SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 132/11
Reportable

In the matter between:

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Appellant

and

TRADEHOLD LTD Respondent

Neutral citation: *Commissioner for the South African Revenue Service v Tradehold Ltd* (132/11) [2012] ZASCA 61 (8 MAY 2012)

Coram: NUGENT, CACHALIA, MALAN, TSHIQI JJA and BORUCHOWITZ AJA

Heard: 12 March 2012

Delivered: 8 May 2012

Summary: Income tax – s 12 of Eighth Schedule of Act 58 of 1962 – deemed disposal of assets – Double Tax Agreement between the Republic of South Africa and Luxembourg – meaning of and effect – Article 13(4) – includes within its ambit capital gains derived from the alienation of all property including a deemed disposal of assets.

ORDER

On appeal from: The Tax Court, Cape Town (Griesel J):

The appeal is dismissed with costs, including those of two counsel.

JUDGMENT

BORUCHOWITZ AJA (NUGENT, CACHALIA, MALAN and TSHIQI JJA concurring)

[1] This is an appeal by the Commissioner for the South African Revenue Service from a decision of the Tax Court, Cape Town (Griesel J). The respondent, Tradehold Limited (Tradehold), had successfully appealed against an additional assessment raised by the Commissioner based on a taxable capital gain which, according to the Commissioner, arose from a deemed disposal by Tradehold of its shares in Tradegro Holdings Limited, in terms of para 12(1) of the Eighth Schedule to the Income Tax Act 58 of 1962 (the Act).

[2] Tradehold is an investment holding company, incorporated in South Africa, with its registered office at 36 Stellenberg Road, Parow, Industria, and is listed on the Johannesburg Stock Exchange. During the tax year under consideration, being the year of assessment ended 28 February 2003, Tradehold's only relevant asset was its 100 per cent shareholding in Tradegro Holdings which, in turn, owned 100 per cent of

the shares in Tradegro Limited, a company incorporated in Guernsey which owned approximately 65 per cent of the issued share capital in the UK-based company, Brown & Jackson plc.

[3] On 2 July 2002, at a meeting of Tradehold'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, Tradehold became effectively managed in Luxembourg. It nevertheless remained a 'resident' in the Republic notwithstanding the relocation of the seat of its effective management to Luxembourg by reason of the definition, at that time, of the term 'resident' in s 2 of the Act.[1] This status changed with effect from 26 February 2003, when the definition was amended and Tradehold ceased to be a resident of the Republic.[2]

[4] Relying on the provisions of para 12 of the Eighth Schedule to the Act, the Commissioner contended that when the respondent relocated its seat of effective management to Luxembourg on 2 July 2002, or when it ceased to be a resident of the Republic on 26 February 2003, it was deemed to have disposed of its only relevant asset, namely its 100 per cent shareholding in Tradegro Holdings, resulting in a capital gain being

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[1]Prior to its amendment and during the period 2 July 2002 to 25 February 2003, the term 'resident' was defined as follows in s 1 of the Act.

'**Section 1**

"Resident" means any –

(a) natural person who is –

…

(b) person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic (but excluding any international headquarter company)…'

[2]The amendment on 26 February 2003 added the following words to the definition of 'resident': '[B]ut does not include any person who is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between Governments of the Republic and that other country for the avoidance of double taxation.'

realised in the 2003 year of assessment in an amount of R405 039 083. This tax is colloquially referred to as an 'exit tax'.

[5] Paragraph 12 of the Eighth Schedule to the Act, insofar as it is relevant, reads:

'**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, which expenditure must be treated as an amount of expenditure actually incurred and paid for the purposes of paragraph 20(1)(*a*).

(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);

(b) an asset of a person who is not a resident, which asset –

(i) becomes an asset of that person's permanent establishment in the Republic otherwise than by way of acquisition; or

(ii) ceases to be an asset of that person's permanent establishment in the Republic otherwise than by way of a disposal contemplated in paragraph 11…'

[6] Paragraph 12 must be read with para 2 of the Eighth Schedule which provides:

'**Application. –** (1) Subject to paragraph 97, this Schedule applies to the disposal on or after valuation date of –

(a) any asset of a resident; and

(b) the following assets of a person who is not a resident, namely –

(i) immovable property situated in the Republic held by that person or any interest or right of whatsoever nature of that person to or in immovable property situated in the Republic; or

(ii) any asset which is attributable to a permanent establishment of that person in the Republic.'

[7] Para 12(1) speaks of a person being 'treated as having disposed of an asset'. This is a deeming provision. A deemed disposal of assets, except those listed in subsection 2(1)(*b*)(i) and(ii), is triggered under para 12 when a company ceases to be a resident of the Republic or is treated as not being a resident as a result of the application of a double tax agreement.

[8] On appeal to the Tax Court it was contended by the respondent that if there was a deemed disposal of the investment by Tradehold during the 2003 year of assessment, the capital gain that resulted from that disposal was not taxable in South Africa but in Luxembourg. The reason therefore was that at the time the capital gain arose the respondent was deemed to be a resident of Luxembourg in terms of Art 4(3) of the Double Tax Agreement (DTA) entered into between South Africa and the Government of the Grand Duchy of Luxembourg on 6 December 2000, which became applicable to South Africa in respect of the years of assessment beginning on or after 1 January 2001.[3] In terms of Art 4(3) the deemed place of residence of a company is the place where its effective management is situated.

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[3]Article 4 insofar as it is relevant provides as follows:
'1. For the purposes of this Convention the term "resident of a Contracting State" means:
(a) in Luxembourg, any person who, under the laws of Luxembourg, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, but this term does not include any person who is liable to tax in Luxembourg in respect only of income from sources in Luxembourg or capital situated therein;
(b) in South Africa, any individual who is ordinarily resident in South Africa and any other person which has its place of effective management in South Africa; and
(c) . . . Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:
2. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the State in which its place of effective management is situated.'

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

'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.'

[10] The Tax Court rejected the Commissioner's argument that the reference in Art 13(4) of the DTA to gains from the alienation of property did not include a deemed disposal of property as contemplated in para 12(2)*(a)* of the Schedule. The Tax Court's reasons are to be found in the following passages in the judgment:

'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.

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

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[4]The full text of Article13 reads:

'Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in other Contracting States may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

3 Gains of an enterprise of a Contracting State from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft, shall be taxable only in that State.

4. 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.'

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.'

[11] The Commissioner's principal submission is that a deemed disposal provided for in para 12 of the Eighth Schedule is not an 'alienation' as contemplated in Art 13(4) of the DTA. It was submitted that something that is deemed to have occurred has not actually occurred and thus a deemed disposal of an asset is notionally different from an alienation thereof. In support of this submission the Commissioner invoked the following dictum of Cave J in *R v Norfolk County Council* (1891) 60 LJ QB 379 at 380:

'Generally speaking when you talk of a thing being deemed to be something, you do not mean to say that it is that which it is deemed to be. It is rather an admission that it is not what it is deemed to be and that, notwithstanding, it is not that particular thing, nevertheless it is deemed to be that thing.'

[12] Reference was also made to *New Union Goldfields Limited v Commissioner for Inland Revenue* 1950 (3) SA 392 (A) at 407A where Van den Heever JA remarked:

'I exclude from consideration all the deeming clauses contained in the Act and those connected with them; for once the Legislature "deems", it departs from reality.'

[13] Citing a dictum from C*ronje NO v Paul Els Investments (Pty) Ltd* 1982 (2) SA 179 (T), it was contended for the Commissioner that the term 'alienation' as used in the DTA bears the same meaning as it does in the domestic law, namely, the action of transferring ownership to another. In *Cronje,* Ackermann J, considering the term in a different context came to the conclusion (at 188A) that 'die woord "alienation" 'n beperkte betekenis het, naamlik die handeling waardeur eiendomsreg oorgedra

word'. Reliance was also placed by the Commissioner on a definition to similar effect in the *Shorter Oxford English Dictionary.* For these reasons, it was submitted, Tradehold was not protected in terms of Art 13(4) from liability for tax resulting from a deemed alienation of its assets.

[14] The following further arguments were advanced. It was argued that if Art 13(4) indeed applied, it would mean that the 'exit tax' could only be levied in the event of a South African taxpayer emigrating to a country which has not entered into a DTA with the Republic containing a provision similar to Art 13(4), which could never have been the intention of the legislature. Moreover, the disposal of an asset contained in subpara 12(1) of the Schedule, is stated to apply 'for purposes of this Schedule' and therefore could not have had any effect on the DTA or have resulted in 'the alienation of property' as contemplated in Art 13(4) In the alternative and on the assumption that the exit tax could be levied it was contended that Tradehold's investment would have been attributable to a permanent establishment and therefore formed part of the assets excluded by para 2(1)(*b*)(ii) of the Eighth Schedule

[15] The DTA is one of many double tax agreements entered into between South Africa and other countries. Its principal objectives are the avoidance of double taxation and the prevention of fiscal evasion. The enabling legislation is s 108 (1) of the Act, which reads:

'108 Prevention of or relief from, double taxation

(1) The National Executive may enter into an agreement with the government of any other country, whereby arrangements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal

assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country.

(2) As soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the *Gazette* and the arrangements so notified shall thereupon have effect as if enacted in this Act.'

[16] Once brought into operation a double tax agreement has the effect of law. Its legal effect was described by Corbett JA in *SIR v Downing* 1975 (4) SA 518 (A) at 523A:

'[A]s long as the convention is 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 Act 58 of 1962 (see s 108(2)).'

[17] Double tax agreements effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries. They achieve the objective of s 108, generally, by stating in which contracting state taxes of a particular kind may be levied or that such taxes shall be taxable only in a particular contracting state or, in some cases, by stating that a particular contracting state may not impose the tax in specified circumstances. A double tax agreement thus modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict.

[18] The DTA is based upon the Model Tax Convention on Income and on Capital agreed to by the committee on Fiscal Affairs of the Organisation for European Economic Co-operation and Development (OECD), which has served as the basis for similar agreements that exist between many countries. In interpreting its provisions one must therefore not expect to find an exact correlation between the wording in the DTA

and that used in the domestic taxing statute. Inevitably, they use wording of a wide nature, intended to encompass the various taxes generally found in the OECD member countries. In addition, because the double tax agreements are intended to encompass not only existing taxes, but also taxes which may come into existence at later dates (see Art 2(2)), and bearing in mind the complex nature of taxation in the various member countries, inevitably the wording in the DTA cannot be expected to match precisely that used in the domestic taxing statute. In *SIR v Downing supra* Corbett JA remarked at 523C-D:

'The convention makes liberal use of what has been termed "international tax language" (see *Ostime (Inspector of Taxes) v Australian Mutual Provident Society*, 1960 AC 459 at p 480).'

[19] It is to be observed that Art 3 groups together a number of general definitions required for the interpretation of the terms used in the DTA. Subarticle 2 provides for a general rule of interpretation for terms used in the DTA that are not defined. 'Alienation' is not one of the defined terms and thus Art 3(2) finds application. [5]

[20] A helpful approach in dealing with the correlation between domestic taxing legislation and a double tax agreement is to be found in *Ostime (Inspector of Taxes) v Australian Mutual Provident Society* [1959] 3 All ER 245. In the speech of Lord Radcliffe (at 248) it was stated that the first step in any interpretive inquiry is to ascertain where in the scheme of the double tax agreement the relevant tax falls, and then to

[5] Art 3(2) reads: As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning which it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.'

consider whether the tax can be imposed consistently with the obligations undertaken thereunder.

[21] The need to interpret international treaties in a manner which gives effect to the purpose of the treaty and which is congruent with the words employed in the treaty is well established. See *Pan American World Airways Inc v SA Fire and Accident Insurance* 1965 (3) SA 150 (A) at 167H; *Potgieter v British Airways plc* 2005 (3) SA 133 (C).

[22] The first step therefore is to determine into which Article of the DTA the particular tax falls. Article 2 of the DTA specifies the taxes to which it applies.[6] With regard to the Republic, it is said to apply to 'the normal tax', which includes tax on capital gains. It is plain that the parties to the DTA intended that all taxes referred to in Art 2 would be dealt with in one or other of the articles of the DTA.

[23] The crisp question that falls to be determined is whether the term 'alienation' as used in the DTA includes within its ambit gains arising from a deemed (as opposed to actual) disposal of assets. As mentioned above the term must be given a meaning that is congruent with the language of the DTA having regard to its object and purpose.

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[6]Article 2 provides as follows:
'Taxes covered
1. The existing taxes to which the Convention shall apply are :
(a) in Luxembourg
. . .
(*b)* in South Africa : (i)the normal tax; and
(ii) the secondary tax on companies
(herein after referred to as "South African tax").
2. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of substantial changes which have been made in their respective taxation laws.

[24] Article 13 is widely cast. It includes within its ambit capital gains derived from the alienation of all property. It is reasonable to suppose that the parties to the DTA were aware of the provisions of the Eighth Schedule and must have intended Art 13 to apply to capital gains of the kind provided in the Schedule. It is of significance that no distinction is drawn in Art 13(4) between capital gains that arise from actual or deemed alienations of property. There is moreover no reason in principle why the parties to the DTA would have intended that Art 13 should apply only to taxes on actual capital gains resulting from actual alienations of property.

[25] Having regard to the factors mentioned, I am of the view that the term 'alienation' as it is used in the DTA is not restricted to actual alienation. It is a neutral term having a broader meaning, comprehending both actual and deemed disposals of assets giving rise to taxable capital gains.

[26] Consequently**,** Art 13(4) of the DTA applies to capital gains that arise from both actual and deemed alienations or disposals of property. It follows therefore that from 2 July 2002, when Tradehold relocated its seat of effective management to Luxembourg, the provisions of the DTA became applicable and that country had exclusive taxing rights in respect of all of Tradehold's capital gains. This conclusion renders it unnecessary to deal with the Commissioner's other contentions.

[27] The Tax Court was thus correct in holding that the Commissioner had incorrectly included a taxable gain resulting from the deemed disposal of Tradehold's investment in its income for the 2003 year of assessment. Accordingly the appeal cannot succeed.

[28] The appeal is dismissed with costs, including those of two counsel.

P BORUCHOWITZ
ACTING JUDGE OF APPEAL

Appearances:

APPELLANT:	PJJ Marais SC with HGA Snyman SC
	Instructed by: The State Attorney, Pretoria The State Attorney, Bloemfontein
RESPONDENT:	PA Solomon SC with J Boltar
	Instructed by: Edward Nathan Sonnenbergs, Cape Town Matsepes Attorneys, Bloemfontein