REPORTABLE

REPUBLIC OF SOUTH AFRICA

TAX COURT

HELD IN CAPE TOWN

Case No **12432**

In the matter between:

TLD LIMITED Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

Court: GRIESEL J

Heard: 18, 19, 20 &21 October 2010

Delivered: 16 November 2010

JUDGMENT

GRIESEL J:

[1] This is an appeal against an additional assessment raised by the respondent ('the Commissioner') in terms of s 79 of the Income Tax Act 58 of 1962. The assessment is based on a taxable gain which, according to the Commissioner, arose from a deemed disposal by the appellant of an asset during the 2003 tax year.

Factual background

[2] The appellant is an investment holding company, incorporated in South Africa, with its registered office at Industria, South Africa. It is listed on the Johannesburg Stock Exchange.

[3] During the tax year under consideration the appellant's only relevant asset was its 100% shareholding in TDO Hld Limited. The latter company, in turn, owned 100% of the shares in TDO Limited, a company incorporated in Guernsey, which owned approximately 65% of the issued share capital in the UK based company, ABC plc.

[4] On 2 July 2002, at a meeting of the appellant's board of directors in Luxembourg, it was resolved that all further board meetings would be held in that country. This had the effect that, as from 2 July 2002, the appellant became effectively managed in Luxembourg and liable for tax in that country.

[5] After that date, the appellant maintained a presence in South Africa in the person of one of its executive directors, Mr M, who continued to perform certain functions on behalf of the appellant from its registered office in Industria until 29 January 2003, when he left South Africa in order to relocate to Europe.

[6] Notwithstanding the relocation of the seat of the appellant's effective management to Luxembourg with effect from 2 July 2002, the appellant remained a 'resident' of the Republic for purposes of the Act by reason of para (b) of the definition relating to any 'person (other than a natural person) which is incorporated, established or formed in the

Republic. . .' This status changed with effect from 26 February 2003, when the following words were added to the definition:

> *'but does not include any person who is deemed exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation'.*[1]

[7] It is thus common cause that –

- by 2 July 2002 the appellant became effectively managed in Luxembourg;
- by 29 January 2003 (with the relocation of Mr M) any permanent establishment which the appellant might have had in the Republic up to that date ceased to exist;
- by 26 February 2003 the appellant ceased to be a resident of the Republic.

Commissioner's grounds of assessment

[8] Based on the foregoing facts, the Commissioner contended that when the appellant ceased to be a resident of the Republic, it is deemed to have disposed of all its assets (in this instance, its shareholding in TDO Hld Limited), resulting in a capital gain being realised in the 2003 year of assessment. In support of these contentions, the Commissioner invoked the provisions of para 12 of the Eighth Schedule to the Act ('the Schedule'):

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[1] Inserted by s 33(1) of Act No 12 of 2003, deemed to have come into operation on 26 February 2003.

> '**12. Events treated as disposals and acquisitions**. – *(1) Where an event described in subparagraph (2) occurs, a person will be treated for the purposes of this Schedule as having disposed of an asset described in that subparagraph for proceeds equal to the market value of the asset at the time of the event and to have immediately reacquired the asset at an expenditure equal to that market value. . .*
>
> *'(2) Subparagraph (1) applies, in the case of –*
>
> *(a) a person who ceases to be a resident, or a resident who is as a result of the application of any agreement entered into by the Republic for the avoidance of double taxation treated as not being a resident, in respect of all assets of that person other than assets in the Republic listed in paragraph 2(1)(b)(i) and (ii); . . .'*

[9] For these provisions to be triggered, a number of requirements must be satisfied, namely -

(a) an 'event', as contemplated by para 12(1) of the Schedule, must have occurred;

(b) the appellant must have ceased being a 'resident', as defined in s1 of the Act; and

(c) the assets in question should not fall among the assets excluded in terms of para 2(1)(b)(ii) of the Schedule; in other words, the assets should not be 'attributable to a permanent establishment' in the Republic.

Each of these concepts bristles with difficulties of interpretation, as became apparent during the hearing before this court. For reasons that follow, however, I do not find it necessary to make any definite findings regarding these intricate issues as there is, to my mind, a shorter and simpler route to reach an answer to the issues raised in this appeal.

Grounds of appeal

[10] In the grounds of appeal advanced in opposition to the assessment, the appellant contended, *inter alia*, that even if there had been a deemed disposal of the asset by the appellant during the 2003 year of assessment as contended for by the Commissioner, the capital gain which resulted from such disposal was not taxable in South Africa, but only in Luxembourg. In this regard, reference was made to the provisions of the agreement for the avoidance of double taxation ('the DTA'), entered into between South Africa and the Government of the Grand Duchy of Luxembourg and gazetted by proclamation on 6 December 2000. The provisions of the DTA accordingly became applicable to South Africa in respect of years of assessment beginning on or after 1 January 2001, with the effect that for as long as the agreement remains in operation, its provisions, so far as they relate to immunity, exemption or relief in respect of income tax in the Republic, have effect as if enacted in the Act.[2]

[11] The terms of the DTA are based upon a model convention contained in the 1963 report of the fiscal committee of the Organisation for European Economic Co-operation and Development (OECD). This model has served as the basis for the veritable network of double taxation conventions existing between this country and other countries and between many other countries *inter se*.[3] In the convention income from different types of source, such as income from immovable property, business profits, profits from the operation of ships or aircraft,

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[2] Section 108(2) of the Act. See also *Secretary for Inland Revenue v Downing* 1975 (4) SA 518 (A) at 523A–B.

[3] *Downing's* case, *loc cit*.

dividends, interest, royalties, etc, is dealt with in separate articles. The issue between the parties in this appeal centres mainly on article 13, which is concerned with 'capital gains'.

[12] Article 13(4) of the DTA provides as follows:

> *'Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident.'*

Paragraph 1 of article 13 deals with the alienation of gains from the alienation of immovable property. Paragraph 2 of that article deals with the alienation of movable property forming part of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State. Paragraph 3 of article 13 deals with gains from the alienation of ships or aircraft. It has not been contended that any of these exceptions are applicable to the asset under discussion in this appeal. It follows, therefore, that in terms of article 13(4) the relevant gain was taxable only in the Contracting State of which the appellant was a 'resident' as contemplated by the DTA. The relocation of its place of effective management caused the appellant to become a resident of Luxembourg in terms of article 4(1)(a) of the DTA. Article 4(3) of the DTA in turn provides that where a company is resident in both contracting States it shall be deemed to be a resident in the State where its place of effective management is situated. On the facts of this case, it is common cause that the appellant's place of effective management since 2 July 2002 was in Luxembourg. Accordingly, in terms of the DTA, the appellant was treated as not being a resident of South Africa.

[13] The Commissioner's answer to this ground of appeal was that article 13(4) of the DTA refers to 'the alienation of any property' and not to a deemed disposal of property as contemplated by para 12(2)(a) of the Schedule. In the result, so it was argued, the taxable capital gain which arose on the deemed disposal of the appellant's assets did not trigger the provisions of article 13(4) of the DTA.

[14] I am unable to accept this argument. In terms of para 2(1)(a) of the Schedule, capital gains tax becomes payable in respect of 'the disposal of any asset of a resident'. Subparagraphs 12(1) and (2) of the Schedule provide that upon an event occurring in terms of those provisions 'a person will be treated for the purposes of this Schedule as having disposed of an asset'. I am unable to see any reason why a deemed disposal of property should not be treated as an alienation of property for purposes of article 13(4) of the DTA. I agree in this regard with counsel for the appellant, who argued that it would be absurd if a taxpayer were to be protected in terms of art 13(4) from liability for tax resulting from a gain from an *actual* alienation of property, but not from a *deemed* alienation of property.

[15] It was contended on behalf of the Commissioner that if the appellant was correct in this regard, it would mean that the deemed disposal provisions of para 12 would never apply if a party were to migrate to a country which is party to a DTA. However, the same might be said in respect of an actual disposal of an asset which falls within article 13(4), but this is not a reason for concluding that the article would not apply in that instance.

[16] For these reasons I am satisfied that the Commissioner's decision in raising the additional assessment is wrong.

Order

[17] In the circumstances, the appeal is UPHELD. The additional assessment by the Commissioner in respect of the 2003 tax year is set aside.

B M GRIESEL
Judge