THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

MEDIA SUMMARY OF JUDGMENT DELIVERED IN THE SUPREME COURT OF APPEAL

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Commissioner for the South African Revenue Service v Coronation Investment Management SA (Pty) Ltd (1269/2021) [2023] ZASCA 10 (07 February 2023)

Today, the Supreme Court of Appeal (SCA) delivered a judgment in which it upheld with costs an appeal by the Commissioner for the South African Revenue Service (SARS) against the decision of Western Cape Division of the High Court, Cape Town, sitting as a tax court (the tax court) which found in favour of Coronation Investment Management SA (Pty) Ltd (CIMSA).

The respondent, CIMSA, is the holding company for the Coronation Group which is registered and tax resident in South Africa. During 2012, CIMSA was a 90% subsidiary of Coronation Fund Managers Limited and the 100% holding company of Coronation Management Company and Coronation Asset Management (Pty) Ltd (CAM), both registered for tax in South Africa. CIMSA was also the 100% holding company of CFM (Isle of Man) Ltd, tax resident in Isle of Man. CFM (Isle of Man) Ltd, in turn, was the 100% owner of Coronation Global Fund Managers (Ireland) Limited (CGFM) and Coronation International Ltd (CIL), which were registered and tax resident in Ireland and the United Kingdom respectively.

The central issue in the appeal was whether the net income of CGFM should have been included in the taxable income of its South African holding company, CIMSA, or whether a tax exemption in terms of s 9D of the Income Tax Act 58 of 1962 (the Act) was applicable to the income that had been earned by CGFM. The answer, said the SCA, was dependent on what the primary functions of CGFM in Dublin, Ireland were. If it were found that the primary operations were conducted in Ireland, then the s 9D exemption would apply. CGFM had adopted an outsource business model where its investment management function was conducted by CAM in South Africa and CIL in the United Kingdom.

SARS assessed the tax liability for the 2012 tax year to have included in its income an amount equal to the entire 'net income' of CGFM. The tax court upheld CIMSA's objection and found that CGFM was a 'foreign business establishment' (FBE) as defined in s 9D(1) of the Act and, accordingly, qualified for a tax exemption. The exemption only applies to foreign entities that qualify as a 'controlled foreign company'. It set aside SARS's additional assessment against CIMSA and ordered it to issue a reduced tax assessment, in which no amount was included in CIMSA's income under s 9D of the Act pertaining to CGFM's income. Consequently, SARS was not entitled to claim (a) understatement penalties in terms of s 222 of the Tax Administration Act 28 of 2011 (the TAA); (b) understatement penalties for provisional tax under paragraph 20 of the Fourth Schedule to the Act; and (c) interest in terms of s 89(2) of the Act.

The location of the 'primary operations', referred to in s 9D(1)*(a)*(ii)–(iv), was pivotal in determining whether CGFM was an FBE as defined. Thus, it was imperative to determine whether the primary operations had been outsourced, and if so, whether an exemption in terms of s 9D exemption was applicable. SARS submitted that the FBE definition requires each of the requirements set out in s 9D(1)*(a)*(i) to (v) to be present in a fixed place of

business in order for a controlled foreign company to qualify as a FBE. If not, the business is not entitled to a tax exemption under s 9D(1)*(a)*. SARS submitted that while it is permissible for a controlled foreign company to outsource locational permanence and economic substance, it must comply with the proviso set out in s 9D and each of the discreet requirements in the subsections *(aa)*, *(bb)* and *(cc)* of the proviso have to be met.

In October of 2007, CGFM applied to the Irish Financial Services Regulatory Authority for authorisation of an Undertakings for Collective Investment and Transferable Securities a (UCITS) and received its licence from the Central Bank of Ireland (CBI) as a 'management company' in accordance with the European Communities Regulations under Investment Services Directive 93/22/EEC 2125. In its business plan, that was attached to its licence application, CGFM presented an outsource business model where CGFM concentrates on being a 'product provider'. All non-core functions, such as investment, administration and custodial functions, are outsourced. According to the business plan, because these functions are outsourced to independent third party service providers, CGFM is not subject to South African Transfer Pricing rules. CIMSA denied that CGFM outsourced functions of 'its business' as referred to in the FBE definition and contended that investment management services were not a necessary part of a fund manager's business.

The SCA held that CGFM's licence entails investment management, and turned to determine whether the nature of CGFM's business in Ireland was that of an investment company or a management company with 'the managed outsourcing of the investment management functions in accordance with the terms of the licence'. The SCA held that it was common cause that the investment function was not located in Ireland. Therefore, if its primary business is that of investment, then its net income as a controlled foreign company should be imputable to CIMSA. CIMSA argued that the 'primary operations' referred to in s 9D(1)*(a)* (ii)-(iv) are practical actions required to operate that particular business. CIMSA further argued that the functions which CGFM outsourced were not functions of the business that it actually conducts in Ireland on a daily basis. The SCA rejected this argument and held that the meaning to be ascribed to 'primary operations' and 'business' must be contextual, which is relative to the definition of a FBE, where the words are found. The FBE definition refers to the 'primary operations of that business', which is a direct reference to the business of the controlled foreign company. The SCA examined CGFM's objects as recorded in its Memorandum of Association and held that the notion that investment management is not CGFM's core business was at odds with what is stated in its memorandum of association. The stated objects of CGFM are, inter alia, to carry on the business of establishing specified collective investment undertakings; to promote, establish, manage, regulate and carry on any investment, unit or other trust or fund; and to carry on the business of investment and financial management. The SCA concluded that the primary operations of CGFM's business (and, therefore, the business of the controlled foreign company as defined) was that of fund management which comprises of investment management. These are not conducted in Ireland, said the SCA. Therefore, CGFM did not meet the requirements for an FBE exemption in terms of s 9D(1). As a result, the SCA held that the net income of CGFM is imputable to CIMSA for the 2012 tax year in terms of s 9D(2).

SARS had imposed an understatement penalty in respect of the imputed net income of CIMSA's 2012 tax year of assessment, in terms of s 222(1) read with s 223 of the TAA, on the basis that there had been a 'substantial understatement resulting in a penalty of 10% of the tax that would otherwise have been paid'. In this regard, CIMSA stated that it relied on a tax opinion procured from a leading tax expert. However, it did not disclose the contents of the opinion, nor make the opinion available to SARS. SARS claim for understatement penalties failed as the SCA held that CIMSA was not obligated to disclose the tax opinion to SARS and that not making the opinion available to SARS was not sufficient to attribute male fides on the part of CIMSA.

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