that there was no method set out for analysing such extensive comparative foreign law authorities, and that it seemed to be a random choice of whatever authorities supported the parties' stance.¹⁷⁰ Hattingh states further that instead of the mere juxta positioning of such extensive list of foreign law authorities that the court should have honed in on the position of German

¹⁶⁶*Gustavson Drilling (1964) Ltd v M.N.R. [1977] 1 S.C.R. 271 at 283.*

¹⁶⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 476.

¹⁶⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 476.

¹⁶⁹Johan Hattingh op cit note 78 at 287.

¹⁷⁰*Ibid* at 292.

law, as South African post-apartheid constitutional order was modelled on the German constitutional dispensation.¹⁷¹

I agree with this contention, and similar to the position in South Africa, Fabricius J discussed Germany's ban on the retrospective application of legislation, with certain exceptions.¹⁷² However, when considering Davis J consideration of the German Law position regarding such retrospective application of legislation, this is not necessarily favourable to the Taxpayer's argument.¹⁷³ Here Davis J considers jurisprudence from the German Constitutional court which sets out the difference between retroactivity and retrospectivity. A statute, in this regard, has retroactive effect when it applies to transactions that would be completed before the new Act came into effect, and the law would alter the legal consequences before it came into existence. Retrospectivity applies when the new law applies to transactions that have begun but that which have not yet been finalised.¹⁷⁴ Here, the court goes on the assumption that retroactive laws are prohibited, while the retrospective counterpart is generally permitted. However, a further nuance that Davis J highlighted was in the context of specifically defined and designated tax years, where retroactivity only applies if the law being considered is passed in the following year; that is to say that it will apply to the previous tax year regardless of when in that year it was introduced.¹⁷⁵ Applying this to the present case, Davis J argued that the Taxpayer in the present matter's 'entire saga' took place within the same tax year, and that this particular

¹⁷¹Ibid.

¹⁷²*Pienaar Brothers (Pty) Ltd* supra note 4 at 477.

¹⁷³*Pienaar Brothers (Pty) Ltd* supra note 4 at 477.

¹⁷⁴*Pienaar Brothers (Pty) Ltd* supra note 4 at 477.

¹⁷⁵Dennis Martin Davis op cit note 132.

distinction drawn by the German jurisprudence would be fatal for the Taxpayer's argument.¹⁷⁶

Moreover, the constitutional right to legal certainty in the law affords taxpayers have a well-established right to know what the law proposes *and then to arrange their affairs in a manner that would attract the least amount of tax possible*'.¹⁷⁷ Based on this principle, and in accordance with the considerable distance between the initial warning and the final enactment, I have to disagree with Davis J's view that the Taxpayer ought to have known that the final amendment would have affected their amalgamation transaction in some or other way, and that if they really did not know that such amendment would have affected their transaction, that their legal advisors should have known, and should have advised them accordingly. When considering how different the initial warning was compared to the final amendment, I do not believe that the Taxpayer or their legal advisors should have been concerned with the subsequent voluntary distribution of the resultant company's share premium. In any event, as mentioned above, this share premium is of a capital nature and not a dividend as defined for income tax purposes. To expect this of the Taxpayer would go completely against the principle of legal certainty and would in essence require the Taxpayer to structure their affairs based on a hypothetical situation that might or might not have materialised. Instead, acting upon legal advice, the Taxpayer took into consideration the existing law at the time, as well as the warnings that section 44(9) of the ITA would be withdrawn because the compulsory distribution led to a loss of STC as opposed to a mere deferral thereof, and structured its affairs in a way

¹⁷⁶Ibid.

¹⁷⁷*Pienaar Brothers (Pty) Ltd* supra note 4 at 451.

that would achieve its BEE objective with the least amount of tax possible.¹⁷⁸ I therefore believe that any competent legal advisor would have advised the Taxpayer to go-ahead with its transaction without the concern that their transaction would be subjected to STC.

In this present case, after having considered all the relevant contextual and factual background, I believe the court correctly applied the rationality test as it is the test to apply when the law in question does not infringe upon rights espoused in the Bill of Rights, and because it is the standard which applies to all legislation under the Rule of Law as entrenched in section 1(c) of the Constitution.¹⁷⁹ More importantly, it is this enquiry that is used to decide whether an action passes constitutional muster in terms of the Rule of Law doctrine.

In accordance with the Taxpayer's argument before the court, I do not believe that any warning was given to the Taxpayer prior to the final enactment of in August 2007. Here, I disagree with Davis J who is of the opinion that sufficient warning was given to the Taxpayer of the relevant taxing authorities' intention to address the unintended loss of STC caused by section 44, particularly by the Minister of Finance in his Budget Speech of 21 February 2007, and then again in a press release on the same day.¹⁸⁰ On this basis, and alongside the right of taxpayers generally to legal certainty, I am of the opinion that the retrospective application of section 44(9A) of

¹⁷⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 451.

¹⁷⁹*Pienaar Brothers (Pty) Ltd* supra note 4 at 480.

¹⁸⁰Dennis Martin Davis op cit note 132.

the ITA is unconstitutional, and that should this matter be taken on appeal that there would be a high probability of the current decision being overturned.

CHAPTER FOUR

4. Conclusion:

As can be seen from above, the Pienaar Brothers (Pty) Ltd case is of great importance in our constitutional dispensation as it is anticipated to be the test case on the constitutionality of retrospective tax legislation, particularly regarding the technique the court used to work through the retrospective tax law changes, and the way it fixed the effective date of future amending legislation by press release.¹⁸¹ In this regard, the case provided us with guidance and jurisprudence in an area in South African tax law that is already plagued with much debate and uncertainty.¹⁸²

From the above we see that the amalgamated company main intention was to introduce a BEE element of ownership into its company in a tax efficient manner. Upon consulting their legal experts they were advised that the best manner in which they could achieve this objective was to enter into an amalgamation agreement in terms of

¹⁸¹Johan Hattingh op cit note 78 at 290.

¹⁸²Brink, J and Brincker, E op cit note 2.

section 44 of the ITA. At this particular time, the law was structured in a way in which it was possible to achieve this objective in a tax efficient matter, particularly because any distribution made by parties to the amalgamation transaction would be tax free. The problem however was that the taxing authorities never intended the section 44 of the ITA amalgamation process to be STC free, and instead intended a temporary deferral thereof. To address this, the taxing authorities accordingly started putting mechanisms in place to limit the loss of such STC.¹⁸³ With hindsight however, the reality was that there existed considerable distance between the fore-warnings given by the taxing officials and the final enactment, as the forewarnings warned taxpayers that they intended on withdrawing the STC exemption, while the actual enactment retained this exemption and instead unusually sought to tax a voluntary subsequent distribution made by the resultant company to the amalgamation transaction.¹⁸⁴ The Taxpayer's problem in the present matter arose in 2011 when SARS sought to tax the Taxpayer on its May 2007 completed transaction, particularly its distribution of its share premium at the time. In addition to this assessment, SARS furthermore also levied interest on such outstanding STC payment from 8 August 2007, the date on which the final enactment was promulgated into law. This was that which accordingly prompted the Taxpayer to bring its matter before the High Court. Here, the prime relief sought by the Taxpayer was an order of constitutional invalidity, while the second order, couched as an alternative to the first was an interpretational argument which had the effect that section 44(9A) of the ITA did not apply to Taxpayer's distribution when it was made because it was a completed transaction.¹⁸⁵ The gist of the

¹⁸³*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

¹⁸⁴*Ibid.*

¹⁸⁵*Pienaar Brothers (Pty) Ltd* supra note 4 at 443.

Taxpayer's constitutional issue requested of the court to declare that the provision did not pass constitutional muster to the extent of its retrospectivity.

Furthermore, one of the important factor highlighted by this analysis was the fact that context is everything in legal disputes.¹⁸⁶ On this basis Davis J argued that while a vaguely drafted press release could in one context be argued to be not to be justified, the same press release could under different circumstances, be justified. This is of particular importance against the backdrop of fluidity and flexibility generally demanded by our economic circumstances. In this regard, and after having considered all the relevant facts of this case, alongside the values espoused in the Rule of Law doctrine within our constitutional dispensation, we see that the content of the forewarnings, and the subsequent content of the Draft Bill of 27 February 2007, was paramount to my decision that the court incorrectly held in favour of SARS. In agreement with Hattingh that there existed considerable distance between the initial warnings and the final enactment.¹⁸⁷ On this basis, and in disagreeing with Davis J, I argued that it was as if no warning at all was given to the taxpayers that section 44(9) of the ITA would be changed in the manner in which it was, and more particularly that such amendment would be retrospective in its operation. From my point of view, this goes completely against citizens and taxpayer's rights to legal certainty, and accordingly violates the Rule of Law.

Furthermore, in conformance with the Taxpayer's approach, I agree that regardless of the existence of a general presumption against the retrospective application of legislation that there could exist exceptions to this rule that will not attract

¹⁸⁶Dennis Martin Davis op cit note 132.

¹⁸⁷Johan Hattingh op cit note 78 at 290.

constitutional sanction.¹⁸⁸ Here I believe that against the backdrop of fluidity required by our government for the effective running of our country that one such exception would be if a proper warning of such change in the law was given and that such change would be made retrospective. The extent and detail of such warning is however debatable, but in the present case, I believe that following the general forewarning of 10 January 2007, that if the warning of the 21 February 2007 contained a further general warning that warned taxpayers that because section 44 of the ITA allowed a loss of tax as opposed to a mere deferral thereof, that the taxing authorities intended on aligning such provision with their initial intention, that I would have been more inclined to argue that it was general enough to cover any types of loss of tax, and specific enough to loss occasioned by section 44 of the ITA, in order to conform with the Rule of Law. If this were the case, would legal advisors have warned the Taxpayer of the risk entailed in proceeding with their transaction. To me, this warning would have accorded with the right to legal certainty and would accordingly have passed constitutional muster.

Furthermore, I agree with Hattingh's contentions that the case gave off the impression that the Rule of Law existed to protect the state against corporate citizens, and that it was as if the doctrine was a mere adornment in our constitutional democracy.¹⁸⁹ At this point, tax morality comes to the fore, which term is based on an agreement between the government and its citizens that in exchange for its protection and accountable governing, that taxpayers would pay their taxes. In accordance with Davis J' views however, I agree that this judgment does not help our current problematic

¹⁸⁸*Pienaar Brothers (Pty) Ltd* supra note 4 at 466.

¹⁸⁹Johan Hattingh op cit note 78 at 290.

status of tax morality, particularly because of the non-conformist matter in which the court dealt with the Rule of Law, and the values espoused thereby.

Furthermore, I agree with Emslie that the Taxpayer did not ‘exploit’ and act unscrupulously when it made use of the so-called ‘loophole’ in the law at the time, and that such argument is fundamentally flawed. In the *Commissioner for Inland Revenue v King*,¹⁹⁰ Schreiner JA stated that there exists a ‘general scope of the Act’, which is expanded when the act is amended. Here he explained that this did not mean that a ‘loophole’ which previously existed implied that the Act meant something other than what was stated and that taxpayers took advantage of this provision in order to subvert what was intended all along. Taxpayers are well within their rights to arrange their affairs in a manner in which they can pay the least amount of tax possible.

Furthermore, I noted that it is unfortunate the Taxpayer’s objective in the present matter was merely to achieve a *bona fide* BEE element into its ownership,¹⁹¹ and the only way that this could have been possible was if the share price was affordable to the prospective BEE buyers. This could only have been done if the Taxpayer (the resultant company after the amalgamation transaction) distributed the income tied up in its share premium account.¹⁹²

It is unfortunate the Taxpayer in this particular case opted not to appeal its loss to the Constitutional Court as the expected costs that it would have incurred would have outweighed its tax liability.¹⁹³

¹⁹⁰1947(2) SA 196 (A).

¹⁹¹Johan Hattingh op cit note 78 at 289.

¹⁹²Ibid at 290.

¹⁹³Ibid.

In the light of the above, I am of the view that should this matter be taken on appeal that there would be a high probability of the current decision being overturned.

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