THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case No: 971/2016

In the matter between:

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **APPELLANT**

and

REUNERT LTD **RESPONDENT**

Neutral citation: *The Commissioner for SARS v Reunert Ltd* (971/2016) [2017] ZASCA 153 (22 November 2017)

Coram: Cachalia, Tshiqi, Seriti, Willis JJA and Ploos van Amstel AJA

Heard: 14 November 2017

Delivered: 22 November 2017

Summary: Liability for income tax: Whether commission earned in terms of agreement accrued to taxpayer: proper interpretation of agreement: language, context, purpose, background: whether interpretation of agreement commercially sensible: whether the manner in which parties gave effect to the agreement accorded with proper interpretation.

ORDER

On appeal from: Tax Court (Mali J sitting as the President):

The appeal is dismissed with costs, including the costs of two counsel where so employed.

JUDGMENT

Cachalia JA (Tshiqi, Seriti, Willis JJA and Ploos van Amstel AJA concurring)

[1] The South African Revenue Service (SARS) appeals against a tax court order upholding Reunert's appeal against its additional assessments for the years 2008 and 2009 amounting to R26 856 859 and R53 143 142 respectively. SARS included these in Reunert's gross income on the ground that they were part of the gross commission that accrued to Reunert under a Sales Promoter Agreement (SPA). Reunert disputes that it acquired an unconditional right to the gross commission and thus incurred a tax liability for the tax years in question.

[2] The facts and the relevant contractual provisions in issue in this appeal are set out in detail and considered later in this judgment. By way of introduction, Reunert held 40 per cent of the shares in Nokia Siemens Networks South Africa (Pty) Ltd (NSN-SA). The remaining 60 per cent of the shares were held by companies in the Nokia Siemens Networks Group (NSN Group). In November 2007 Reunert and the NSN entities (NSN) concluded the SPA in terms of which NSN

appointed Reunert as their sales promoter. In terms of clause 4 Reunert would earn a commission as consideration for its services.

[3] Shorn of its verbiage its material provisions were the following: NSN undertook, in clause 4.3, to pay Reunert commission twice a year from 1 January 2008. For the period January to June, commission was payable on 31 July and, for the period from July to December, it was payable on 31 January the following year. Clause 4.1 provided for the commission to be calculated as a percentage of NSN's turnover in Southern Africa. The calculation was based on a sliding scale percentage of sales revenue. Importantly, it was made 'subject to' clause 4.9, which in effect said that Reunert's actual commission as calculated would be reduced by the 'grossed-up' value: that is, the pre-tax value of any dividend Reunert received from NSN-SA. Clause 4.10 enabled the sales revenue for each period to be converted from Euros into Rands based on the average exchange rate for each month for the purpose of calculating the commission.

[4] The appeal turns on the correct interpretation of clauses 4.1 and 4.9. Read together, they provide for Reunert's commission to be calculated in two steps. The first is to calculate the gross commission in terms of clause 4.1. The second is to calculate the net commission in terms of clause 4.9 by deducting the 'grossed-up' value of any dividend Reunert received from NSA-SA at any time up to the date of the calculation. Read thus, submits Reunert, it had no unconditional right to the gross commission because this was always subject to deduction of the grossed-up value of any further dividends received until the final date of payment. Only then did Reunert acquire an unconditional right to the net commission. It follows that only the net commission, determined after the deduction of the further dividends, accrued to Reunert for tax purposes.

[5] Reunert submits that its evidence demonstrated that NSA-SA supplemented the dividends it paid to Reunert when they fell below the levels preceding the

agreement, which accords with the purpose of clause 4 and the manner in which they implemented the agreement.

[6] SARS contends, on the other hand, that the gross commission accrued to Reunert in terms of clause 4.1 because it was possible to calculate the amount from month to month in accordance with clause 4.10, the right to receive it having vested when the sale of products were made. It was thus immaterial whether or not Reunert received the dividends. The dividends Reunert in fact received from NSN-SA in terms of clause 4.9 thus constituted payments of the gross commission by NSN-SA to it in terms of clause 4.1 and accrued to it for tax purposes.

[7] SARS also relies on the notes in Reunert's 2009 and 2010 annual financial statements, which say that 'NSN may pay a dividend to Reunert as a method of settlement of commission income'. These notes, contends SARS, accord with its interpretation of clause 4.9, namely that the clause concerns the method by which Reunert was paid its commission earnings and had no bearing on the date of its accrual.

[8] The tax court upheld Reunert's interpretation of the relevant clauses. SARS maintains that it erred in doing so.

[9] A proper interpretation of the relevant provisions of clause 4 requires a consideration of their language, the context within which they appear, their purpose and the background giving rise to them. In addition, as the clause is apparently aimed at achieving a legitimate commercial purpose, an interpretation that sensibly advances this purpose rather than one inimical to it should be chosen.[1]

[1] *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 18.

[10] While the starting point in this exercise is usually the text itself, it is convenient to commence with the undisputed background facts.

[11] Mr David Rawlinson was Reunert's financial director when the SPA was concluded and retired as CEO. He explained the circumstances that led to its conclusion. In 2007, the Nokia Group acquired the global telecommunications division of the Siemens Group and established the NSN Group. It succeeded the Siemens Group as the majority shareholder in Siemens SA and changed the latter's name to NSN-SA.

[12] Reunert held 40 per cent and the NSN Group held 60 per cent of the shares in NSN-SA, a South African company through which the Siemens Group – which consists of NSN-SA and NSN Group – sold its telecommunications products throughout Africa. Their shareholders' agreement obliged the Siemens Group to channel all its Southern African business through NSN-SA, which it did. Siemens Group in fact channelled all its African business through NSN-SA. NSN-SA was consequently 'extremely profitable' and paid 'extremely good' dividends to its shareholders, including Reunert.

[13] The NSN Group thereafter changed its business model. It decided to stop conducting its African business through NSN-SA. Reunert was concerned that this would diminish NSN-SA's profitability and particularly the dividend stream it received from NSN-SA. It thus suggested to NSN Group that they buy out Reunert's share in NSN-SA. NSN Group was however keen to maintain Reunert as a partner in NSN-SA because of its close relationships with their biggest South African customers. NSN Group therefore persuaded Reunert to stay by offering to top-up the dividends it received from NSN-SA if they fell below historical levels. These were the circumstances that led to the adoption of the disputed clauses in the SPA and the background to which we must have regard in their proper interpretation.

[14] The parties gave effect to this arrangement by two agreements in November 2007. The first was a new Shareholders' Agreement in terms of which Reunert agreed to stay on as a 40 per cent shareholder in NSN-SA. The second was the SPA in terms of which NSN undertook to pay Reunert commission and to top-up the dividends it received from NSN-SA as and when necessary if they fell below historical levels.

[15] On this understanding, which was given effect to in the SPA, NSN appointed Reunert as its sales promoter in Southern Africa. It undertook, in clause 4, to pay commission to Reunert as follows. Clause 4.3 said that, with effect from 1 January 2008, NSN would pay commission to Reunert for the period from January to June on 31 July, and for the full year to December, on 31 January the following year. Clause 4.1 provided for the commission to be calculated on the basis of a percentage of NSN Group's sales revenue in Southern Africa. This formula was devised to maintain the dividend stream Reunert had received, historically, from NSN-SA expressed as a percentage of NSN's Southern African turnover. Clause 4.1 however expressly provided that its calculation was 'subject to clause 4.9'.

[16] Clause 4.9 provided that, if Reunert received a dividend ('shareholder payment') from NSN-SA, the commission payable to Reunert had to be calculated by taking into account the 'grossed-up' dividend:

'If Reunert receives a Shareholder Payment [a dividend] from NSN-SA after 1 January 2008, the amount of the Commission payable to Reunert for any period after 1 January 2008, shall be calculated by taking into account any Grossed Up Shareholder Payments received by Reunert. If a Shareholder Payment is received by Reunert from NSN-SA on any date other than the date of payment of Commission in terms of this Agreement, the next amount of the Commission payment due to Reunert shall be determined by taking into account the Grossed Up Shareholder Payment. NSN-SA shall be entitled to determine which member of the NSN Group shall be entitled to adjust the Commission payable by it to Reunert as a result of the provisions of this clause 4.9.'

The clause went on to prescribe a formula for calculating the grossed-up dividend. It was, in effect, the calculation of the pre-tax value of the (tax free) dividend. It meant that the commission payable to Reunert on any payment date (the net commission) was an amount equal to the prescribed percentage of NSN's sales revenue, calculated in terms of clause 4.1 (the gross commission) less the grossed-up value of any dividend Reunert had received. If the grossed-up value of the dividend exceeded the gross commission, no commission was payable and the excess of the grossed-up dividend was carried forward to the calculation of the commission payable on the next payment date. If the grossed-up value of the dividend fell short of the gross commission, NSN was obliged to pay the shortfall only.

[17] Simply put, these clauses had the following commercial implications: First, Reunert was entitled to commission only if the grossed-up value of the dividends it received from NSN-SA fell short of the gross commission calculated in terms of clause 4.1. If the grossed-up value of the dividends matched or exceeded the gross commission, Reunert would not receive a commission. Secondly, if the grossed-up value of the dividends fell short of the gross commission calculated in terms of this clause, Reunert was entitled only to so much as would compensate it for the shortfall. Thirdly, Reunert's commission was calculated twice a year, on 31 July (the interim payment), and on 31 January the following year (the final payment). Until the calculation was done, it was impossible to ascertain whether Reunert would be entitled to any commission at all, and, if so, what the amount would be.

[18] On this basis, Reunert contended successfully before the tax court that it was liable to pay income tax only on the net commissions calculated in terms of clause 4.9 and not on the gross commission calculated in terms of clause 4.1, as SARS insisted it was. The reason was that Reunert never became unconditionally entitled to the gross commission calculated in terms of clause 4.1 because this calculation was always subject to reduction in terms of clause 4.9. It was not possible to determine, until the last day, whether Reunert would be entitled to any commission at all and, if so, how much. Reunert thus never became unconditionally

entitled to the gross commission calculated in terms of clause 4.1 because its claim was contingent upon the further dividends it might receive at any time until the last day. Only then did it become possible to determine the net commission in terms of clause 4.9. This was the only commission to which Reunert became unconditionally entitled. In other words, it was the only commission that accrued to Reunert for tax purposes.

[19] SARS contended in the tax court, as it does before us, that Reunert became unconditionally entitled to commission in terms of clause 4.1 for the tax years in question. This was because it was possible for Reunert to ascertain in terms of clause 4.10 the commission due to it, monthly. I do not think there is any merit in this submission. Clause 4.10 enabled the sales revenue for each period to be converted from Euros into Rands based on the average exchange rate for each month for the purpose of calculating the commission; it has no bearing on Reunert's entitlement to receive commission, as the tax court correctly found.

[20] But the more fundamental problem with SARS' contention that clause 4.1 vested Reunert with an unconditional right to gross commission based on a sliding scale percentage of sales revenue is that this calculation was expressly made 'subject to clause 4.9'. The words 'subject to' are usually used in statutes as subordinating language to denote that the first clause (clause 4.1) is subordinate to the second (clause 4.9).[2] In other words Reunert's entitlement to receive a commission in clause 4.1 is subordinated by clause 4.9, which provides for a further reduction if Reunert receives a dividend from NSN-SA at any time before the final payment date.

[21] SARS contends however that clause 4.9 does not have this effect. Read contextually, so the argument goes, it is a material term of the SPA, which deals with the amount of commission payable and the method by which Reunert is paid its

[2] *University of the Free State v Afriforum & another* 2017 (4) SA 283 (SCA) para 35.

commission earnings; it does not concern the determination of the amount to which Reunert has become entitled.

[22] I consider SARS' reading of these clauses to be at odds with their language. Clause 4.1 says expressly that the 'amount determined' to be paid to Reunert as commission is 'subject to' clause 4.9. Clause 4.9 is thus as integral to the calculation of Reunert's commission as is clause 4.1. This is because it emphatically says that if Reunert receives a dividend from NSN-SA, the commission payable to it 'shall be calculated' and 'shall be determined' by deducting the grossed-up value of the dividend. Furthermore, clause 4.9 says in terms that the NSN-SA is entitled to 'adjust the commission payable by it to Reunert as a result of the provisions of this clause.' This can only mean that Reunert is entitled to receive whatever the adjusted amount is determined to be due to it, not the commission determined under clause 4.1.

[23] It follows that Reunert's claim to commission could only be determined by subjecting the calculation in 4.1 to any possible reduction by the grossed-up value, that is, the pre-tax value, of any dividend Reunert received from NSN-SA in terms of clause 4.9 until the payment date. So, SARS' contention that Reunert became entitled to commission in terms of clause 4.1 must fail as it flies in the face of the express language of the clause. It is also at odds with Rawlinson's evidence regarding the background and purpose of the SPA, which was devised to protect the dividend stream that Reunert received historically from NSN-SA. This was done, he said, by ensuring that there was a top-up mechanism should Reunert's dividend stream fall below a prescribed level. This purpose found expression in clause 4.9.

[24] In addition, Reunert's interpretation yields a sensible commercial result. It serves its purpose of topping-up the dividends Reunert receives from NSA-SA, whenever they fall below historical levels. On the other hand, SARS' contention that NSN-SA's dividend payments to Reunert also constituted commission payments has no apparent commercial rationale. It carries the unavoidable implication that a

dividend paid by a company to its shareholder, is at the same time being treated as a payment of a debt owed to the shareholder. As Reunert correctly submits, it can only be the one or the other, but never both.

[25] What remains is to determine the dispute regarding the manner in which the SPA was implemented. Reunert contends that its unchallenged evidence demonstrates conclusively that the parties implemented the SPA in a manner consistent with its interpretation of clause 4. SARS, on the other hand, points to the notes in Reunert's 2008 and 2009 annual financial statements which treat the dividend as payment of a commission due to it as provided for in clause 4.9. It contends that the manner in which the payments were dealt with in the statements supports its interpretation of the clause, which is that the dividend declared was used as a method of paying the commission that had already accrued to Reunert for the sale of products.

[26] It is unnecessary to traverse Reunert's evidence in any detail as it was not seriously disputed. Reunert called four witnesses. Rawlinson was the first. He was followed by Mr Shane Francois Prinsloo, who is an accountant and NSN's tax adviser; Ms Annemarie Schroeder, Reunert's tax adviser, and Ms Manuela Krog, a chartered accountant who was responsible for Reunert's audit whilst she was a partner at the audit company, Deloittes. In a nutshell the effect of their evidence was that Reunert never became entitled to or received any gross commission. The only commission to which it became entitled and in fact received was the amount determined after the deduction of dividends. Their evidence, supported by telling documentary proof, showed that Reunert never invoiced NSN-SA for gross commission – the only commission for which NSN-SA was invoiced, and made payment, was the net commission as envisaged in clause 4.9.

[27] SARS has another difficulty: Not only did the parties implement the agreement as testified by their witnesses, but SARS itself issued a receipt for a payment of R20

million from NSN-SA in February 2009. The payment was for income tax on the dividend paid to Reunert in the tax year in question. In other words, SARS acknowledged the payment to Reunert as a dividend and not commission. I reiterate what I said earlier, it could only be one or the other, not both.

[28] It is therefore clear that the parties to the SPA – including SARS – did not treat the gross commission calculation in terms of clause 4.1 as a debt NSN-SA owed Reunert, or deal with dividends paid to Reunert as the payment of such a debt. It is also clear from their evidence that the commission did not accrue monthly as and when sales were made but accrued only at the end of the six month period after the gross commission was reduced by the dividends paid out. They were emphatic that the dividend declared was not used as a method of paying the commission that had already accrued to Reunert.

[29] Of course, on this last aspect – that the dividend declared was a method of settlement of commission income – the notes to the annual financial statements are admittedly inconsistent with their evidence. Rawlinson testified that this was an error but there was no explanation for how the error had occurred. He had in fact signed them off. Schroeder also could not explain the error. It also weighs against Reunert that it did not call the person or persons who were responsible for preparing the statements for the relevant period to explain the error.

[30] However, it was not contended that any of the evidence of Reunert's witnesses, in particular Rawlinson's, was untruthful. And, given the weight of the undisputed evidence regarding the manner in which the parties implemented the SPA, which is at odds with how it is described in the notes to the annual financial statements, I consider that Reunert discharged the onus of proving that SARS' decision to disallow its objection to the assessments was wrong. I come to this conclusion despite what the notes in the annual financial statements say because, in addition to the evidence of how the parties implemented the agreement, the

background facts leading to its conclusion and a proper interpretation of clauses 4.1 read with 4.9, which includes a consideration of their purpose, permit no other finding.[3]

[31] In the result the appeal is dismissed with costs, including the costs of two counsel where so employed.

_____

A Cachalia

Judge of Appeal

[3] Compare *Anglo Platinum Management Services (Pty) Ltd v Commissioner, South African Revenue Service* 2016 (3) SA 406 SCA para 34.

Appearances:

For Appellant:	P Ginsburg SC (with him G Goldman) Instructed by: RW Attorneys, Pretoria Phatshoane Henney Attorneys, Bloemfontein
For Respondent:	W Trengove SC Instructed by: Cliff Dekker Hofmeyr Inc, Sandown Honey Attorneys, Bloemfontein