**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

CC Case No: 47/2023

SCA Case No: 1269/2021

In the matter between:

**CORONATION INVESTMENT MANAGEMENT SA (PROPRIETARY) LIMITED** Applicant / Respondent in application for leave to cross-appeal

and

**THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE** Respondent / Applicant in application for leave to cross-appeal

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**CORONATION'S WRITTEN SUBMISSIONS IN THE APPLICATION FOR LEAVE TO APPEAL**

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## A. INTRODUCTION

1. The Supreme Court of Appeal ("**SCA**"), reversing the decision of the tax court, upheld an assessment issued by the respondent ("**SARS**") on the applicant ("**CIMSA**") under section 9D(2)(*a*) of the Income Tax Act 58 of 1962 ("**the ITA**").

2. SARS applied that section to include in CIMSA's own taxable income for its 2012 year of assessment an amount equal to the "*net income*" of CIMSA's Irish fund manager subsidiary, Coronation Global Fund Managers (Ireland) Limited ("**CGFM**"). CGFM was a controlled foreign company ("**CFC**") of CIMSA, as defined in section 9D of the ITA.

3. SARS is not permitted to take into account, in determining the "*net income*" of a CFC, any amount which is attributable to a "*foreign business establishment*" of that CFC.[1] The term "*foreign business establishment*" ("**FBE**") is defined in section 9D(1) of the ITA.

4. A key issue for determination in this application for leave to appeal, and in the appeal, involves the correct interpretation of the phrases "*the business of that controlled foreign company*" and "*the primary operations of that business*" as used in the FBE definition.

5. SARS assessed CIMSA on the basis that CGFM did not have an FBE in Ireland. This was based on an overbroad and insensible interpretation of the FBE definition, and particularly what was to be understood by "*the business*" of a CFC. SARS' interpretation frustrated a key recognised objective of the section 9D regime, which is not to restrict South African residents' international competitiveness in establishing foreign companies that can

[1] Section 9D(9)(b).

compete on a level tax playing field with their local peers.

6. The effect of the SCA's judgment[2] is that the "*business*" of a CFC comprises everything that the company could itself theoretically do in pursuing a commercial endeavour, irrespective of the regulatory model within which the CFC operates and the business model actually adopted by the CFC, or even whether the CFC is legally entitled to do all those things.

7. On this approach, for purposes of the FBE definition, a CFC must be understood to have a "*true business*"[3] that may differ from how the CFC itself conceives of or structures its business. Once the "*true business*" is identified, any delegation to a third party of what may be viewed as core functions of the "*true business*" necessarily means that the CFC is not itself conducting the primary operations of that business, and so cannot have an FBE anywhere in the world, notwithstanding that it can demonstrate real economic substance in its conduct of its actual business in the foreign jurisdiction.

8. We respectfully submit that the SCA's interpretation of the FBE definition leads to "*insensible or unbusinesslike results*", [4] and fails to advance the remedy or to suppress the mischief at which section 9D is directed. The SCA's judgment has a major impact not only on CIMSA, but on all South African resident companies with CFCs doing business in foreign jurisdictions and which rely on the existence of an FBE to prevent being subjected, over and above local tax in those jurisdictions, to South African tax on an amount equal to

[2] Record, Vol 17, pp 1687—1715.

[3] See paragraph [51] of the SCA judgment where this phrase is used - Record, Vol 17, pp 1709 - 1710.

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

the CFC's net income.[5]

9. Moreover, the SCA erred in finding that "*the primary operations of CGFM's business … is that of fund management which includes investment management*".[6] As we shall explain below, CGFM had not been granted a licence to perform investment management trading activities and could not lawfully have performed investment management trading activities. In effect, the SCA held that the "*business*" of CGFM involved an activity (i.e. investment management trading) that it would have been unlawful for CGFM to perform. That flies in the face of the interpretive presumption that, when the FBE definition refers to a "*business*", it envisages a lawful business.[7]

10. CIMSA seeks leave to appeal in terms of section 167(3)(b)(*ii*) of the Constitution. It contends that the matter involves an arguable question of law of general public importance which this Court should decide. The proper interpretation of "*the business of that controlled foreign company*" and "*the primary operations of that business*" for purposes of the FBE definition, involves a question of law[8] that transcends the interests of CIMSA and is of general public importance. As will be apparent from our further submissions, the interests of justice favour leave being granted.

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[5] Effectively, the resident company pays the difference between South African income tax on the net foreign income and the foreign tax paid. This is by virtue of the claiming of a foreign tax credit being permitted under section 6*quat* of the ITA. In other words, when the resident company pays income tax in South Africa, it is entitled to claim a rebate equal to the taxes paid by the CFC in the foreign country.

[6] SCA judgment – Record, Vol 17, p 1711 para 55.

[7] *S v Mapheele* 1963 (2) SA 651 (A) at 655D-E.

[8] *Big G Restaurants (Pty) Limited v Commissioner for the South African Revenue Service* 2020 (6) SA 1 (CC) at para [11]; *Clicks Retailers (Pty) Limited v Commissioner for the South African Revenue Service* 2021 (4) SA 390 (CC) at para [24].

11. Should leave to appeal be granted, CIMSA seeks an order setting aside the decision of the SCA to uphold SARS' imposition of tax and interest.

12. We expand on these core submissions under the following headings:

12.1. the dispute and the legislative context;

12.2. material facts;

12.3. leave to appeal should be granted;

12.4. merits of the appeal;

12.5. relief sought by CIMSA.

## B. THE DISPUTE AND THE LEGISLATIVE CONTEXT

13. In general, the issues in a tax appeal are those set out in the SARS statement of grounds of assessment, the taxpayer's statement of grounds of appeal, and SARS' statement of reply.[9]

[9] Tax court rules 31 – 34. SARS did not file a statement of reply in terms of rule 33.

14. In the present case, there were no material disputes of fact. The evidence was clear as to the purpose for which, the manner in which, and the regulatory environment and conditions under which, CGFM was established and operated. The dispute involved the proper interpretation of section 9D ("*Net income of controlled foreign companies*") and in particular the FBE definition, and its consequent application to the facts.

15. Because CGFM was a controlled foreign company of CIMSA, an amount equal to its net income would be taxed in the hands of CIMSA unless the income was attributable to an FBE of CGFM.[10]

16. The relevant paragraph (*a*) of the FBE definition provides as follows:

> "**foreign business establishment, in relation to a controlled foreign company, means-**
>
> **(a) a fixed place of business located in a country other than the Republic that is used or will continue to be used for the carrying on of the business of that controlled foreign company for a period of not less than one year, where –**
>
> **(i) that business is conducted through one or more offices, shops, factories, warehouses or other structures;**
>
> **(ii) that fixed place of business is suitably staffed with on-site managerial and operational employees of that controlled foreign company who conduct the primary operations of that business;**
>
> **(iii) that fixed place of business is suitably equipped for conducting the primary operations of that business;**
>
> **(iv) that fixed place of business has suitable facilities for conducting the**

[10] Other potential bases of exclusion exist in section 9D, but are not relevant to the present case.

**primary operations of that business; and**

**(v) that fixed place of business is located outside the Republic solely or mainly for a purpose other than the postponement or reduction of any tax imposed by any sphere of government in the Republic:**

**Provided that for the purposes of determining whether there is a fixed place of business as contemplated in this definition, a controlled foreign company may take into account the utilisation of structures as contemplated in subparagraph (i), employees as contemplated in subparagraph (ii), equipment as contemplated in subparagraph (iii), and facilities as contemplated in subparagraph (iv) of any other company –**

**(aa) if that other company is subject to tax in the country in which the fixed place of business of the controlled foreign company is located by virtue of residence, place of effective management or other criteria of a similar nature;**

**(bb) if that other company forms part of the same group of companies as the controlled foreign company; and**

**(cc) to the extent that the structures, employees, equipment and facilities are located in the same country as the fixed place of business of the controlled foreign company.**"

17. The appeal turns on two parts of that definition:

17.1. First, identifying "*the business of that controlled foreign company*".

17.2. Second, determining whether the fixed place of business was suitably staffed and equipped for conducting "*the primary operations of that business*".

18. The SCA judgment provides background to section 9D and the role of the FBE exemption.[11] It relies on a document issued in June 2002 by National Treasury entitled "Detailed Explanation to Section 9D of the Income Tax Act" (the "**Treasury Explanation**").[12]

19. As the SCA recognised, section 9D was introduced as part of the shift in 2001 from a source-based system of taxation to a residence-based system. The world-wide income of a South African tax resident is now subject to normal tax. Non-residents are only subject to tax in South Africa to the extent that they have income from a source in South Africa.

20. Thus foreign companies, including subsidiaries of South African residents, conducting business exclusively outside South Africa (i.e. not having income from a South African source) are not subject to tax in South Africa under the residence-based system.

21. Section 9D does not subject a foreign company to South African tax. Instead, it subjects the South African holding company or shareholders of a CFC to tax on an amount equal to the "*net income*" of that CFC, as determined under section 9D. Its purpose is anti-avoidance, as stated in the Explanatory Memorandum to the 2009 Taxation Laws Amendment Bill:

> "**Section 9D is an anti-avoidance provision that is generally aimed at preventing South African residents from shifting tainted forms of taxable income outside the South African taxing jurisdiction by investing through a CFC.**"[13]

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[11] At paras [5] and [6] of the SCA judgment - Record, Vol 17, pp 1691 - 1692.

[12] The Treasury Explanation can be found at Record, Vol 18, pp 1786 - 1814.

[13] At p 73, para 4.1.I.

22. The SCA correctly recognised the policy imperative to allow certain CFCs to "*operate free from tax.*"[14] This was the reason for the introduction of exemptions, such as the FBE exemption, into section 9D.

23. It was also recognised that the FBE exemption serves the purpose of international competitiveness (formulated as follows by the SCA: "*allowing South African owned subsidiaries to operate on the same level tax fields as foreign owned rivals operating in the same low-taxed foreign environments*").[15] This is apparent from the following extract from the Treasury Explanation:

> **"A pure anti-deferral regime would immediately deem back all the South African owned foreign company income so that none of this foreign income receives any advantage over domestic income. Yet, section 9D (like other internationally used regimes of its kind) falls short of this purity in order to cater for international competitiveness. International competitiveness dictates that foreign company income should be ignored so that South African multinationals can fully compete on an equal basis with their foreign local rivals. …**
>
> **The principles of anti-deferral and international competitiveness are diametrically opposed. … Antideferral warrants complete taxation, whereas international competitiveness warrants complete exemption. In the end, section 9D follows international norms favouring a balanced approach. Section 9D achieves this balance by favouring international competitiveness (i.e., exemption) where the income stems from active operations. Anti-deferral (i.e., immediate taxation) applies where the income stems from passive investments or from transactions that meet objective criteria with a high tax avoidance risk."**[16]

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[14] At para [6] of the SCA judgment - Record, Vol 17, pp 1691 - 1692.

[15] At para [6] of the SCA judgment - Record, Vol 17, pp 1691 - 1692.

[16] Treasury Explanation pp. 1 - 2, para B. Underlining added. Record, Vol 18, pp 1790 - 1791. See also the Explanatory Memorandum to the Revenue Laws Amendment Bill, 2002 pp. 14 ("*Active income of CFCs*

24. The Treasury Explanation goes on to say that the FBE exemption

> **"[a]s a policy matter, … promotes international competitiveness. This rule applies only if the income poses no threat to the South African tax base… In operational terms, the business must be suitably equipped with on-site operational managers and employees, equipment, and other facilities to conduct the primary (e.g., core daily) operations of that business. <u>This substance element ensures that the business is more than just a paper transaction or a disguised form of passive income.</u>"**[17]
>
> **"A business establishment essentially involves a business that has some permanence, <u>some economic substance</u>, and a non-tax business reason for operating abroad rather than at home."**[18]

25. Treasury also stated that "*the business establishment threshold is fairly light*".[19]

26. The FBE definition replaced the prior "*business establishment*" definition in 2006. The relevant Explanatory Memorandum stated as follows:

> "**A CFC engaged in active foreign business does not generate includible income for South African Income Tax purposes. The exception applies <u>if the business is truly active, has some nexus to the country of residence and used for *bona fide* non-tax business purposes</u>. The legislation sets out several tests that are used in order to determine these features. …**

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*are, however, exempt under section 9D(9) in order to ensure that foreign businesses remain competitive with local businesses in the foreign country from a tax point of view. This active income includes income attributable to a business establishment, unless it is passive or diversionary*.")

[17] Treasury Explanation p. 8, para C.1 (Record, Vol 18, p 1797); p. 9, para ii (Record, Vol 18, p 1798). Underlining added.

[18] Treasury Explanation p. 9, para 2 (Record, Vol 18, p 1798). Underlining added.

[19] Treasury Explanation p. 12, para c (Record, Vol 18, p 1801).

***Reasons for change***

**The current definition of business establishment is too rigid, making it difficult for South African companies that are conducting genuine non-tax business activities. …**"[20]

27. Olivier & Honiball *International Tax: A South African Perspective* state that the legislature attempted to strike a balance between granting an exemption to income derived from "*legitimate business activities*" and income derived from "*illusory or non-substantive business undertakings (i.e. mobile and diversionary business income and mobile passive income)*".[21] The aim of paragraph (*a*) of the FBE definition is to ensure that the place of business has economic substance and does not merely exist on paper.[22]

28. The relevant legislative purposes, against which the FBE definition must be interpreted, are therefore as follows:

28.1. Section 9D combats tax avoidance in the form of deferral of income, i.e. a South African resident shifting income to a foreign resident controlled by it.

28.2. The FBE exemption promotes international competitiveness, so that "*truly active*" foreign businesses with real substance (i.e. not paper, illusory or non-substantive business undertakings) are able to compete on a level tax playing field with their foreign rivals. In other words, it seeks to ensure that the South African controlling company is not effectively subjected to tax on the foreign income at a higher rate

[20] At p. 53. Underlining added.

[21] 5th edition p. 581.

[22] *Ibid* p. 582.

than its foreign competitors are required to pay.

29. As will be expanded upon below, the SCA has, through its restrictive interpretation of "*the business of a controlled foreign company*" and the "*primary operations of that business*", introduced a rigidity in the FBE exemption that will stultify the ability of South African-based multinationals to compete internationally through subsidiaries.

## C. MATERIAL FACTS

30. The relevant facts were undisputed. We summarise them below.

### *Corporate structure*

31. The SCA described the corporate structure of the Coronation group in 2012 in paragraph 2 of the judgment.[23]

### *Establishment of CGFM*

32. CGFM was established in Ireland in 1997 as a "*fund management*" company to provide foreign investment opportunities to South African-based clients in the form of Irish-domiciled collective investment funds or schemes (**"CISs"**).[24] A CIS is sometimes also called a "*unit trust*". It receives and pools money from external investors for investment in terms of the prospectus of the fund.

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[23] Record, Vol 17, p 1690. An organogram of the structure can be found at Record, Vol 2, p 128.

[24] Record, Vol 12, p 1158, line 22 - p 1159, line 10, read with Vol 12, p 1160, lines 4 - 9 and Vol 12, p 1161, lines 13 – 21; Vol 12, p 1170, line 17 – p 1171, line 9. The statement in para [12] of the SCA judgment (Record, Vol 17, p 1694) that CGFM was incorporated to provide opportunities to invest also in South African domiciled CISs is incorrect. CGFM only engaged with Irish CISs.

33. A CIS is a different entity from a fund manager, which contracts to provide management services to the CIS.[25]

34. The Coronation Group chose Ireland as the place to establish foreign CISs because of the well-regarded regulatory environment which that country had established and its role as a centre of excellence for functions such as administration, accounting, trusteeship and custodianship of assets.[26]

35. As a matter of Irish law, a South African entity (such as CIMSA) is not permitted to manage Irish-domiciled CISs.[27] It is necessary to set up and appoint an Irish fund management company to do so.[28] That is why Coronation established CGFM in Ireland.

36. No tax aspects drove the decision to establish CGFM in Ireland. It was purely a business decision made by the Coronation Group.[29]

***Fund management and investment management activities***

37. A key distinction in the present case is between "*fund management*" and "*investment management.*"

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[25] In the case of CGFM, the terms of the fund management contract are incorporated in the trust deed pertaining to the CIS – Record, Vol 6, p 538 – Vol 7, p 628.

[26] Record, Vol 12, p 1161, lines 2 – 21; Vol 14, p 1326, lines 3 – 10; Vol 16, p 1586, line 13 – p 1590, line 6; Vol 16, p 1592, line 19 – p 1593, line 6; Vol 16, p 1638, line 7 – p 1639, line 4.

[27] Record, Vol 12, p 1161, line 22 – p 1162 at line 3.

[28] This addresses the question posed by Hack AJ to Mr Casey at Record, Vol 16, p 1637, as to why a South African fund manager could not manage foreign funds from its office in South Africa, and merely appoint a foreign investment manager. The answer is that such a South African entity cannot, by law, contract to manage an Irish-domiciled fund. Such funds had to be managed by a foreign (Irish or European) fund manager, in this case CGFM.

[29] Record, Vol 12, p 1162, lines 4 - 16.

38. A fund manager (or "*management company*") is a licensed entity that operates under the auspices of a financial regulator in providing fund management services to a CIS. It manages "*funds*" in the sense of managing CISs (i.e. providing management services to separate pooled investment vehicles, not allocating the money or assets invested in these vehicles *per se*). The fund manager bears ultimate responsibility to the regulator and the investors for all regulatory, legal and investor-related aspects of a CIS, including fund administration, trusteeship/ custodianship, investment management and distribution/ marketing activities.[30]

39. An investment manager, on the other hand, undertakes the professional allocation of money invested in a CIS, subject to the CIS's investment mandate and limits as set out in the prospectus issued by the fund manager. At a simplified level, the investment manager chooses which assets to buy, hold or sell on behalf of the CIS. This activity was referred to in the evidence as "*investment management trading activities*" to distinguish it from other aspects of investment management such as the setting of investment policies and restrictions for the CIS, and supervising the conduct of investment managers.[31]

40. CGFM was established and licensed in Ireland as a fund manager. As is typical in the industry, it did not itself conduct investment management trading activities, but rather

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[30] The Transfer Pricing Report states that the business of the Funds (i.e. the CISs) is to invest the money they receive in terms of investment guidelines in the prospectus - Record, Vol 11, p 1049, para 2.1.

In the case of CGFM, the terms of the fund management contract are incorporated in the trust deed pertaining to the CIS – Record, Vol 6, p 538 – 580.

Record, Vol 12, p 1173, lines 1 - 8; Vol 12, p 1173, line 19 - p 1176, line 19; Vol 12, p 1178, line 15 – p 1179, line 7.

[31] Record, Vol 12, p 1175, line 20 - p 1176, line 19; Vol 16, p 1546, line 4 – p 1549, line 1; Vol, 16, p 1568, line 22; Vol 16, p 1570, line 5; Vol 16, p 1575, line 10 – p 1576, line 10.

contracted with suitably-licensed and independently-regulated specialist investment managers (CAM in South Africa and CIL in London) to perform those tasks for the CISs it managed, but subject to its overall supervision.[32]

41. The Irish business was an exact mirror of the fund-management component of Coronation's South African business, where Coronation Management Company (RF) (Pty) Ltd ("**CMC**") was established as a fund manager (or "*management company*") for South African-domiciled CISs. CMC did not conduct investment management trading activities, but contracted with specialist investment managers (that are licensed under a different licensing regime) to do so. This is consistent with how all South African fund managers operate.[33]

***The CGFM licence***

42. The fund management industry in Ireland (as in South Africa) is a tightly regulated one. CGFM was licensed and supervised by the Central Bank of Ireland ("**CBI**") as a Management Company (i.e. a fund manager) under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations (i.e. it was a **"UCITS Management Company"**).[34]

43. In its business plan, presented as part of its licence application, CGFM undertook to follow a delegated business model in which it would conduct specified fund management

[32] Record, Vol 12, p 1157, line 20 – p 1157, line 2; Vol 12, p 1160, lines 2 – 9; Vol 12, p 1176, line 20 – p 1179, line 7; Vol 13, p 1190, line 15 – p 1191, line 9.

[33] Record, Vol 13, p 1190, line 15 – p 1191, line 9; Vol 13, p 1200, lines 7 – 17.

[34] Record, Vol 1, pp 20 – 26; Vol 12, p 1166, line 14 – p 1167, line 15.

functions, and would delegate (*inter alia*) investment management trading activities to competent third parties, while retaining overall supervision of, and responsibility to the regulator for, those functions. The CBI reviewed the application on the basis that CGFM was "*a management company who will delegate all constituent [collective portfolio management] functions to third parties and [will] maintain the management functions*."[35]

44. Despite what the SCA found[36] and what SARS submits[37], CGFM was not approved by the CBI to perform investment management trading activities itself. As a matter of Irish law, presented in the uncontested evidence of an expert witness (the Irish solicitor Ms T Doyle), the extent to which CGFM may conduct activities depends upon the representations made to the CBI when applying for the licence. These are contained in the business plan, which details how the applicant proposes to conduct itself, and the resources at its disposal.

45. Where an applicant applies on the basis that it will adopt the recognised "*delegation model*" of fund management, it would not be lawful for it to carry out the delegated activities itself. Doing so is illegal and would expose it to the risk of losing the licence. This is notwithstanding the fact that the written licence cross-refers *inter alia* to the broader term "*investment management*" as part of the scope of the licence, and does not expressly articulate the legal limitations referred to in this paragraph.[38]

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[35] Record, Vol 12, p 1134.

[36] See para [39] of the SCA judgment – Record, Vol 17, p 1705.

[37] Record, Vol 19, p 1854, para 38.

[38] Record, Vol 2, p 137, para 5 – 138 para 7; Vol 16, p 1545, line 21 – p 1546, line 1; Vol 16, p 1549, line 2 – 1551, line 15.

46. It follows that, if CGFM wished to carry out investment management trading activities itself, it would be required to make a further application to the CBI. This would be fundamentally different from its first (and actual) application. CGFM would then have to demonstrate local resourcing to conduct different operations. Comprehensive detail would have to be provided about the qualifications and experience of the persons who would be employed to carry on the activity, what systems they would use, and what policies would be adopted. This was not needed in an application under the delegated model, as the delegated suppliers of these services were independently regulated.[39]

47. As the SCA recognised, the "*delegation*" or "*outsourcing*" business model was the dominant model for Irish fund management businesses: 70% - 80% of such businesses operated on that basis.[40]

48. So typical was this model of fund management that the permitted manner and extent of

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As Ms Doyle pointed out, aspects such as the setting of investment parameters and supervision of the investment manager also fall within "investment management." CGFM performed those parts of investment management: Record, Vol 16, p 1546, line 12 – p 1549, line 1.

The contention in CGFM's rule 32 statement that the limitation was "*express*" was not correct, but the uncontested evidence nonetheless established that the limitation existed in law.

[39] Record, Vol 2, p 137, para 5 – 138 para 7; Vol 16, p 1545, line 21 – p 1546, line 1; Vol 16, p 1549, line 2 – 1551, line 15. Such investment managers would have to be licensed themselves and their conduct monitored and regulated by responsible bodies in Ireland or their recognised home countries.

[40] Para [41] of the SCA judgment – Record, Vol 17, p 1705.

See also Record, Vol 18, p 1744, para 18 first sentence (common cause); Vol 12, p 1176, line 20 – p 1179, line 7; Vol 13, p 1200, lines 5 - 18.

This was confirmed in the evidence of both Mr Casey (e.g. Record, Vol 2, p 385, para 13; Vol 16, p 1594, line 4 - p 1595, line 3) and Ms Doyle (e.g. Record, Vol 2, p 142, para 21; Vol 16, p 1560, lines 3 – 25). Mr Snalam stated that this was "*the norm*" (Record, Vol 12, p 1188, lines 6 – 25), Ms Doyle stated that it was "*typical*" and that "*the majority*" of UCITS fund management companies were authorised on that basis (Record, Vol 16, p 1560, lines 12 - 20), Mr Casey described the practice as "*overwhelming*" (Record, Vol 2, p 386, para 18), "*commonplace*" (Record, Vol 16, p 1594, lines 7 – 24) and "*the prevalent model*" (Record, Vol 16, p1066, lines 4 - 10).

delegation was expressly set out in the regulations referred to in paragraph [32][41] of the SCA judgment. These regulations highlighted the need for effective supervision of delegates; that any delegate performing investment management activities must itself be registered and subject to prudential supervision; that the mandate could be withdrawn in the interests of investors; that the fund manager's responsibility is not affected by delegation; and importantly, that the fund manager could not delegate its functions to the extent that it became a "*letter-box entity*".

49. The "*managerial functions*" that CGFM was licensed and required to perform were listed in its business plan and consisted of (1) decision taking; (2) monitoring compliance; (3) risk management; (4) monitoring of investment performance; (5) financial control; (6) monitoring of capital; (7) internal audit; and (8) supervision of delegates.[42] The CBI identified these as "*operational functions*".[43] The business plan was updated in 2011 to include (9) complaints handling and (10) accounting policies and procedures.[44]

50. It was not possible to delegate these fund management functions. Far from indicating that these functions are "*incidental*" to the business of a fund manager (as SARS suggests[45]), this demonstrates that they are integral to the business of a fund management company.

51. So central to the business of CGFM was the use of a delegation model for investment

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[41] Record, Vol 17, pp 1701 – 1702.

[42] Referred to in para [36] of the SCA judgment – Record, Vol 17, p 1703 - 1704. See also Record, Vol 2, pp 183 - 203.

[43] Record, Vol 12, p 1134.

[44] Record, Vol 4, pp 312 - 339.

[45] Record, Vol 19, p 1859, para 43.5.

management trading activities (and other functions such as administration and distribution) that the prospectus for each of the CISs which CGFM would manage specified that delegation would occur, and indeed set out the identity and credentials of the investment manager and other delegates. Any investor would therefore have invested on the understanding that these functions would be delegated to the identified professionals.[46]

52. Likewise, the trust deeds of the CISs in respect of which CGFM was appointed as fund manager recognised the delegation of the investment management trading activities to investment managers.[47]

53. The ability to contract out investment management trading activities to professionals in the field gave the fund manager a competitive edge, enabling it to choose the best service provider. This was ultimately in the best interests of investors.[48]

54. Nor was this an Irish phenomenon only. The delegation business model is also typical in Europe and South Africa (an example being CMC, Coronation Group's South African fund manager or management company, contracting out investment management trading activities to specialist entities licensed to perform those functions, which CMC is not licensed to perform itself).[49] CIMSA is not aware that any South African manager of

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[46] Record, Vol 13, p 1203, lines 6 – 11; Vol 6, p 511, para 13.

[47] Record, Vol 7, pp 602 – 603, clause 21.05.

[48] Record, Vol 2, p 383, para 9, Vol 2, p 385, paras 13 & 14; Vol 16, p 1591, line 9 – 1592, line 3, Vol 16, p 1592, line 19 – p 1593, line 6.

Mr Snalam referred to "*best of breed*" managers: Record, Vol 13, p 1206, lines 11 – 18.

[49] Record, Vol 12, p 1156, lines 17 – 21; Vol 13, p 1189, line 18 – p 1190, line 11, Vol 13, p 1200, lines 7 – 17; Vol 16, p 1625, lines 15 – 20.

collective investment schemes performs investment management trading activities itself. Contracting out that activity is the industry norm.[50]

***What CGFM actually did in Dublin***

55. Pursuant to its licence, CGFM operated as a fund manager under the recognised delegation model. The nature of its functions was as recorded in paragraph [15][51] of the SCA judgment. This involved, in overview, ensuring compliance with all regulatory requirements, investor communication and management, risk management, financial control and reporting, investment change management (i.e. adjusting investment parameters) and, importantly, the appointment and ongoing supervision of service providers, including those performing investment management trading activities.

56. CGFM performed its licensed activities through:

56.1. its directors, who met quarterly and set the strategy for the company; and

56.2. the executive team in the Dublin office, who ensured compliance with all regulatory requirements, communicated with the regulator, investors and service providers, performed financial and risk management functions, and exercised ongoing supervision over the delegated functions.[52]

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[50] Record, Vol 17, p 1667. This makes sense as investment management trading activity is a specialist function that can be provided to multiple clients, including fund managers authorised in different jurisdictions, or directly to entities such as retirement funds and life insurers.

[51] Record, Vol 17, p 1695 - 1696.

[52] Record, Vol 12, p 1183, line 24 – p 1184, line 12.

57. The substantial activities of the Dublin office in the period in question were explained in the evidence of CGFM's managing director, Mr King. The key evidence is summarised in "**MM8**"[53] to CIMSA's founding affidavit. There was no dispute that CGFM provided effective ongoing supervision of its service providers (including investment managers) from its Dublin office.

58. The thrust of Mr King's evidence was that the many functions undertaken in the Dublin office were aimed at ensuring compliance with the licence. He certainly did not testify that "*the licence largely looked after itself*", as stated by the SCA in paragraph [36][54] of its judgment. He said that if CGFM complied with the regulations (which required the substantial activities mentioned above) and took necessary action in the best interests of the investors, even where not prescribed in detail in the regulation, only then was there nothing further to be done to support the licence.[55]

59. Mr King's evidence provided a clear perspective of the business of a delegating fund manager. Paying attention to the actual performance of the appointed investment managers is a limited part of what CGFM does. CIMSA presented minutes[56] and board packs[57] of

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The number of staff members was between three and five from time to time. During 2012 there were three permanent staff members: the managing director, a fund accountant and a fund administrator – and a part-time compliance officer.

In 2013 a full-time compliance officer was appointed - Record, Vol 14, p 1338, line 18 – p 1339, line 12; Vol 15, 1425, line 22 – p 1426, line 9.

[53] Record, Vol 18, pp 1816 - 1834.

[54] Record, Vol 17, p 1704.

[55] Record, Vol 15, p 1471, line 7 – p 1473, line 4.

[56] Record, Vol 8, pp 719 - 758.

[57] Record, Vol 8, p 759 – Vol 9, p 853.

CGFM Board meetings which show that the bulk of issues addressed involved aspects like regulatory compliance, managing investors' entry to and exit from CISs, resolution of regulatory breaches, effective supervision of delegates, and communications with regulators.

60. The evidence was also that the performance of investment management (trading) activities is not the main driver of CGFM's income. The fee earned by CGFM is authorised by the relevant CIS prospectus, and is percentage-based and calculated on the market value of the assets of the funds (CISs). This is made up mostly of the capital contributed by the investor, before any investment management takes place. Without the existence of the CIS and its authorised fund manager, there would have been no fee collected. If the fund management activities did not take place, there would have been no assets to manage and no investment management trading activity to delegate. It is the confidence that the investors place in CGFM as the regulated fund manager, and in how it takes responsibility for the performance of functions such as administration and the allocation of invested funds as envisaged in the prospectus, that gives rise to the ability to earn any fee at all.[58]

## D. LEAVE TO APPEAL SHOULD BE GRANTED

61. The requirements for leave to appeal under this Court's expanded jurisdiction were considered in *Paulsen v Slip Knot Investments 777 (Pty) Ltd*.[59] In the tax context, they

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[58] Record, Vol 6, p. 512 para 14, Vol 13, p 1206, line 19 – p 1207, line 6; Vol 13 p. 1211 line 14 – p. 1212 line 12; Vol 15, p 1428, line 24 – p 1430, line 8. *Cf*. Record, Vol 14, p 1314, lines 1 – 13; Vol 13, p 1207, line 24 – p 1208, line 7; Vol 13, p 1208, lines 7 – 20; Vol 14, p 1296, line 19 – p 1298, line 5; Vol 14, p 1301, lines 15 – 25; Vol 14, p 1313, lines 9 – 22; Vol 14 , p 1313, line 23.

[59] 2015 (3) SA 479 (CC) at paras [16]-[31].

were addressed in *Big G Restaurants (Pty) Ltd v Commissioner for the South African Revenue Service*[60] and *Clicks Retailers (Pty) Ltd v Commissioner for South African Revenue Service*[61].

62. For the reasons that follow, we submit that the requirements for leave to appeal are satisfied in this case.

***Arguable points of law***

63. Central to the dispute is the proper interpretation of the phrases "*the business of that controlled foreign company*" and "*the primary operations of that business*" in the FBE definition.

64. In *Big G*, Madlanga J at para [11] stated that the interpretation of the contracts there in issue was a quintessential question of law. But he went on to say that this interpretive question was "*closely bound up with the interpretation of section 24C(2): what is the nature of the contract envisaged in the section?*" That was also a question of law.

65. In the same vein, the issue in the present case is: "*what is the nature of the business, and the primary operations of that business, envisaged in the FBE definition?*" This is a question of statutory interpretation and hence a question of law. A question relating to the interpretation of a statute triggers this Court's jurisdiction "*on its own*."[62]

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[60] 2020 (6) SA 1 (CC).

[61] 2021 (4) SA 390 (CC).

[62] *Ascendis Animal Health (Pty) Ltd v Merck Sharp Dohme Corporation* 2020 (1) SA 327 (CC) at para [36].

66. In summary (and as will be expanded upon below):

66.1. The SCA interpreted the words "*the business of that controlled foreign company*" in the FBE definition as referring to a theoretical idea of a business (here the business of a fund manager), not the business that the CFC actually undertakes and is legally permitted to undertake (i.e. what it actually does to pursue its commercial objectives within the parameters of its licensing). The SCA effectively held that a CFC can have a "*business*" for purposes of the FBE definition which differs from how it actually operates. We shall submit below that the language of the provision, viewed in its context and with regard to its purpose, does not permit of such an interpretation.

66.2. Based on this error, the SCA regarded the FBE definition as automatically precluding any outsourcing or delegation of the main functions of the theoretical business (here the theoretical business of "*a fund manager*"), without recognising that such delegation on a managed basis is in fact a core feature of the actual business of the CFC.

66.3. We submit that, on a proper interpretation, the "*business*" of the CFC is what the CFC actually does, as envisaged in its business model, not everything that it could notionally do. That, in turn, circumscribes the "*primary operations of that business*". The relevant question is whether the "*primary operations*" of <u>that actual business</u> are conducted from a fixed and properly resourced fixed place of business in a foreign jurisdiction, or whether that place of business lacks substance.

67. Contrary to what SARS argues,[63] CIMSA's contention that the matter involves a question of law (i.e. is based on statutory interpretation) is not something new, thought up to justify this application for leave to appeal. It has always been CIMSA's case that the word "*business*" must relate to the commercial activity actually undertaken by the CFC. For example, in its heads of argument before the SCA,[64] CIMSA advanced the following arguments:

67.1. *"The word "business" in the ordinary sense can therefore only be understood in the context of the person whose business is under examination. The nature of a person's business is determined by what that person actually does (i.e. their commercial activity)."*[65]

67.2. *"It is thus submitted that the term "the business of that controlled foreign company" refers to the commercial activity actually undertaken by that CFC."*[66]

67.3. *"SARS adopts a different approach towards the meaning of "business". It may be viewed as a normative approach. It involves an ideal notion of what a particular business entails, i.e. what an entity in that area of commercial endeavour (in this case, fund management) must necessarily do, without regard to what the entity actually sets itself up to do. The "principal operations" of that business are then*

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[63] Record, Vol 19, p 1838, para 12 – p 1839, para 15 and Vol 19, p. 1865, para 60.

[64] These are not part of the record but can be supplied if so required.

[65] Para 41 of CIMSA's heads of argument in the SCA.

[66] Para 42 of CIMSA's heads of argument in the SCA.

*tested against this ideal, rather than against the actual business of the entity.*"[67]

68. It has also always been CIMSA's case on the pleadings that "*business*" must be interpreted as referring to the activity actually undertaken by the CFC. At paragraph 33.1 of its Rule 32 statement, CIMSA pleaded that the SARS disallowance of the objection is not in keeping with the FBE definition in that, *inter alia*, the first requirement is to determine what CGFM's business is, and thereafter to assess whether the principal operations of that business are conducted in the foreign jurisdiction. [68] As early as in its notice of objection, CIMSA had stated that "*the difference in approach between CIM and SARS is largely a legal one relating to the interpretation of the statutory requirements for an FBE*".[69]

69. Thus, the legal issue which lies at the heart of the SCA judgment, and on which CIMSA relies in seeking leave to appeal, has always been part of (and indeed central to) its case.

70. Furthermore, SARS' contention that CIMSA's appeal does not involve an interpretative issue is invalidated by its lengthy contentions regarding the manner in which the FBE definition should be interpreted having regard to the context in which it appears[70], as well as the purpose sought to be achieved thereby.[71]

71. This Court has held that a point of law is "*arguable*" if it has "*reasonable prospects of*

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[67] Para 46 of CIMSA's heads of argument in the SCA.

[68] Record, Vol 18, p 1769.

[69] Vol 1 p 7 para 5.6.

[70] See in this regard paras 23.11 (Record, Vol 19, p 1845), 42 (Record, Vol 19, pp 1855 - 1857), 43.7 (Record, Vol 19, pp 1859 - 1860) and 57 (Record, Vol 19, pp 1864 - 1865) of SARS' opposing affidavit.

[71] SARS's argument in this regard can be found at paras 48 – 58 of SARS' opposing affidavit - Record, Vol 19, pp 1861 - 1865.

*success*".[72] That is the case here since the tax court and the SCA reached opposing conclusions on the interpretation of "*the business*". We elaborate in section E on why, in our respectful submission, the SCA's interpretation was incorrect.

***General public importance***

72. As was recognised in the MoneyWeb article attached as "**MM3**"[73] to CIMSA's founding affidavit, the impact of the SCA judgment extends well beyond the immediate interests of CIMSA and Coronation.

73. There are numerous other South African financial industry participants that have established fund management companies in foreign jurisdictions (including Ireland) and that provide services to CISs in those jurisdictions. These all follow the common industry model of delegating services, including investment management trading activities. Based on publicly available information (including that published by the Financial Sector Conduct Authority and the Association for Savings and Investment South Africa), there are over 20 South African groups in this position, offering access to more than 50 CIS's and their sub-funds, with reported assets under management exceeding R400 billion.[74] All of them would be directly impacted by the SCA judgment.

74. But the influence of the SCA judgment extends more widely than the fund management industry. It affects, or potentially affects, every South African resident with a CFC in

[72] *University of Johannesburg v Auckland Park Theological Seminary* [2021] 8 BCLR 807 (CC) para 47.

[73] Record, Vol 17, pp 1736 - 1739.

[74] Record, Vol 17, pp 1682 - 1683, para 110.

respect of which the FBE exemption is or may be claimed.

75. Coronation reviewed the fifty largest tax resident companies listed on the Johannesburg Stock Exchange and identified those that would have CFCs, based on its knowledge of their operations. This encompassed 48 of the top 50 companies. It stands to reason that many of these would rely upon the FBE exemption.[75]

76. Each resident currently relying on the FBE exemption will have to reconsider their position, firstly to determine what business its CFCs "*should*" be conducting (i.e. what SARS may view as their "*real business*"), and secondly to consider whether their CFCs delegate or sub-contract functions in a manner that deprives them of an FBE despite their not ever having intended to perform those functions because they use other entities to do so.

77. SARS was invited to tell this Court, without breaching its obligations of confidentiality, how many South African taxpayers claim the FBE exemption.[76] It declined this invitation and only stated that there are no appeals currently pending, and that there are some residents that do not claim the FBE exemption.[77]

78. Neither of these incidental facts undermines CIMSA's contention, supported by paragraphs 73 to 76 above, that the SCA judgment will have a wide-ranging effect on South African taxpayers who claim the FBE exemption, and is therefore of general public importance.

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[75] Record, Vol 17, p 1683, para 113.

[76] Record, Vol 17, p 1683, para 112.

[77] Record, Vol 19, p 1844, para 23.10.

79. Many businesses adopt innovative business models. These often involve managed co-operation with service providers for the provision of what might be called core services or products[78]. Each of these conducted by a CFC will be subject to the SCA's interpretation of the FBE definition. Any refinement of their business model to pursue greater efficiencies will also result in fiscal uncertainty. This is likely to discourage South African entities from expanding offshore and seeking to compete on a level tax playing field with their foreign rivals, particularly where they employ a delegation model. That, in turn, is likely to retard the growth of South African-based multinationals, to the detriment of the South African economy.

***Interests of justice***

80. Given the wide range of interests affected by the SCA judgment, its material significance for the South African economy and the absence of prior authority on the central issue, it would be in the interests of justice for this Court to assume jurisdiction over the appeal.

81. CIMSA's arguments prevailed in the tax court. We respectfully submit that CIMSA has more than reasonable prospects of success in relation to these arguments. In particular, if this Court endorses the notion that the "*business*" means what the CFC actually does (i.e. its business model), CIMSA's appeal would necessarily succeed. It was not disputed that the Dublin office has sufficient staff, equipment and facilities to carry out the management and oversight functions which CGFM undertook to the CBI and investors that it would do. It is clear that the primary operations of a management company employing the delegation

[78] Record, Vol 17, p 1676, para 92 – p 1678, para 93.

model of fund management are carried out at the fixed place of business in Dublin.

***Conclusion***

82. For all the reasons set out above, leave to appeal should be granted in terms of section 167(3)(b)(ii) of the Constitution.

## E. THE APPEAL SHOULD BE UPHELD

83. In the event that leave to appeal were to be granted, we submit that the appeal should be upheld for the reasons that follow.

***The meaning of "business" and "primary operations of that business"***

84. CIMSA's argument has consistently been a straightforward one. In a nutshell, the argument goes like this:

84.1. On a proper interpretation of the FBE definition, one must first identify "*the business of [the] controlled foreign company*". That is a necessary step in order to isolate the "*the primary operations of that business*", as referred to in paragraphs (*ii*), (*iii*) and (*iv*) of the FBE definition. In other words, the "*primary operations of [the CFC's] business*" cannot be wider than "*the business of [the CFC]".*

84.2. A CFC's business is not defined by what it could potentially or theoretically do, but by what it actually does.

84.3. Applying this to CGFM, its "*business*" is to be a licensed "*fund manager*" of Irish-domiciled funds in accordance with the same "*delegation model*" which is adopted, with the approval of the CBI, by the vast majority of Irish fund managers. CGFM's "*business*" was never one in which it actually carried out the functions of investment management trading activity, fund administration, custodianship or marketing.

85. We shall refer to CIMSA's interpretation of the FBE definition as the "*actual-business interpretation*". This interpretation means that the business of a CFC, and the primary operations of that business, must be determined by having regard to what the CFC in fact does.

86. The SCA rejected the actual-business interpretation. The SCA held that the business of a CFC, and the primary operations of that business, are determined by having regard to what activities the CFC could perform even if the CFC does not in fact perform those activities. We shall refer to this as the "*notional-business interpretation*".

87. The SCA adopted the notional-business interpretation by the following process of reasoning:

87.1. The SCA recorded CIMSA's argument that the business of a CFC must be determined "*by what that entity actually does*, *the normal commercial activity which it undertakes on a day-to-day basis*".[79] The SCA said that, according to

[79] At para [43] of the SCA judgment – Record, Vol 17, p 1706.

CGFM, its business was *"fund management, entailing the active management of its service providers, plus regulatory compliance*"); and that the "*primary operations*" referred to in paragraphs (*ii*) to (*iv*) of the FBE definition are the practical actions required to operate that particular business.[80]

87.2. The SCA rejected CIMSA's argument as "*not [holding] water*".[81] It held that the meaning ascribed to "*primary operations*" and "*business*" must be "*contextual, relative to the definition of a FBE, where the words are found*".[82]

87.3. The essence of the SCA's reasoning is found in paragraphs [50] and [51] of the judgment.[83] The theme of these paragraphs is that a CFC's "*business*" comprises everything material that the company could do in the conduct of a particular commercial endeavour, and that outsourcing any of these functions necessarily means that the CFC is not conducting the operations of that business, even if the CFC always envisaged third parties performing that function and resourced itself accordingly.

88. In short, the SCA rejected the notion that a CFC's "*business*" is determined by reference to how the CFC actually chooses to operate. This is apparent from the following *dicta* in the SCA judgment:

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[80] At paras [43] and [44] of the SCA judgment – Record, Vol 17, pp 1706 - 1707.

[81] At para [45] of the SCA judgment – Record, Vol 17, p 1707.

[82] Para [45] of the SCA judgment Record, Vol 17, p 1707.

[83] Record, Vol 17, pp 1709 - 1710.

88.1. "*the fact that CGFM was permitted to outsource functions does not mean that the scope of its business is confined to supervision of the functions which it has outsourced, together with regulatory compliance. Its operations are determined by those activities for which it sought, and was granted, a licence. That it elected to outsource those functions, does not exclude these functions from the scope of its business. On the contrary, these functions had to fall within the ambit of its business in order to be outsourced*"[84];

88.2. "*[t]he choice of a particular business model cannot alter the primary operations of a company*"[85] ; and

88.3. "*the nature of CGFM's business was not transformed from an investment business to a managerial one by outsourcing its investment functions*"[86].

89. We submit that the SCA's categorical statement that "*the choice of a particular business model cannot alter the primary operations of a company*" demonstrates the fallacy in its interpretation. A company's "*business,*" in any ordinary sense of the word, is reflected in its business model (i.e. how it chooses to do business and what activities it may lawfully perform). Its primary operations are necessarily those that give effect to, or execute, the business model. It cannot have operations (primary or otherwise) that are not part of its chosen business. Where an entity has chosen from the outset to operate as a management company using a delegation model, there can be no suggestion that some notional "*true*

[84] Para [50] of the SCA judgment – Record, Vol 17, p 1709.

[85] Para [51] of the SCA judgment – Record, Vol 17, pp 1709 - 1710.

[86] Para [51] of the SCA judgment - Record, Vol 17, pp 1709 - 1710.

*business*" of that company has thereby been "*transformed*" into something else. The "*business*" is, and aways was, reflected in what the entity actually did.

90. The SCA's interpretation means that the "*business*" of a CFC comprises everything that the CFC could itself theoretically do in pursuing a commercial endeavour, even if the CFC does not do it. We submit that it is counter-intuitive to say that the "*business*" of a CFC involves activities that the CFC does not, in fact, perform. To use a hypothetical example: if a tour company could notionally provide package tours but elects not to do so as part of its business model, then it would make little sense to say that its "*business*" involves package tours. Moreover, the SCA's interpretation means that a CFC which elects not to perform activities that are held to constitute the "*true business*"[87] of a participant in that industry, could not have an FBE anywhere in the world. Such an outcome does not accord with the ordinary language of the FBE definition.

91. The SCA's approach also leads to insensible and unbusinesslike results that fail to advance the remedy or to suppress the mischief at which section 9D is directed. This can be seen by having regard to the implications of the notional-business interpretation in the case of CGFM:

91.1. As stated above, section 9D targets "*deferral*" of tax by residents who shift income to a foreign subsidiary. The SCA referred to the legislative purpose of preventing "*diversionary, passive or mobile income*" from eroding the South African tax

[87] See paragraph [51] of the SCA judgment where this phrase is used - Record, Vol 17, pp 1709 - 1710.

base.[88] These are the three types of income that the Treasury Explanation identifies as not falling within the ambit of the FBE definition.[89]

91.2. However, the income of CGFM does not fit into any one of these three categories of tainted income. Its income could for legal reasons never have been earned in South Africa so was not shifted offshore (as diversionary income is); it was not income in the form of dividends, interest and royalties (i.e. it was not passive income); and its business was by no means a shell business with a post-box address and no non-tax reason for its existence (i.e. it was not mobile income). The fact that CGFM was established for commercial, non-tax reasons was not disputed.

91.3. Faced with the reality that CGFM's business did not earn income that threatened the South African tax base in one of these forms, the SCA resorted to stating that this was not the extent of the legislative purpose. Instead, it said, the legislation also "*limited*" the situation where an exemption is obtained over earnings in a low tax jurisdiction when the primary operations of the business are not conducted there.[90]

91.4. The SCA did not cite any support for this statement, and we submit that there is none. As is apparent from the sources cited in paragraphs 26 to 30 above, the "*commercial substance*" provisions of the FBE definition are there to prevent the

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[88] Para [53] and footnote 18 of the SCA judgment - Record, Vol 17, p 1710.

[89] Para C1 on page 8 of the Treasury Explanation – Record, Vol 18, p 1797.

[90] Para [53] of the SCA judgment – Record, Vol 17, p 1710.

exclusion *inter alia* of mobile income, i.e. income attributable to paper, illusory or non-substantive business undertakings. It is against those established purposes that the FBE definition must be interpreted. The SCA however effectively "*created*" a further purpose for the words which were subject to interpretation exclusively from the words themselves, which is a self-fulfilling and circular exercise, and not a legitimate method of statutory interpretation.

91.5. The SCA ought to have interpreted the words in question with a view to ensuring that whatever the unique nature of the business actually undertaken by the CFC (as a company), there was substance in conducting <u>that business</u> in the foreign fixed place of business. In other words, the concern would be to ensure that the fixed place of business was not the location of illusory or non-substantive operations, or a "*letterbox company*". On the present facts, there was no dispute that the Dublin office had economic substance, and was suitably staffed to conduct the business of a management company using the delegation model, and the income could never be described as "*mobile*".

92. The insensible result of the SCA's interpretation of "*the business of a CFC*" and "*the primary operations of that business*" is further demonstrated when regard is had to the realities of commerce. The FBE definition will have to be applied to the businesses of <u>all</u> CFCs, even those whose business is not regulated by a licence. However, the idea of a notional "*ideal*" business – which involves the performance of all of what may be thought of as "*core functions*" – is uncommercial and unrealistic, as the following examples demonstrate:

92.1. A business such as Uber provides transport to the public, but the company owns no vehicles and does not itself provide this "*core*" service. The "*business*" is properly understood as one providing a managed and supervised platform for the provision of transport by outsourced service providers. On the SCA's approach, however, because this transport company does not itself provide transport, it could never have an FBE, no matter how substantial its management operations are.

92.2. Likewise, the core service of a business like AirBnB is the provision of accommodation, but the company does not own or manage hotels and arranges with third parties to actually provide the accommodation service. It would be absurd to conclude that the work it actually does in providing accommodation to clients through managed delegation is not its business, and hence that it cannot have an FBE because it does not in fact conduct the business of owning and operating accommodation establishments.

92.3. A provider of satellite television to subscribers will inevitably outsource the core function of feeding a signal to clients' television sets to a third party satellite operator. On the SCA's approach, its foreign business (involving *inter alia* the organisation and supervision of that satellite feed delivery function) could not have an FBE because it does not perform the "*primary operations"* of a business that it does not recognise as its own.

92.4. Similarly, a courier company that outsources the actual parcel delivery to a third party, or a sports goods supplier that outsources manufacture of its core product, would on the SCA's approach not have an FBE because it does not perform the

"*primary operations*" of that notional business.

93. SARS argues that the hypothetical question as to whether each of the above examples would qualify as a FBE is to be determined on the facts of what the "*business*" of the relevant entity entails and what its "*primary operations*" are.[91] However, the SCA's approach prevents such a fact-based analysis – it posits a "*true*" or "*ideal*" type of business as that of the CFC, and tests the location of the "*primary operations*" against that (inapplicable) yardstick.

94. The point is that there is no single "*ideal*" way to conceive of a business, particularly having regard to innovation in commerce. The manner in which companies employ and manage third-party resources to achieve their commercial purposes does not mean that they are not performing "*their business*" – on the contrary, that is exactly what they are doing. The SCA's approach is therefore unrealistic and unduly rigid, and would frustrate the establishment of competitive and innovative foreign businesses by South African tax residents – to the obvious detriment of the economy and the *fiscus*.

95. This also brings into focus the second acknowledged statutory purpose of the FBE definition, namely the achievement of the statutory objective of international competitiveness for offshore businesses held in CFCs. That purpose is radically undermined by the SCA's adoption of the notional-business interpretation:

95.1. An interpretation of "*the business*" and "*the primary operations of that business*"

[91] Record: Vol 19, p. 1845, para 23.10.

that accommodates only a single ideal concept of what "*the business*" entails, with the outsourcing of an important component thereof being fatal to having an FBE, would preclude residents competing with foreign rivals not subject to the same strictures.

95.2. Assume, for example, that a mobile network operator (X) is resident in South Africa and has a wholly-owned subsidiary in a neighbouring country. Assume further that, in the neighbouring country, X chooses as part of its business model to roam on the network of another network operator in order to provide telecommunications services to X's customers rather than to build its own network. If the notional-business interpretation is correct, then X could not have an FBE in the neighbouring country because the "*true business*" [92] of a mobile network operator would presumably be said to involve designing, constructing and maintaining a radio network. Such an outcome would render the activities of X uncompetitive in the neighbouring country and would require X to build its own radio network if it wishes to compete there.

95.3. The present facts provide a striking real-life example of the difficulty. It is common cause that the vast majority of Irish fund managers operate using the recognised and regulated delegation model. The same is true of fund managers in Europe and South Africa. CIMSA, on the SCA's approach, is absolutely prohibited from doing what its Irish competitors are doing if it wishes to have a CFC with an FBE in Ireland. The only way in which it can escape exposure to

[92] See paragraph [51] of the SCA judgment where this phrase is used - Record, Vol 17, pp 1709 - 1710.

South African tax rates (to which its competitors are not subject) is to set up CGFM in a manner that is necessarily uncompetitive, since it cannot then choose and manage "*best of class*" delegated investment managers as its competitors can do, and must instead use an in-house resource, without the benefit of economies of scale.

95.4. This also reveals the inherent illogicality in paragraph [54] of the SCA judgment.[93] The SCA says that "*[t]o enjoy the* same *tax levels as its foreign rivals, thereby making it internationally competitive, the primary operations of that company must take place in the same foreign jurisdiction*." What the SCA means (applied to the present example) is that to enjoy the same tax levels as its competitors, CIMSA must select the "*ideal*" and all-inclusive form of that business, and then set up the CFC in a manner that necessarily makes it uncompetitive, by resourcing itself to perform functions that are much more efficiently and sensibly outsourced, as its competitors do. This outcome cannot be in keeping with the purpose of the provisions in question, and is actively inimical to international competitiveness.

95.5. SARS adopts a similarly illogical approach in its opposing affidavit, in which it incorrectly states that the FBE definition promotes international competitiveness "*by providing a CFC with two opportunities* to *qualify for the exemption - if the locational permanence and economic substance requirements* [of SARS' "ideal" and all-inclusive form of that business] *are not met by the CFC, it can still qualify for the exemption, but then it must bring itself within the parameters of the*

[93] Record, Vol 17, p 1710.

*proviso*".[94] However, this would require the resident to set up the CFC in a manner that necessarily makes it uncompetitive, by resourcing itself (whether in the CFC or in other group subsidiaries in the same jurisdiction) to perform functions that are more efficiently outsourced, as its competitors do.[95]

95.6. The same concern does not exist if the FBE definition is read as CIMSA contends it must be, namely that the foreign fixed place of business has the necessary substance to perform the primary operations of the CFC's actual business (which business may include management and supervision of other functions) at the fixed place of business. Such an interpretation is to be preferred to one that may discourage international expansion by South African tax residents.

96. We further stress that section 9D and the FBE definition do not use the word "*outsource*." The focus is on economic substance. The FBE definition is not an "*anti-outsourcing*" provision, as appears to be central to the SCA's understanding.[96] It seeks to ensure that a foreign business has economic substance in the foreign jurisdiction, regardless of its chosen business model, and is not an illusory or "*paper*" business.

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[94] Record, Vol 17, pp 1864 - 1865, para 57.

[95] The proviso does not provide any material flexibility as the companies envisaged therein must still be part of the taxpayer's group in the foreign jurisdiction, i.e. this does not permit the taxpayer to contract with "*best of class*" third parties for specialised functions.

[96] See e.g. Record, Vol 17 p. 1710 (para [54]). Nor is the proviso to the FBE definition, which was referred to in the SCA judgment but played no role in the ultimate decision, definitive of permissible outsourcing (as SARS has argued). It merely assists a group whose resources are held across different companies within a single foreign jurisdiction to "pool" those resources for purposes of demonstrating economic substance in conducting the CFC's business. Outsourcing activities to fellow group companies is not a typical scenario.

97. We accordingly submit that the SCA erred in adopting the notional-business interpretation rather than the actual-business interpretation. This was an erroneous, non-contextual and non-purposive interpretation of the concepts of a CFC's "*business*" and the "*primary operations*" of that business.

***The appeal must succeed if the actual-business interpretation is adopted***

98. The notional-business interpretation provides the strut for the SCA's conclusion that the FBE exemption does not apply to CGFM. The SCA explained that "*if the key operations of the business have been outsourced (here, investment management), then the fixed place of business in Ireland lacks the staff and facilities to conduct those operations*".[97] In other words, the SCA held that without the investment management operations, it could not be said that CGFM was conducting its primary operations in Ireland (or anywhere else in the world, for that matter).

99. If the actual-business interpretation is adopted and applied to CGFM, then the outcome is the exact opposite. The reasons for this are self-evident:

99.1. CGFM's actual "*business*" is to be a licensed "*fund manager*" of Irish-domiciled funds in accordance with the same "*delegation model*" which is adopted, with the approval of the CBI, by the vast majority of Irish fund managers.

99.2. CGFM's "*business*" was never one in which it actually carried out the functions of investment management trading activity, fund administration, custodianship or

[97] SCA judgment – Vol 17, p 1710 para 52.

marketing. It was, from the outset, a business that performed the recognised "*management functions*," including the supervision of delegates. That was the business it undertook to the CBI and to investors (*via* the prospectus) that it would carry on.

99.3. Having identified that factually the "*business*" of CGFM is that of a fund manager, the next question is whether the Dublin office was sufficiently staffed and equipped to carry out the "*primary operations*" of that business.

99.4. There was no question that the Dublin office had sufficient staff and equipment to enable CGFM to perform the primary functions needed to carry on fund management in accordance with the delegation model in that fixed place of business. CGFM therefore satisfied the requirements in (*ii*), (*iii*) and (*iv*) of the FBE definition because the fixed place of business was suitable for the business that CGFM in fact conducted in Dublin.

100. In short, once it is recognised that CGFM's actual business is that of a fund manager on the delegated model, the entire case falls into place: it was never suggested that the Dublin office lacked the economic substance to perform the primary operations of CGFM's business under the managed delegation model.

***The appeal must succeed even if the notional-business interpretation were to be adopted***

101. Even if it were to be assumed for the sake of argument that the notional-business interpretation is correct, the SCA judgment would still be incorrect for the reasons that follow.

102. The notional-business interpretation means that, when reference is made in the FBE definition to the "*business*" and the "*primary operations of that business*" , it refers to the business that could notionally be conducted by a CFC even if the CFC does not in fact conduct that business. However, the notional business would have to be a lawful one since it is a general presumption of statutory interpretation that, when a statute refers to an action, it must be a lawful action. The presumption has been explained as follows:

> "*It is a recognised canon of construction of statutes that any reference in any law to any action or conduct, is presumed, unless the contrary intention appears from the statute itself, to be a reference to a lawful or valid action or conduct*".[98]

103. Contrary to the finding of the SCA, CGFM had not been granted a licence to perform investment management trading activities. The correct position was that CGFM's licence was, in law, limited to being a fund management company which *inter alia* supervised the performance of delegates. That was the evidence of Ms Doyle, who testified that the UCITS licence did not permit CGFM to carry out investment management trading activities and that CGFM would have breached the licence had it done so without seeking permission from the CBI.[99]

104. Significantly, Ms Doyle's evidence on this score was not challenged in cross-examination. It was therefore common cause that CGFM could not lawfully have performed investment management trading activities.

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[98] *S v Mapheele* 1963 (2) SA 651 (A) at 655D-E. The presumption has been frequently referred to: see for example *MTN International (Mauritius) Limited v CSARS* 2014 (5) SA 225 (SCA) para 10 and *City of Tshwane Metropolitan Municipality v Lombardy Developments (Pty) Ltd* [2018] 3 All SA 605 (SCA) para 21.

[99] Record, Vol 16, pp 1549 to 1551.

105. The SCA held that "*the primary operations of CGFM's business … is that of fund management which includes investment management*",[100] and that the requirements for an FBE exemption were not satisfied because those "*primary operations*" were not being conducted in Ireland. In effect, therefore, the SCA held that the business of CGFM involved an activity (i.e. investment management trading) that it would have been unlawful for CGFM to perform. Such an outcome flies in the face of the interpretive presumption that, when the FBE definition refers to a "*business*", it must be a lawful business.

***Conclusion***

106. For all the reasons given above, we submit that the SCA erred in upholding the appeal.

[100] SCA judgment – Record, Vol 17, p 1711 para 55.

## F. RELIEF SOUGHT

107. CIMSA asks for an order in the following terms:

> *(a) The applicant is granted leave to appeal.*
>
> *(b) The appeal is upheld and the order of the Supreme Court of Appeal is replaced with an order as follows:*
>
> > *'The appeal is dismissed with costs, including the costs consequent upon the employment of two counsel.'*
>
> *(c) The respondent is directed to pay the costs of the application for leave to appeal and the costs of the appeal, including the costs of two counsel.*

**ALFRED COCKRELL SC**
**MICHAEL JANISCH SC**
**CAROLINE ROGERS**
**VITIMA JERE**

Counsel for applicant
Chambers, Cape Town
13 October 2023

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

**CCT Case No.: 47/2023**
**SCA Case No.: 1269/2021**
**Tax Court Case No.: 24596**

In the matter between:

| | |
|---|---|
| **CORONATION INVESTMENT MANAGEMENT** | Applicant in the appeal/ |
| **SA (PROPRIETARY) LTD** | Respondent in the cross-appeal |

and

| | |
|---|---|
| **THE COMMISSIONER FOR THE** | Applicant in the cross-appeal/ |
| **SOUTH AFRICAN REVENUE SERVICE** | Respondent in the appeal |

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## FILING SHEET

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The respondent in the application for leave to appeal hereby presents the following documents for service and filing:

1. Heads of argument;
2. Practice note; and
3. List of authorities.

**Dated** at **Cape Town** on this the **27th** day of **October 2023**.

**THE STATE ATTORNEY**

**Per :** _____

**Ms N Hendricks**

Attorneys for the respondent in the appeal
4th Floor
22 Long Street
**CAPE TOWN**
Tel: 021 441 9200
Email:Nhendricks2@justice.gov.za
[Ref: 600/20/P23]
c/o
**THE STATE ATTORNEY**
Room 1320, 11th Floor
North State Building
95 Market Street, Cnr of Kruis Street
**JOHANNESBURG**
Tel: 011 330 7660
Email: Vdhulam@justice.gov.za
[Ref: VJ Dhulam]

**TO:** **THE REGISTRAR OF THE CONSTITUTIONAL COURT**
**BRAAMFONTEIN**

**AND TO:** **BOWMAN GILFILLAN INC**
Attorneys for the applicant in the appeal
22 Bree Street
**CAPE TOWN**
Tel: 021 4807820
Fax: 021 48303200
Email: james.mckinnell@bowmanslaw.com
juliachoate@bowmanslaw.com
[Ref: J McKinnell/ld/1143062]

c/o

**BOWMAN GILFILLAN INC**

11 Alice Lane

Sandton

**JOHANNESBURG**

2196

Tel: 011 6699383

Email: faye.bozalek@bowmanslaw.com

[Ref: F Bozalek]

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

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# RESPONDENT'S HEADS OF ARGUMENT IN THE APPLICATION FOR LEAVE TO APPEAL

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## TABLE OF CONTENTS

## [A] INTRODUCTION

1. The respondent ("*the Commissioner*") assessed the applicant ("*CIMSA*") for the 2012 year of assessment by including in its income an amount equal to the entire "*net income*" (as defined) for the 2012 year of Coronation Global Fund Managers (Ireland) Limited ("*CGFM*"). CGFM was incorporated in Ireland and is an Irish resident company situate in Dublin, Ireland.

2. Central to this assessment is whether CIMSA was entitled, for income tax purposes, to exclude from its income in its 2012 year of assessment an amount equal to the entire "*net income*" of CGFM for the 2012 year on the basis that CGFM qualified as a "*foreign business establishment*" ("*FBE*") as defined in section 9D(9)(b) of the Income Tax Act, No. 58 of 1962 ("*the IT Act*").[1]

3. It is common cause that in the 2012 year of assessment CGFM was a "*controlled foreign company*" (as defined) of CIMSA, as envisaged in section 9D and that CGFM, as a CFC in relation to its South African shareholder, is subject to the SA tax law provisions.[2]

4. Section 9D(2) provides for the imputation of the net income of a controlled foreign company ("*a CFC*") to a resident company holding participation rights in that CFC.

5. The imputation of income of a CFC is subject to certain exceptions. One such exception relates to the net income of a CFC that qualifies as an FBE in terms of

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1 References that follow are to sections of the IT Act unless otherwise indicated.

2 Record: vol 18, p. 1751, paragraph 34 (rule 31 statement) and p. 1778, paragraph 73 (rule 32 statement).

section 9D(9)(b) ("*the FBE exemption*").

6. The FBE exemption provides that in determining the net income of a CFC, any amount "*which is attributable to any foreign business establishment of that controlled foreign company*" must not be taken into account. In these circumstances, when determining the net income of the CFC that qualifies as an FBE, such income is not taken into account in determining the tax liability of the South African resident shareholders. CIMSA relied on the FBE exemption for excluding the net income of CGFM from its income in the 2012 year of assessment.

7. The Commissioner disagreed with this exclusion and on 23 March 2017 raised an additional assessment against CIMSA in respect of the 2012 year of assessment. The Commissioner was of the view that CGFM was not entitled to the FBE exemption because it did not comply with the requirements of the definition of a "*foreign business establishment*".

8. CIMSA has objected to and appealed against the additional assessment on the basis that all the income of CGFM is attributable to an FBE of CGFM situate in Dublin, Ireland. Consequently, the Commissioner was wrong in exercising his power under section 9D(2)(a);[3]

9. CIMSA has also objected to and appealed against the imposition by SARS of: (1) understatement penalties under section 222 of the Tax Administration Act, No. 28 of 2011 ("*the TAA*");[4] (2) under-estimation penalties for provisional tax under paragraph 20 of the Fourth Schedule to the IT Act,[5] and (3) interest in terms of section 89*quat*(2) of the IT Act.

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3 The Commissioner partially allowed CIMSA's objection by allowing CIMSA's foreign tax credits and issued a reduced assessment for additional tax in the amount of R19 317 275.

4 A 10% understatement penalty was imposed in the amount of R1 931 727.

5 An under-estimation penalty was imposed in the amount of R2 385 657.

10. The Tax Court found that CIMSA was entitled to the FBE exemption and upheld the appeal. It set aside the additional assessment for the 2012 year of assessment and directed the Commissioner to issue CIMSA with a reduced assessment for its 2012 year of assessment in which no amount was included under section 9D in respect of the income of CGFM.

11. On appeal, the Supreme Court of Appeal ("*the SCA*") held that CIMSA was not entitled to the FBE exemption and upheld the appeal. The SCA directed CIMSA to pay the amount assessed in the additional assessment but held that CIMSA was not liable for understatement penalties and under-estimation penalties.[6]

12. CIMSA thereupon applied for leave to appeal to the Constitutional Court. The Commissioner applied for leave to cross-appeal the SCA's findings in respect of the understatement penalties and under-estimation penalties.

13. On 6 September 2023 this court directed that both the application for leave to appeal and the application for leave to cross-appeal would be set down for hearing in due course and that heads of argument be filed by the parties in accordance with the timetable set forth therein.

## [B] THE MATERIAL FACTS

14. CIMSA is a South African registered and tax resident company and the holding company for the international operations as well as the treasury functions for the Coronation Fund Managers Group ("*the Coronation Group*").

15. The corporate structure of the Coronation Group during the 2012 year of assessment is set out in paragraph [2] of the SCA judgment.[7]

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6 Record: vol 17, p.1689.
7 Record: vol 17, p. 1690; record: vol 2, p. 128 (exhibit A).

16. The Coronation Group was founded in 1993, as a leading fund management group offering a comprehensive range of local and international, traditional fund management and multi-manager alternative investment products to institutional and individual investors.[8] The Coronation Group's ultimate holding company, Coronation Fund Managers Limited ("*CFM*") is listed on the Johannesburg Stock Exchange, South Africa and has a number of local and offshore subsidiaries. The Coronation Group provides the opportunity for clients to invest in South African domiciled and Irish domiciled collective investment funds ("*collective investment schemes*" or "*CIS*").

17. In the 2012 financial year the Coronation Group operated through three major offshore fund structures, two of which are domiciled in Ireland and one in the Cayman Islands.[9]

18. CFM's 2012 Transfer Pricing Report states that the "*business*" of these CIS offshore fund structures is to invest the money that they receive in terms of their investment guidelines, as per the prospectus and to obtain returns for their investors in excess of the fees charged to the investors. The level of expected returns is dependent on the strategy and risk profile of the fund, which is detailed in the prospectus.[10]

19. In order to operate, establish and manage a CIS in Ireland, a management company had to be incorporated and licensed. A South African entity cannot be appointed as fund manager in respect of an Irish domiciled CIS. The Coronation Group appointed CGFM as the fund manager of its collective investment scheme (CIS) in Ireland.

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8 Record: vol 11, p. 1048, paragraph 1.1 (CFM Transfer Pricing Report for the financial year ended 30 September 2012).

9 Record: vol 11, p. 1049, paragraph 2.1.

10 Record: vol 11, p. 1049, paragraph 2.1. The Transfer Pricing Report was prepared by ENS in consultation with CIMSA. Mr Snalam testified that CIMSA provided the information to ENS as to how the business operated and ENS pulled everything together for purposes of the report and which was then ratified as to correctness in terms of how the business operated (vol 13, p. 1248, line 8 to p.1249, line 4.) Mr Snalam accepted that everything in the transfer pricing report was correct (vol 13, p. 1249, lines 2-4).

## [C] THE INVESTMENT MANAGEMENT LICENCE

20. CGFM applied to the Irish Financial Services Regulatory Authority on 23 October 2007 for authorisation of a UCITS "*management company*" under the European Communities (Undertakings for Collective Investment and Transferable Securities) Regulations, 2003 ("*the UCITS regulations*").[11]

21. On 25 October 2007 CGFM obtained its authorisation from the Central Bank of Ireland ("*CBI*") ("*the investment management licence*") under the European Investment Directive 93/22/EEC and the Investment Intermediaries Act, 1995 ("*IIA*") as a "*management company*" under the UCITS regulations.[12] CGFM thus obtained an investment management licence under the Investment Services Directive 93/22/EEC.[13]

22. In the business plan submitted in support of its application to be licenced as a management company, CGFM presented an outsource business model,[14] in terms of which CGFM elected to "*outsource*" or "*delegate*" the following activities attributed to a management company:

    22.1. Investment management: This function was delegated to Coronation International Limited ("*CIL*"), a United Kingdom tax registered and tax resident company and to Coronation Asset Management (Pty Ltd ("*CAM*") a South African tax registered and tax resident company.

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[11] Record: vol 2, pp. 146 - 207. This was the culmination of an application process that commenced on 5 June 2007 (record: vol 12, pp. 1093 - 1146).

[12] Record: vol 1, pp. 20 - 25. In terms of the licence granted by the CBI to CGFM on 25 October 2007 to act as a UCITS management company, the following is stated under the heading *'Authorisation of a UCITS management company' - 'This is to certify that Coronation Fund Managers (Ireland) Ltd established on 2 September 1997 has on 25 October 2007 been authorised by the Irish Financial Services Regulatory Authority as a management company in accordance with the provisions of the European Communities (undertakings for collective investment in transferable securities) Regulations, 2003 as amended…".* (emphasis supplied).

[13] Record: vol 18, p 1744, paragraph 17 (the rule 31 statement). This is admitted by CIMSA in the rule 32 statement at record: vol 18, p 1774, paragraph 60.

[14] Record: vol 18, p. 1744, paragraph 18; record: vol 12, p.1176, line 20 to p.1179, line 7.

22.2. Administration: This function was delegated to JP Morgan Hedge Fund Services (Ireland) Limited and JP Morgan Administration Services (Ireland) Limited.

22.3. Custody: This function was delegated to JP Morgan Bank (Ireland) Plc.

22.4. Distribution. This function was delegated by to CIL.[15]

23. These activities outsourced by CGFM constituted the sum total of all the activities attributed to a management company.

24. Schedule 1 of the investment management licence[16] authorised CGFM to perform collective portfolio management and expressly excluded individual portfolio management.

25. The UCITS regulations, 2011[17] defines:

25.1. "*collective portfolio management*" as "*the management of UCITS and other collective investment undertakings, and includes the functions specified in Schedule 1*".[18] (emphasis supplied).

25.2. a "*management company*" as "*a company the regular business of which is the management of UCITS in the form of Unit Trusts, common contractual funds or investment companies (or any combination thereof), and includes the functions specified in Schedule 1.*"[19] (underlining added).

26. Schedule 1 of the UCITS regulations, 2011[20] sets out the functions that are included in

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15 Record: vol 2, p. 153, paragraph 7 read with p. 177, paragraph 10.4; record: vol 11, p. 1051 to p.1054, paragraphs 3.2 to 3.5.4.
16 Record: vol 1, p. 25.
17 Record: vol 9, pp. 854 - 989.
18 Record: vol 9, p. 866.
19 Record: vol 9, p. 868.
20 Record: vol 10, p. 964.

collective portfolio management, namely (1) Investment Management, (2) Administration, and (3) Marketing.

27. Although CGFM applied for and was granted the investment management licence on the basis that the activities of investment management, administration and marketing would be delegated (or outsourced) by it, CGFM still retained ultimate responsibility for those functions. The evidence of Ms Doyle[21] and Mr Casey[22] was unequivocal that the delegation of investment management activities would not relieve CGFM of its ongoing responsibility to the CBI and that CGFM would also retain monitoring and oversight obligations in respect of the delegated functions.

28. CIMSA seeks to draw a distinction between the delegation of the investment management function by it and what it calls the "*investment management trading activities.*"[23] It contends that "*despite what the SCA found and what SARS submits, CGFM was not approved by the CBI to perform investment management trading activities itself.*"[24] The distinction sought to be drawn is devoid of merit and serves only to obfuscate the issues that this court is called upon to consider. In. this regard the following is highlighted:

    28.1. The activity of investment management is an all-encompassing activity and includes investment management trading activities. A licensed management company is not ascribed a separate or additional activity of "*invest management trading activities*". CIMSA's own witness, Ms Doyle testified that investment management trading activities are a component of the investment management activity.[25]

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21 Record: vol 16, p. 1572, line 23 to p.1573, line 17. Ms Doyle testified that investment management trading activities are a component of investment management activities (at vol 6, p. 1569, lines 3 to 8).
22 Record: vol 16, p. 1591, lines 5 to 8.
23 Heads of argument: p.5, paragraph 9.
24 Heads of argument: p17, paragraph 44.
25 Record: vol 16, p 1669, lines 3 to 8.

28.2. This is demonstrated by the application submitted to the Irish Financial Services Regulatory Authority titled "*Application for the authorisation of a UCITS Management Company*".[26] Delegation is addressed in the application which provides that a management company may delegate functions subject to the provisions of the UCITS Regulations and requires an applicant to submit in its Business Plan the functions which it intends delegating.[27]

28.3. In responding to this requirement in its Business Plan, under the heading "*Appointment of Service Providers*", CIMSA stated that the "*service providers listed below have been appointed to carry out investment management, trustee, administration …*"[28]. In respect of the investment management function, CIMSA lists the "*Investment Manager*" as CIL and CAM (the very entities that will perform the investment management trading activities). Thus, on its own showing, CIMSA accepted that the trading activities are included in the investment management function. It is wholly inappropriate to now seek to draw this distinction when trading activities are embedded in investment management.

28.4. The plain absurdity of CIMSA's focus on "*investment management trading activities*" (as being a substantively different activity) goes even further. While CIMSA accepts that it delegated its investment management function, it criticises the SCA's finding that "*the primary operations of CGFM's business is that of fund management … which includes investment management*" on the basis that "*CGFM had not been granted a license to perform investment management trading activities and could not lawfully have performed investment management trading activities.*"[29] CIMSA simply misses the point: the three activities are the

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26 Record: vol 2, p. 146.
27 Record: vol 2, p. 153, paragraph 7.
28 Record: vol 2, p. 177, paragraph 10.4.
29 Heads of argument: p.5, paragraph 9.

functions of CGFM due to it being licensed as a "*management company*". Those three activities are only capable of being delegated by CGFM because it possesses them. CGFM's outsource business model made provision for the delegation of *inter alia* the investment management function, which includes the trading activity which were delegated to CIL and CAM.

28.5. CIMSA states that the "*investment management trading activities*" was referred to in the evidence as such to distinguish it from "*other aspects of investment management.*"[30] The reality is that CGFM outsourced all the investment management activities attributed to it as a licensed management company, so there are in fact *no* other aspects of investment management to speak of that CGFM was capable of performing or that it retained.

28.6. The only remaining functions that CGFM was compelled to perform were the "*managerial functions*" attached to Collective Portfolio Management. The managerial functions were not capable of being delegated[31] and had to be carried out in Ireland[32] and attached to CGFM irrespective of whether the functions of investment management, administration and marketing were delegated or not (i.e., performed in-house by CGFM). CGFM's contention that it "*undertook*", pursuant to the delegated business model to "*conduct specified fund management functions*"[33] (i.e., managerial functions) is not only contrived but also patently wrong – it was compelled to perform these managerial functions.

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30 Heads of argument: p.15, paragraph 39.

31 CIMSA agrees that the managerial functions could not be delegated, but erroneously refers to these functions as "*management functions*" - heads of argument, p.16, paragraph 43. CIMSA's confusion stems from it misquoting the relevant passage in paragraph 43 of its heads of argument (at p.17) by substituting the word "*managerial functions*" in the original text (at record: vol 12, p.1134) with "*management functions.*"

32 Record: vol 2, p. 153, paragraph 6.

33 Heads of argument: p.16, paragraph 43.

28.7. Signally, CIMSA contends that the "*managerial functions*" constitute the business of CGFM. The Commissioner contends that the managerial functions are merely incidental to the business of a fund manager, as the SCA found (we deal with this in greater detail in section [H]).

29. Pursuant to the licence, CGFM was appointed as fund manager of the Coronation Group's Irish domiciled CIS, being the Coronation Global Opportunities Fund and the Coronation Universal Fund. CGFM was also appointed to manage Coronation Investment Holdings Ltd ("*CIHL*"), an umbrella limited liability corporate alternative investment fund domiciled in the Cayman Islands.

## [D] THE FBE DEFINITION

30. Section 9D defines a CFC as "*any foreign company where more than 50% of the total participation rights in that foreign company are directly or indirectly held, or more than 50% of the voting rights in that foreign company are directly or indirectly exercisable, by one or more persons that are residents other than persons that are headquarter companies...*".

31. It is common cause that CGFM is a CFC in relation to CIMSA as envisaged in section 9D because it indirectly holds a 100% interest in CGFM. CIMSA had claimed an exemption in terms of section 9D(9)(b) in relation to the net income generated by CGFM which implied that CGFM met the requirements of an FBE.

32. If this was so, as CIMSA contends, the income attributable to CGFM (as an FBE of the CFC) is excluded from the "*net income*" of CIMSA, in terms of section 9D(9)(b).

33. If not, as the Commissioner contends, section 9D(2) provides for the imputation of the "*net income*" of CGFM to CIMSA, a resident company holding participation rights in that CFC.

34. The definition of "*foreign business establishment*" and the requirements to qualify as an FBE are set out in section 9D(1). The definition is reproduced in paragraph [10] of the SCA judgment[34] and is not repeated here.

35. The following aspects of the FBE definition are highlighted below.

36. Firstly, paragraph (a) contains a broad general description of the term "*foreign business establishment*", which brings out the essential characteristics relevant to the exemption. This general requirement is directed at ensuring that the CFC has a "*substantial presence*" in the country in which it operates.[35]

37. Secondly, subparagraphs (i) to (v) list the specific requirements that a CFC must possess in order for it to qualify as an FBE:[36]

    37.1. Subparagraph (i) relates to the "*locational permanence*" of the business of the CFC.

    37.2. Subparagraph (ii) to (iv) relates to the "*economic substance*" of the business of the CFC.

    37.3. Subparagraph (v) relates to the "*non-tax business reason*" of the business of the CFC.

38. Thirdly, and we submit crucially, the proviso to the FBE definition expressly allows for the outsourcing of the locational permanence and the economic substance of a CFC as contemplated in subparagraphs (i), (ii), (iii) and (iv). The proviso makes it clear that when analysing whether a CFC meets these requirements, the utilisation by that CFC of structures, employees, equipment and facilities belonging to one or more other

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34 Record: vol 17, p. 1693.
35 De Koker and Williams *Silke on South African Income Tax* 5.44 at pp. 5-61 to 5-62.
36 The terms "*locational permanence*", "*economic substance*" and "*non-tax business reason*" appear from the rule 31 statement at record: vol 18, p. 1750, paragraph 31.

companies may be taken into account. However, for purposes of taking it into account, the other company:

38.1. Must be subject to tax in the country in which the fixed place of business of the CFC is located by virtue of residence, place of effective management or other criteria of a similar nature (proviso (aa));

38.2. Must form part of the same group of companies as the CFC (proviso (bb)); and

38.3. To the extent that the structures, employees, equipment and facilities are located in the same country as its fixed place of business (proviso (cc)).

39. It is clear from the FBE definition that the legislature affords a CFC not one but two opportunities to qualify as an FBE, and thus to be eligible for the exemption. In this regard, the definition of an FBE under paragraph (a):

39.1. Requires that each of the requirements in subparagraphs (i) to (v) be present in a fixed place of business in order for a CFC to qualify as an FBE; alternatively

39.2. If any of the requirements in subparagraphs (i) to (iv) are not present at the fixed place of business, the CFC is still able to qualify as an FBE if each of the discreet requirements in subsections (aa), (bb) and (cc) of proviso is met.

40. A proviso is not a separate and independent enactment. The words of a proviso are dependent on the principal enacting words, to which they are attached as a proviso and must be read and considered in relation to the principal matter to which it is a proviso. The words of the proviso cannot be read as though divorced from their

context.[37]

41. De Koker and Williams, in relation to the proviso, state the following:[38]

> *"Few companies function completely independently, and businesses form partnerships with suppliers as well as with outside contractors. Working with outside contractors, or outsourcing, enables companies to conduct their activities more efficiently and effectively. Although it would be contrary to the definition of a FBE for all the activities of a business establishment to be outsourced to third-party suppliers, some outsourcing of activities is possible. To the extent that it is provided by a group company, this is expressly recognised subject to certain conditions .... But which functions may be outsourced to other parties must always depend on the particular facts and, to some extent, may vary according to the nature of the industry. Where outsourcing does occur, a manager should possess experience, knowledge and skills in relation to the primary business operations and must also have the authority to dismiss an underperforming outsourcing serviced provider. Clearly the personnel, equipment and facilities for the critical 'primary operations' of a business, cannot be outsourced; but secondary operations, which are presumably determined in accordance with reference to turnover, profitability or assets employed, need not necessarily require dedicated personnel, equipment and facilities."* (underlining added).

42. CGFM outsources its investment management function to CAM, a South African resident and to CIL, a UK resident, contrary to the requirements of proviso (aa) and (cc), as both CAM and CIL are not subject to tax in Ireland and the operational employees that the function is outsourced to is not located in Ireland. CGFM accordingly does not meet the requirements of an FBE.

43. Had CGFM met the requirements of proviso (aa) and (cc), it would have qualified as

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37 *Director of Public Prosecutions, Kwazulu-Natal v Ramdass* 2019 (2) SACR 1 (SCA) at [14].
38 *Op cit* at 5.44, p. 5-63.

an FBE, within the meaning of the definition.

## [E] THE ISSUES IN DISPUTE

44. Before addressing the issues in dispute, it is apposite to commence by setting out what is not in dispute *apropos* the definition of an FBE:

44.1. That CGFM, as a CFC of CIMSA, has a fixed place of business in Ireland, as contemplated in paragraph (a) of the definition;

44.2. The "*locational permanence*" of the business of the CFC, as contemplated in subparagraph (i) of the definition; and

44.3. The "*non-tax business reason*" of the business of the CFC, as contemplated in subparagraph (v) of the definition.

45. The disputed issues relate to the economic substance of the business of the CFC (subparagraphs (i) - (iv) of the definition of an FBE) and whether those requirements are met in the context of the "*business*" conducted by CGFM in Ireland. In order to determine whether the business operations of CGFM qualifies it as an FBE, it is necessary to consider what "*business*" exactly CGFM conducts in Ireland and what the "*primary operations of that business*" entails.

46. It is against the above background that the opposing contentions of the Commissioner and CIMSA which are summarised below fall to be considered:

*The Commissioner's contentions*

46.1. CGFM is licensed by the CBI as an investment management company having obtained an investment management licence.

46.2. The activities of a management company, whether such activities are

delegated or not, are: (1) investment management (which includes the trading activities); (2) administration; and (3) marketing.

46.3. The core or primary operation of an investment management company is investment management. Investment management is a primary operation of CGFM, having applied for and having obtained an investment management licence from the CBI.

46.4. CGFM outsources all its functions for which it is licensed as a management company, including its primary function of investment management, to offshore entities, namely CIL (in South Africa) and CAM (in London).

46.5. CGFM's primary function of investment management in terms of the investment management licence, is accordingly not conducted by CGFM in Ireland.

46.6. The question whether CGFM qualifies as an FBE, notwithstanding the outsourcing of such primary operations to offshore entities, must be answered with reference to the proviso to the definition of FBE.

46.7. CGFM does not meet the requirements of an FBE as such functions are not outsourced to a company in Ireland where CGFM is located, as required in terms of the proviso.

46.8. Had the "primary operations" of the "business" of CGFM, as aforesaid, been outsourced to a company that is subject to tax in Ireland where CGFM is located (proviso (aa)), within the same group of companies as CGFM (proviso (bb)) and to the extent that the structures, employees, equipment and facilities are located in Ireland where CGFM is located (proviso (cc)), it would have qualified as an FBE, as defined.

46.9. CGFM's fund management business includes the outsourcing of its investment management function. The actual performance of investment management services is not a primary operation of CGFM's business. The outsourcing of the investment management function constitutes the outsourcing of an ancillary function.

46.10. The primary operations of CGFM's fund management business are all conducted by it in Ireland. CIMSA contends that its primary operation is the "*managed outsourcing of the investment management function in accordance with the terms of the licence*".[39]

46.11. CGFM does *not* rely on the proviso to the definition of an FBE in order to determine whether it meets the requirements of an FBE as (it contends that) its primary operations has not been outsourced.

## [F] INTERPRETATION OF THE LEGISLATION

47. The interpretive process enjoined by section 9D of necessity involves examining what constitutes: (1) "*the business of that controlled foreign company*"; and (2) the "*primary operations of that business*".

48. In *Natal Joint Municipal Pension Fund v Endumeni Municipality*[40] this court held that *"[i]nterpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances*

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39 Record: vol 18, p 1769, paragraph 33.2.

40 2012 (4) SA 593 (SCA) at paragraph [18]. See also *Tshwane City v Blair Atholl Homeowners Association* 2019 (3) SA 398 (SCA) at paragraphs [61] to [64].

*attendant upon its coming into existence ...*"

49. Important to the interpretative process, and subject to the need to contextualise the provision and to read it purposively and sensibly, is that words in a statute must be given their ordinary meaning, unless this would result in an absurdity.[41]

50. We also point out that the *contra fiscum* rule finds no application in this matter since there is no ambiguity whatsoever in the statutory provisions under consideration.[42]

51. When interpreting the words "*the business of that controlled foreign company*" and "*the primary operations of that business*" in the definition of an FBE, this must of necessity take into account: (1) the ordinary grammatical and literal meaning of the words used; (2) the purpose of section 9D; and the context of paragraph (a) of the definition of an FBE and the broader context of section 9D, with a view to achieving a reasonable, sensible and business-like interpretation.

52. Section 9D is an anti-avoidance provision.[43] It is aimed at preventing South African residents from excluding certain taxable income from the South African taxing jurisdiction through investments in CFCs. Oguttu A *International Tax Law* in the chapter "*Curbing tax avoidance resulting from investments in offshore companies*" explains the purpose of the South African CFC legislation and the competing principles of anti-deferral and international competitiveness as follows:

> "*Apart from the fact that South African residents are taxed on a 'residence basis of taxation' which ensure that South African resident companies are taxable on their worldwide income, South Africa also has legislation that prevents South African residents from deferring South African tax on foreign income that is derived from non-resident companies. In order to bring into the tax*

41 *Smyth v Investec Bank Limited* 2018 (1) SA 494 (SCA) at paragraphs [27] and [28].
42 *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* 1975 (4) SA 715 (A) at 727H–728A.
43 Olivier & Honiball *International Tax, A South African Perspective* 2011 (5th Ed) at paragraph 3.1, p. 561.

*net the income earned by South African owned foreign entities (such as foreign subsidiaries) and to counter the deferral of taxes, the worldwide taxation of South African residents is extended in the Income Tax Act in order to deem income of a foreign company to be that of South African residents, notwithstanding the fact that the actual income is received by or accrues to a foreign company. Through the use of CFC legislation, the delay or deferral of taxes is curbed by taxing the South African owners of foreign companies on the income earned by those foreign companies, as if they had repatriated their foreign income as soon as it was earned…"*[44] *and*

*"From a policy perspective, all of these exemptions are part of a framework that seeks to strike fair balance between protecting the tax base and the need for South African multi nationals to be internationally competitive."*[45] (emphasis supplied).

53. In June 2002, National Treasury issued a "*Detailed Explanation to Section 9D of the Income Tax Act*" ("*the Treasury Explanation*").[46] The purpose of section 9D was described as requiring a "*complex balancing approach*" between two diametrically opposed principles of anti-deferral (which warrants complete taxation) and international competitiveness (which warrants complete exemption).

54. The fact that the FBE definition promotes international competitiveness is manifest:

54.1. Although the Treasury Explanation makes it clear that the exemption favours international competitiveness[47], we submit that this can only be so to the extent that a South African resident is able to bring itself within the parameters of the jurisdictional requirements of the exemption, and in the present matter, within the jurisdictional requirements of the FBE definition. To the extent that a South African resident entity is *not* able to do so, anti-

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44 1st Edition, paragraph 5.5, p. 139.
45 1st edition, paragraph 5.5, p. 140.
46 Record: vol 18, pp. 1790 to 1791. The Treasury Explanation of these competing principles is replicated in paragraph 23 of CIMSA's heads of argument.
47 Record: vol 18, paragraph C1, pp. 1797.

deferral will prevail, which will warrant complete taxation.

54.2. As we have pointed out, the FBE definition provides a CFC with two opportunities to qualify for the exemption – if the locational permanence and economic substance requirements are not met by the CFC, it can still qualify for the exemption, but then it must bring itself within the parametres of the proviso. If the CFC is still unable to do so, as in the case of CGFM (by not complying with the requirements of the *proviso*) anti-deferral will prevail which warrants complete taxation in South Africa.

55. The requirements of an FBE determine *inter alia* that income derived from substantive business activities carried on offshore is not subject to taxation in the hands of South African residents, while non substantive business undertakings remain subject to the CFC legislation and taxed in the hands of the South African residents. Olivier *et al* state the following in relation to the FBE exemption:[48]

> *'From the wording of section 9D(9)(b) it is clear that in granting the exemption, the legislature attempted to strike a balance between granting an exemption to income derived from legitimate business activities and that derived from illusory or non-substantive business undertakings."*

56. De Koker and Williams[49] state the following pertaining to the requirements of an FBE:

> *"This requirement is directed at ensuring that the CFC has a substantial presence in the country in which it operates. In this context, the CFC must have a fixed place of business that comprises the necessary physical infrastructure - in the form of suitable premises, equipment, personnel and facilities - to perform the primary operations of that business".*

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48 *Id* at paragraph 3.3.2, p. 581.
49 *Loc cit* at p. 5-61, paragraph 5.44.

(emphasis added).

57. The evidence before the Tax Court was that the outsource business model adopted by CGFM constitutes a common commercial practice in the sphere of fund management in Ireland where approximately 70% to 80% of the fund industry utilise the outsource model.[50] We submit that this commercial practice is not relevant to the definition of an FBE, and in particular, when determining what CGFM's "*business*" is and what constitutes the "*primary operations*" of such business. In this regard:

57.1. While CGFM, as a CFC of a South African resident is entitled from a business perspective to structure its affairs in whatever way it deems fit in Ireland, as a CFC in relation to its South African shareholders it is subject to the South Africa legislative provisions, in particular the definition of an FBE to determine whether it qualifies for the FBE exemption.

57.2. For purposes of considering whether a CFC qualifies as an FBE, one has to give meaning to the words used in the legislation having regard to the context provided by reading the provision in light of the document as a whole and the circumstances attendant upon its coming into existence.[51]

57.3. In *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue*[52] the following was stated in relation to the anti-avoidance provision in section 103(2) of the IT Act:

> "*Sec. 103 of the Act is clearly directed at defeating tax avoidance schemes. It does not impose a tax, nor does it relate to the tax imposed by the Act or to the liability therefor or to the incidence thereof, but rather to schemes designed for the*

50 Record: vol 4, p. 385, paragraph 15.
51 *Endumeni* at paragraph [18].
52 *Supra* fn 35.

*avoidance of liability therefor. It should, in my view, therefore, not be construed as a taxing measure but rather in such a way that it will advance the remedy provided by the section and supress the mischief against which the section is directed.*" (emphasis added).

57.4. The definition of an FBE therefore falls to be interpreted in light of the question whether the income derived by the CFC is from substantive business activities, within the meaning and ambit of the definition.

57.5. The advancement of the remedy and the suppression of the mischief to which that section is directed plainly cannot have regard to the "*common commercial practice*" of outsourcing arrangements in Ireland but must be interpreted in light of the definition of an FBE, and in particular whether the business model of outsourcing adopted by CGFM in Ireland entitles a CFC to the FBE exemption.

## [G] LEAVE TO APPEAL SHOULD BE REFUSED

58. CIMSA's contends that this matter engages the jurisdiction of this court pursuant to the provisions of section 167(3)(b)(ii) of the Constitution on the basis that the matter "*raises an arguable point of law of general public importance which ought to be considered*" The Commissioner contends that it does not, and that leave to appeal should be refused.

*Arguable point of law*

59. CIMSA submits that the appeal raises and turns on a point of law[53] (paragraph 14) requiring the guidance of this court to "*clarify the meaning and the application of a statutory provision (the FBE exemption of the CFC rules)*".[54] Furthermore, that the point of law is the

[53] Record: vol 17, p. 1654, paragraph 14.1
[54] Record: vol 17, p. 1654, paragraph 14.3.

*"proper interpretation of section 9D … and in particular the FBE definition and its application to the facts."*[55].

60. The dispute before the SCA and indeed, before the Tax Court, was whether those facts (which were largely common cause)[56], supported the competing narratives of the Commissioner or CIMSA on what constitutes, for purposes of the requirements of the FBE definition:

60.1. The "*business*" of CGFM in Dublin, Ireland; and

60.2. The "*primary operations of that* [CGFM's] *business*".

61. This was the basis on which the parties approached the matter in their pleadings and in the hearing before the Tax Court and in the SCA. CIMSA called two lay witnesses who testified on these factual issues. CIMSA also called two expert witnesses who testified amongst other things on the Irish regulatory environment, the outsourcing model chosen by CGFM and the fact that CGFM retained ultimate responsibility for the licenced activities. Both the Tax Court and the SCA determined the matter by having regard to the factual evidence.

62. CIMSA, in an attempt to clothe this court with jurisdiction, has for the first time in its application for leave to appeal sought to rely on a point of law. Its new-found contention that the proposed appeal to this court turns on the proper interpretation of the FBE definition is contrived. Neither the SCA nor the Tax Court undertook any interpretative exercise relative to section 9D, or in particular, the FBE definition. Notably, neither court was called upon to do so since the matter turned exclusively on issues of fact.

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55 Record: vol 17, p. 1654, paragraph 18.

56 CIMSA goes as far as stating in its heads of argument at paragraph 14 that "… *there were no material disputes of fact.*"

62.1. The SCA quoted the FBE definition in section 9D(1)[57] and proceeded to enumerate the factual issues which it was required to determine[58], as follows:

*'The location of the 'primary operations', referred to in Section 9D(1)(a)(ii) – (iv) is pivotal in determining whether CGFM is an FBE as defined. This requires a determination as to the nature of CGFM's business in Ireland, and in particular, whether the primary operations have been outsourced, and if so, whether an exemption in terms of Section 9D is applicable."* (highlighting added).

62.2. Under the heading "*Pleadings and Evidence*"[59] the SCA proceeded to delineate the factual issues relative to whether CGFM qualified for the FBE exemption and highlighted the parties' opposing contentions.

62.3. The SCA held that its finding of what constitutes the primary operations of CGFM's business was reached "[*On*] *these particular facts.*"[60]

63. It is manifest from the SCA judgment (and the Tax Court judgment) that the issue for determination was what constituted the "*business*" of CGFM in Ireland and what the "*primary operations of that business*" entailed, by having regard to the facts. The determination of those factual questions was central to whether or not the FBE exemption found application. The SCA held that CGFM did *not* qualify for the FBE exemption. The ambit of the factual dispute is succinctly summarised by the SCA in paragraphs [17] to [20] of the judgment.[61]

64. CIMSA submits that the SCA utilised a *"patently incorrect approach"* to what constitutes *"the business of that controlled the foreign company"*[62] Even if CIMSA was correct in this

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57 Record: vol 17, p. 1693, paragraph [10].
58 Record: vol 17, pp. 1693 to 1694, paragraph [11].
59 Record: vol 17, p. 1694 to 1698, paragraphs [12] to [21].
60 Record: vol 17, pp. 1711, paragraph [55].
61 Record: vol 17, pp. 1696 to 1697.
62 Record: vol 17, pp. 1670, paragraph 71.

submission (which is denied) this would go to the question of the proper evaluation or assessment of the evidence by the SCA which would constitute an error of fact, and not one of law. This, in effect, constitutes an acknowledgement that the matter turns on fact, not an arguable point of law[63] and this court's jurisdiction is therefore not engaged.

65. The SCA, in a clear and well-reasoned judgment, upheld the Commissioner's appeal against the decision of the Tax Court. By having regard to the factual evidence before it, the SCA determined what the *"business"* of CGFM entailed and what the *"primary operations of that business"* was. In this regard the following is highlighted:

65.1. As regards the question what the *"business"* of CGFM entailed in Ireland, the court dealt with this in paragraphs [27] to [39][64] by prefacing that determination with the question (in paragraph [27])[65], *"[W]hat is the precise nature of the business that CGFM's license approves?"* By this, the SCA appreciated the centrality of the Investment Management Licence that CGFM applied for and was granted by the CBI. (underlining added).

65.2. As regards the question of what the *"primary operations"* of CGFM's "*business*" entailed, the SCA dealt with this in paragraphs [40] to [54][66] and concluded that the primary operations of CGFM was "*investment management.*"

66. We submit that the SCA reached its conclusions on a correct understanding of the facts (in respect of which there were no material disputes) and by the application of the facts to the requirements of the FBE definition in section 9D of the ITA, for

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63 See *General Council of the Bar of South Africa v Jiba and Others* 2019 (8) BCLR 919 (CC) at paragraph [58].
64 Record: vol 17, pp. 1700 to 1705.
65 Record: vol 17, p. 1700.
66 Record: vol 17, pp. 1705 to 1710. 66 Record: vol 17, pp. 1700 to 1705.
66 Record: vol 17, p. 1700.
66 Record: vol 17, pp. 1705 to 1710.

purposes of determining whether CGFM qualifies for the FBE exemption.

*General public importance*

67. CIMSA contends that the matter is of general public importance in that *"the impact of the SCA judgment extends well beyond the immediate interest of CIMSA and Coronation"*, which includes *"industry participants that have established fund management companies in foreign jurisdictions (including Ireland) and that provide services to CISs in those jurisdictions"* and also *"potentially affects, every South African resident with a CFC in respect of which the FBE exemption is or maybe claimed"*.[67]

68. We submit that the SCA judgment has *no* impact on the general public and can under no circumstances be said to be of *"general public importance"*.

69. This is a narrow and isolated case, entirely fact dependent. The SCA stated in paragraph [55][68] of the judgment that the conclusion is reached "*on these particular facts*". Those facts were determined with reference to the pleadings, the documents referred to in the judgment and the evidence adduced by the four witnesses called by CIMSA.

70. A court, approached in a different matter with a different set of facts pertaining to the "*business*" and its "*primary operations*" of a CFC will make a determination based on those facts. The SCA judgment (decided on CIMSA's own particular facts) cannot influence the application of those facts (in a different matter) to the FBE definition.

71. It is thus not correct to say, as CIMSA does, that the SCA judgment *"affects, or potentially affects, every South African resident with a CFC in respect of which the FBE exemption is or may be claimed"*.

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67 Record: vol 17, pp. 1682 to 1683, paragraphs 109 to 11; CIMSA's heads of argument: pp. 28 to 29, paragraphs 72 to 74.

68 Record: vol 17, p. 1711.

72. In the opposing affidavit to CIMSA's application for leave to appeal, the deponent stated definitively that there are no appeals pending where there is a dispute concerning the FBE status of a CFC (save for the present matter). Furthermore, that she was also aware of South African residents with a CFC that do *not* claim the FBE exemption. This, we submit, is illustrative of the fact that a simple application of the facts (based on what "*business*" the CFC conducts and what the "*primary operations*" of that business is) to the uncontentious requirements of the FBE definition, will yield an answer whether a CFC qualifies for the FBE exemption.

73. Because this is a fact-dependant enquiry, the question, hypothetically raised by CIMSA in paragraph 92 of its heads of argument, whether Uber, Air BnB, providers of satellite television and courier companies qualify as an FBE, is not only meaningless but also premature in the absence of facts pointing to what the "*business*" of the relevant entity entails and what its "*primary operations*" are.

73.1. For example, CIMSA contends that the provision of transport is the "*core*" service that Uber provides, yet Uber owns no vehicles.

73.2. An internet search describes the Uber business model as follows: "*Uber works as a digital aggregator app platform, connecting passengers who need a ride from point A to point B with drivers that are willing to serve them… **'Passengers'** generate the demand, **'Drivers'** supply the demand and **'Uber'** acts as the marketplace/facilitator to make this all happen seamlessly on a mobile platform.*"[69] (underlining added).

73.3. CIMSA assumes, without more, that Uber is a "*transport company*", and because it is not providing transport, the SCA's judgment has the effect that Uber could never have an FBE. Quite apart from the fact that Uber is not a South

[69] https:/mobisoftinfotech.com: *Uber Business Model Explained: From Start to Finish.*

African resident company and that the CFC legislation could never apply to it, this assumption is wrong:

73.3.1. Firstly, it appears that Uber merely provides the platform (the app) which facilitates the demand by passengers and the availability of drivers to supply that demand. Uber is not a "*transport company*" *per se* but merely facilitates transport through its app platform.

73.3.2. Secondly, the SCA judgment, decided as it were on its own particular facts, can have no bearing or influence on the particular set of facts exclusive to Uber on how it conducts its business.

74. In the circumstances, CIMSA is incorrect in seeking to impute those findings of the SCA to several other divergent and incomparable businesses. It is simply irresponsible and dangerous to seek to do so, as the Uber example demonstrates. CIMSA's underlying confusion is premised on its misconception that the SCA preferred the notion that there is an ideal or normative view of a business.

*Interests of justice*

75. This matter differs completely from, for example, *Paulsen and Another v Slip Knot Investments 777 (Pty) Limited*[70] and the principles espoused therein find no application in the present matter. As was pointed out in *Slip Knot*, the fact that a matter raises an arguable point of law of general public importance (which is not the case here) is not in itself sufficient: It must also be in the interests of justice for it to warrant the granting of leave to appeal.[71]

76. As regards the interests of justice, we submit that CIMSA does not enjoy any

[70] 2015 (3) SA 479 (CC) at paragraph [26].
[71] At paragraphs [13] – [31].

reasonable prospect of success on appeal. CIMSA's contentions as regards the "*business*" and the "*primary operations of that business*" are fatally flawed. Crucially, it fails to take into account the *proviso* to the FBE definition, which specifically deals with outsourcing arrangements and the requirements to be met in order to qualify for the exemption, notwithstanding the outsourcing of the "*primary operations*" of the business. This, under circumstances where CGFM factually engaged in the outsourcing of its "*primary*" or "*core*" functions of its business i.e., investment management.

77. The issues that the SCA had to determine were clearly, authoritatively and correctly addressed by the SCA, based on the particular facts of the matter.

78. CIMSA's complaint relates to the correctness of the SCA's decision on the merits. CIMSA's contention is essentially that it ought to have succeeded in the SCA had that court evaluated or analysed the evidence differently. The effect of this is that if an unsuccessful litigant does not like the way a court (including the SCA) interpreted or applied the law to the facts, a constitutional matter arises giving this court jurisdiction. That can never be so and was certainly not intended by section 167(3)(b) of the Constitution.

79. The purpose of section 167(3)(b) is to limit the matters which warrant the attention of this court, in its capacity as the highest court of the Republic. If any complaint that a lower court had failed to assess the evidence or applied the law in a manner that a litigant thought was incorrect gave rise to a constitutional matter, the jurisdictional net would be widened to such a degree that leave could be given to almost any unsuccessful litigant. This is simply untenable.

80. The present application is nothing more than an impermissible attempt by CIMSA, unhappy with the outcome of the matter in the SCA, to convert what was always a clear factual dispute, in respect of which CIMSA has poor prospects of success, into

an *"arguable point of law"*. These are not circumstances in which the interests of justice warrant the matter being heard by the Constitutional Court.

81. We now turn to examine what "*business*" is conducted by CGFM and what constitutes its "*primary operations*".

## [H] THE BUSINESS OF CGFM

82. Before dealing with this question of what the business of CGFM *is*, we deem it apposite to deal first with the issue of what the business of CGFM *is not.*

*What CGFM's business is not*

83. CIMSA describes its "*business*" pursuant to the delegated business model as conducting "*specified fund management functions, and would delegate (inter alia) investment management trading activities to competent third parties, while retaining overall supervision of, and responsibility to the regulator for, those functions*"[72].

84. The so-called "*specified fund management functions*" which CIMSA contends constitutes CGFM's business are the eight "*managerial functions*" that attach to Collective Portfolio Management. These functions are listed in the Appendix to the application by CGFM to the CBI for authorisation as a Management Company.[73] These consisted of (1) decision taking (2) monitoring compliance (3) risk management (4) monitoring of investment performance (5) financial control (6) monitoring of capital (7) internal audit and (8) supervision of delegates.

85. The fallacy in what CIMSA contends constitutes the business of CGFM lies in the fact that eight "*managerial functions*" constitute ancillary functions and *not* "*primary functions*"

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[72] Heads of argument: p.43, paragraph 43.
[73] Record: vol 2, p.168.

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72 Heads of argument: p.43, paragraph 43.
73 Record: vol 2, p.168.

of a management company.

86. The CBI was cognisant of the fact that CGFM would delegate/outsource the activities for which it was licenced as a Management Company (investment management, administration and marketing) to third parties and that the only operational functions retained by CGFM would be the performance of managerial functions. The CBI reviewed CGFM's application and stated the following:

*"The business plan refers to the Company delegating certain CPM [Collective Portfolio Management] functions to other parties upon authorisation. On that basis and in the context of Irish funds under management, the financial regulator has reviewed the application by the Company as a management company who will delegate all constituent CPM functions to third parties and consequently the only operational functions retained by the company will be the performance of the managerial functions."*[74] (emphasis added).

87. Thus, the only remaining functions that CGFM could perform were the "*managerial functions*" attached to Collective Portfolio Management.

88. CGFM's contention that it "*undertook*", pursuant to the delegated business model, to "*conduct specified fund management functions*"[75] is transparently and patently wrong:

88.1. First, the categorisation by CIMSA of the eight "*managerial functions*" as "*management functions*" is incorrect. This confusion seemingly arises from CIMSA misunderstanding and misquoting the CBI's response in paragraph 43 of its heads of argument. Whereas the CBI stated categorically that it has reviewed the application by CGFM as a "*management company who will delegate all constituent CPM functions to third parties and consequently the only operational*

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74 Record: vol 12, p. 1134, paragraph ii.
75 Heads of argument: p.16, paragraph 43.

*functions retained by the [CGFM] will be the performance of the managerial functions*", CIMSA misquotes this by stating that the CBI reviewed the application on the basis that CGFM was a management company "*who will delegate all constituent [collective portfolio management] functions to third parties and [will] maintain the management functions.*"[76] (underlining inserted).

88.2. Far from undertaking to perform the managerial functions, CGFM was compelled to perform these functions in terms of its license as a management company. The managerial functions were not capable of being delegated[77] and had to be carried out in Ireland.[78] Importantly, the managerial functions attached to CGFM whether the functions of investment management, administration and marketing were delegated or not (i.e. performed in-house by CGFM or outsourced). CGFM would have had to perform these managerial functions regardless. Mr King testified that these eight managerial functions are functions that CGFM is responsible for, and which are carried out by CGFM at the Dublin office.

88.3. This illustrates how CIMSA confuses the activities of a "*management company*" (for which it is licensed, and which constitutes its business) with the performance of the "*managerial functions*" attached to collective portfolio management, which is merely incidental to the business of a management company (and which it contends constitutes its business).

89. The performance of the eight managerial functions, which CGFM contends constitutes its business, are accordingly incidental functions to Collective Portfolio

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76 Heads of argument: p.16, paragraph 43.

77 CIMSA agrees that the managerial functions could not be delegated, but erroneously refers to these functions as "*management functions*" – heads of argument, p.16, paragraph 43.

78 Record: vol 2, p. 153, paragraph 6.

Management and can therefore not be its business.

90. In the circumstances, CIMSA's contention that the performance by it of the eight managerial functions, renders its business the *"managed outsourcing of its activities and the maintenance of the license"* seeks to elevate the incidental activities of a Management Company to the actual business conducted by the Management Company.

91. We submit that this is ultimately destructive of CIMSA's contention that its business entailed the eight managerial incidental functions attributable to Collective Portfolio Management.

*What CGFM's business is*

92. The word "*business*" is not defined in either the IT Act or in the TAA. The ordinary dictionary meaning would thus apply.[79] Business is defined in the Concise Oxford Dictionary as "*one's regular occupation, profession or trade; a task or duty.*"

93. CGFM is authorised as a UCITS Management Company pursuant to the Investment Intermediaries Act, 1995 ("*the IIA*"). The IIA is aimed at "*investment business firms*" and is:

> "*An Act to make provision in relation to investment business firms and investment product intermediaries and for the authorisation and supervision of investment businesses and investment product intermediaries by the Central Bank of Ireland.*"[80]

94. Mr King confirmed that the IIA was aimed at investment business firms[81] which is defined in the IIA as "*any person who provides one or more investment business services or*

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79 The court held in *De Beers Industrial Diamonds Division (Pty) Ltd v Ishizuka* 1980 (2) SA 191 (T) at 196E-F that dictionary meanings do not govern but afford a useful guide to interpretation but again must yield to the contextual approach.

80 Record: vol 15, p. 1438, line 23 to p.1439, line 6. The IIA does not form part of the record. It will however be made available to this court, if required. It is also accessible on https://www.irishstatutebook.ie.

81 Record: vol 15, p. 1439, line 7 to p.1440, line 9.

Management and can therefore not be its business.

90. In the circumstances, CIMSA's contention that the performance by it of the eight managerial functions, renders its business the *"managed outsourcing of its activities and the maintenance of the license"* seeks to elevate the incidental activities of a Management Company to the actual business conducted by the Management Company.

91. We submit that this is ultimately destructive of CIMSA's contention that its business entailed the eight managerial incidental functions attributable to Collective Portfolio Management.

*What CGFM's business is*

92. The word "*business*" is not defined in either the IT Act or in the TAA. The ordinary dictionary meaning would thus apply.[79] Business is defined in the Concise Oxford Dictionary as "*one's regular occupation, profession or trade; a task or duty.*"

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81 Record: vol 15, p. 1439, line 7 to p.1440, line 9.

*investment advice to third parties on a professional basis*".

95. In CGFM's business plan[82] submitted with the application for an investment management licence, with reference to its memorandum of association[83], describes CGFM's business exclusively as that of an investment business:

> "...*The principal objective of the Company is to 'carry on the business of promoting, establishing, managing, regulating and carrying on, either alone or with others, any investment, unit or other trust or fund including a fund company (whether fixed or variable or a combination thereof) of or concerning any share, stocks, debentures, debenture stocks, bonds, loans, obligations and securities issued or guaranteed by any company constituted or carrying on business in Ireland or elsewhere, or by any government sovereign ruler, commissioners, local or otherwise, whether at home or abroad, or any property, right or interest therein (including derivatives, shares, warrants, conversion rights and similar rights and instruments).*" (highlighting added).

96. The fact that CGFM conducts the business of investments is also apparent from the objects of CGFM as set out in the memorandum of association.[84]

97. The business of CGFM based on its own founding documents, is thus one of conducting investments.

98. CIMSA's contends that CGFM's business is the "*managed outsourcing of the investment management function in accordance with the terms of the Licence*",[85] and, as contended before the Tax Court, the maintenance of its investment management licence (resulting from

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82 Record: vol 2, p. 173, paragraph 6; CGFM's subsequent business plan dated 1 July 2011 describes the business of CGFM in identical terms: record: vol 3, p. 283.

83 Record: vol 11, p. 1033, paragraph 2(1)(b).

84 Record: vol 11, p. paragraph 2(1)(a): "*To carry on the business of establishing specified collective investment undertakings and to provide for such undertakings investment management services including but not limited to financial advisory services, administration services, marketing services, placement services, brokerage services, agency services and all other services of a financial nature and generally to deal in units of the undertaking managed by the company*"; record: vol 11, p. 1034, paragraph (2(1)(c): "To carry on the business of investment and financial management." (emphasis added),

85 Record: vol 18, p. 1769, paragraph 33.2 (CIMSA's rule 32 pleading).

the outsourcing of its investment management function), is entirely at odds with the founding documents of CGFM which unequivocally describes its business as an investment business. The fallacy in CIMSA's approach in contending that the business of CGFM is anything other than that of investments is apparent if one has regard to the following factors:

98.1. CGFM did not apply to the CBI for an investment management licence to maintain such licence but did so for purposes of conducting investments in CGFM by investing the money that they receive in terms of their investment guidelines, as per the prospectus and to obtain returns for their investors in excess of the fees charged to the investors.

98.2. Mr Snalam testified that CGFM derives its income from a fee based on the assets under management. He agreed that the income was derived from investments made by the investors and stated that if there were no assets under management there would be no fees for CGFM to earn. And without the investment management licence, there would be no assets under management.[86] The assets under management are comprised exclusively of investor funds.[87]

98.3. Mr King testified that the assets under management consist of the money which investors invest in collective investment schemes. It is the contributions of investors from which CGFM derives its fees.[88]

98.4. The Tax Court stated, consistent with the objects of CGFM, summarized the business of CGFM as follows:

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86 Record: vol 13, p. 1241, lines 7 – 15.
87 Record: vol 14, p. 1295, line 8 to p.1296, line 3.
88 Record: vol 15, p. 1489, lines 1 – 24.

> *"The Appellant conducts business in the financial realm. A very simple explanation of its business is that it has customers who give it their money which the Appellant in turn uses for the purpose of generating income for its clients. Its source of income for the service consists primarily of fees ..."*[89] and
>
> *"I summarise this to say that part of its business is to solicit funds from investors which it manages in various forms to obtain a profitable return both to pay it a fee and to distribute to the investors."*[90] (emphasis supplied)

98.5. The only reason why investors would invest in CGFM is because it is a holder of an investment management licence for collective portfolio management. As Mr Snalam testified:

> *"Without the license, there can be no funds. Without the funds, there would be no money for investment managers to manage, administrators to administer or any of those service providers to have any service related to."*[91]

99. CIMSA's account of what constitutes CGFM's business is based on a fundamentally flawed construct and seemingly arises as a result of CIMSA's:

99.1. Misreading of the terms of the investment management licence granted to it by the CBI and the consequent mischaracterisation of the terms thereof (*"CIMSA's misconstruction of the licence"*); and

99.2. Misconception that its true business of investments is transformed into *"the managed outsourcing of the investment management function"* simply because it elected a business model of outsourcing in terms of which the function of investment

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89 Record: vol 17, p. 1722, paragraph 10.
90 Record: vol 17, p. 1722, paragraph 12.
91 Record: vol 14, p. 1296, line 18 to p.1297, line 3.

management is outsourced ("*business model of outsourcing*").

*CIMSA's misconstruction of the licence*

100. Rule 34 of the rules promulgated in terms of section 103 of the TAA provides that the issues in a tax appeal are those contained in the SARS' statement of grounds of assessment (in terms of rule 31), the taxpayer's statement of grounds of appeal (in terms of rule 32) and the SARS' statement of reply.

101. CIMSA asserts in its rule 32 statement that:

101.1. In terms of the licence, "*CGFM has not been approved by the CBI to perform investment management (i.e. individual portfolio management services …) or other non-core services as set out in Regulation 16(3)(b) of the UCITS Regulations.*"[92]

101.2. CGFM is not approved "*itself to perform investment management services*".[93]

101.3. CGFM accordingly contracts with authorised service providers (i.e. CIL and CAM) for the provision of investment management services, which are conducted on an outsourced basis under the ultimate oversight, direction, regulatory compliance monitoring and supervision of CGFM as fund manager.[94]

102. Contrary to CIMSA's contention, CGFM's investment management licence did not impose a condition that CGFM may not conduct investment management. To the contrary, investment management is integral to its licence as an authorised management company.

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92 Record: vol 18, p. 1765, paragraph 18.2.
93 Record: vol 18, p.1765, paragraph 23.
94 Record: vol 18, p. 1765, paragraph 23.

103. Schedule 1 of the licence[95] provides that CGFM is licenced to engage collective portfolio management.

104. CGFM is not authorised to provide individual portfolio management services or other non-core services as set out in regulation 16(3)(b). This restriction is in keeping with CGFM's application for authorisation as a management company in terms of which CGFM made application only for collective portfolio management and not for individual portfolio management or other non-core services.[96]

105. The functions of CGFM, in terms of the investment management licence granted to it for conducting collective portfolio management, includes the activities of investment management, administration and marketing.

106. CGFM's licence is thus an all-encompassing, blanket authorisation by the CBI in terms of which CGFM was authorised as a management company to perform collective portfolio management which includes the activities of investment management, administration and marketing.

107. CIMSA's contention that CGFM has not been approved to perform investment management services by pleading that the investment management licence "*expressly excluded investment management from its ambit*"[97] is manifestly wrong, in that:

    107.1. The fact that the CGFM is not authorised to provide individual portfolio management services or other non-core service has been interpreted to mean that CGFM is "*not permitted to perform investment management.*"[98]

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95 Record: vol 1, p. 25.

96 Record: vol 2, pp. 153 to 154, paragraphs 6 to 9; Mr Snalam testified that the licence was consistent with the application that CGFM made to the CBI for collective portfolio management and not for individual portfolio management – record: vol 13, p. 1243, line 18 to p.1244, line 14.

97 Record: vol 18, p. 1774, paragraph 60.2.

98 Record: vol 18, p. 1764, paragraph 18.2.

107.2. The licence does not state that CGFM is not approved by the CBI to perform investment management. On the contrary, the authorisation includes everything except "*individual portfolio management*" and non-core services, neither of which CGFM applied for.

107.3. The licence expressly provides that in the event that CGFM wishes to carry out individual portfolio management services and/or other non-core services (such as investment advice, safekeeping and administration), CGFM was required to obtain the appropriate extension of its authorisation from the CBI.

107.4. What CGFM in fact applied for and what it was in fact granted was a licence to conduct "*collective portfolio management*". There were no conditions, restrictions or qualifications attached and it matters not that the investment management function was outsourced.

108. Mr Snalam testified that the functions of investment management, administration and marketing are "*core functions*" of a management company for which CGFM is responsible.[99] This was echoed by Mr King.[100] CGFM is required to perform these core functions, as a fund management company "*whether it outsources them or not.*"[101] This evidence accords with the fact that the investment management licence issued to CGFM had no conditions attached to it relative to the three activities which CGFM was mandated to perform as an authorised management company and the common cause fact that the licence was issued by the CBI with full knowledge that those functions would be outsourced by CGFM.

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99 Record: vol 13, p. 1252, lines 12 – 22; record: vol 14, p. 1286, line 20 to p.1287, line 12; record: vol 14, p. 1288, lines 14 – 20.

100 Record: vol 15, p. 1480 line 9 to p.1481, line 13.

101 Record: vol 13, p. 1241, line 20 to p.1242, line 20; record: vol 13, p. 1252, lines 12 – 22; record: vol 14, p. 1286, line 20 to p.1287, line 12; record: vol 14, p. 1288, lines 14 – 20.

109. Mr Snalam testified that with a staff complement of four, CGFM did not have the capacity, skill and resources to perform the core functions of a management company which necessitated CGFM electing the outsource model. But it could, with the four staff members, exercise the supervision required in terms of the licence i.e., supervising the functions of the outsourced service providers.[102]

*Business model of outsourcing*

110. CIMSA's contention is essentially this:

110.1. For purposes of its business operations, CGFM elected a particular business model of outsourcing *inter alia* its investment management function.

110.2. CGFM was not itself authorised to perform investment management services.[103]

110.3. Because CGFM outsources the investment management function, CGFM now carries on the business of fund management which involves the governance of, ultimate responsibility to both the CIS and the regulator for all regulatory, legal and investor related aspects of the CIS including investment management.[104]

110.4. Because of the adoption of a particular business model, CGFM's business is converted into "*the managed outsourcing of its investment management function*" by the performance of the managerial functions.[105]

110.5. Investment management is therefore neither the business nor the primary

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102 Record: vol 13, p. 1238, line 14 to p.1240, line 14.
103 Record: vol 18, p. 1764, paragraph 18.2; vol 18, p. 1769, paragraph 33.2.
104 Record: vol 18, p. 1765, paragraphs 21 to 22.
105 Record: vol 18, p. 1769, paragraph 33.2.

operation of CGFM.[106]

111. We submit that CIMSA's contentions are wholly unconvincing and untenable. Not only is it contradicted by its own witness, Mr Snalam, who testified that investment management is a core function of CGFM, for which it retains responsibility irrespective of whether the function is outsourced or not, but on CIMSA's approach this would mean that a CFC is at liberty to arrange its business operations in the foreign jurisdiction by outsourcing the substantive functions of its "*business*" and then contending that the remaining activities constitute the (new) "*business*" to which the Commissioner is bound to have regard, even though the essential substance of the business is unaltered by virtue of the business licence granted to it.

112. This court considered what constituted the core function of a trader in *McCarthy Ltd v Gore NO*[107] by having regard to the nature of the undertaking and whether this constituted its core business or was incidental thereto. The CBI was cognisant of the fact that CGFM[108] would delegate its activities to third parties and "*consequently the only operational functions retained by the Company will be the performance of managerial functions.*"[109]

113. More fundamentally, and since the proviso to the definition of an FBE expressly allows outsourcing, CIMSA's approach has the effect of impermissibly attempting to sidestep the proviso, which specifically contemplates the circumstances under which a CFC may, notwithstanding outsourcing arrangements, still qualify as an FBE. In *casu*, CIMSA's approach has the effect of circumventing the proviso which requires that outsourcing of the primary operation (investment management) must be done in the same country where the CFC is located (Ireland) whereas CGFM outsourced this function to CIL in the United Kingdom and CAM in South Africa. Had CIL and CAM

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[106] *Id* paragraph 24.
[107] 2007 (6) SA 366 SCA at paragraphs [11] and [12].
[108] Record: vol 11, pp. 2035 to 2057, at p. 2042, paragraphs 6 and 7, and the appendix at p. 2057.
[109] Record: vol 12, p 1135, paragraph ii.

been based in Ireland, there would have been no difficulty with the outsourcing.

114. The UCITS regulations deals specifically with delegations.[110] Clause 23(1)(a) provides that a management company may delegate activities to third parties for the purpose of the "*more efficient conduct of the company's business*".[111]

114.1. It is clear that what is envisaged in the UCITS regulations is that the delegated activities are those of the management company.

114.2. The purpose of delegation of activities is all about efficiency of conducting the company's business and delegation does not detract from the business of the company.

114.3. In *casu*, if the management company's business is investments, the delegation of that function is only for efficiency and does not and cannot serve to alter the business of the company (as CIMSA contends).

115. It is clear from clause 23 of the UCITS regulations[112] that a management company, notwithstanding the delegation of its functions, must at all times retain and exercise overall control of the relevant company's management. The following bears emphasis:

115.1. This would entail the exercise and overall control of the core functions of a business that is licensed as a management company, being investment management, administration and marketing. Clause 23(1)(e) expressly refers to investment management as a core function.[113] Clause 23(1)(b)[114] specifically provides, in this regard that "*the delegation mandate does not prevent the effectiveness of supervision over the management company, and in particular, it shall not*

[110] Record: vol 10, pp. 884 to 885, clause 23.
[111] Record: vol 10, p. 884.
[112] *Ibid.*
[113] Record: vol 10, p. 885.
[114] Record: vol 10, p. 885.

*prevent the management company from acting, or the UCITS from being managed, in the best interest of its investors.*"

115.2. The liability of the management company is also not affected by the fact that the management company delegated any of its activities to third parties.[115] Mr Snalam testified that the CBI will always have recourse to CGFM as fund manager "*if something goes wrong in any three of those activities.*"[116]

115.3. A delegation of activities does not prevent the management company from giving any further instructions to undertakings to which functions are delegated or from withdrawing the mandate, or both with immediate effect when this is in the interest of investors.[117]

116. We accordingly submit that the notion that the investment activities that are outsourced to CIL and CAM does not form part of the activities of CGFM (as the management company), is unsustainable:

116.1. The very act of outsourcing/delegating signifies that such outsourced function is the function of the party doing the outsourcing. This is based on the trite principle that a party can only delegate a function which it in fact possesses.

116.2. In terms of the UCITS regulations, investment management is a core function[118] that resides squarely with CGFM as the licensed management company.

116.3. The UCITS regulations makes it abundantly clear that the management

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[115] Record: vol 10, p. 885, clause 23(2).
[116] Record: vol 14, p. 1301, lines 13 to 25.
[117] Record: vol 10, p. 885, clause 23(1)(g).
[118] Record: vol 10, p. 885, clause 23(1)(e).

company bears the ultimate responsibility for its activities (investment management, administration and outsourcing), notwithstanding the delegation of its functions.

116.4. Notwithstanding the fact that the business plan was specifically premised on an outsource business model, the licence issued by the CBI to CGFM on 25 October 2007[119] was unconditional. It included all three activities. CIMSA's contention that the licence precludes CGFM from performing investment management, is not only manifestly wrong but wholly unsustainable on the facts of this matter.[120]

117. The "*Delegate Oversight*" guidance issued by the CBI also makes it clear that notwithstanding the delegation by a management company of its functions (investment management, administration and marketing), the management company is obliged to retain and exercise overall control of the company's management[121] and provides as follows in clause 14:

"*Retained tasks and delegated tasks.*

*14. A fund management company may, notwithstanding the ultimate management responsibility of its board, delegate in whole or in part certain specific tasks which form part of the fund management company's management functions. While the tasks may be delegated, however ultimate responsibility for those management functions themselves cannot be delegated. Delegation is permitted but responsibility is retained. The terms of any delegation should, therefore, be such as will facilitate the discharge by directors of:*

[119] Record: vol 1, p.20.
[120] Record: vol 18, p.1764, paragraph 18.2.
[121] Record: vol 5, pp. 451 – 453.

- *their duties to the relevant fund management company (including those relating to that company's discharge of its obligations in respect of investment funds it manages); and*

- *any other responsibilities assumed by them to other persons, for example the shareholders (investors) pursuant to the prospectus, where it is a self-managed investment company*". (emphasis added).

118. Under the heading "*Retained tasks*" the CBI guidance deals specifically with the tasks and responsibilities retained by a management company notwithstanding delegation and provides that the management company should "*take all major strategic and operational decisions affecting the fund management company and any investment funds it manages*".[122] (underlining supplied)

119. The CBI guidance makes it clear that notwithstanding the delegation of the task, this does not release the board from its ultimate responsibility for the relevant management functions.[123]

120. The idea that the delegation of functions removes such function from the management company, as CIMSA contends, is accordingly, not only contrary to the investment management licence granted to CGFM, the UCITS regulations and the CBI guidance in relation to delegation, but is also devoid of merit, on a practical level. This is supported by the fact that, notwithstanding delegation of the investment management function, the revenue generated by CGFM is generated by that very function i.e., investment management.

121. Contrary to the clear import of the UCITS regulations and the guidance offered by the

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[122] *Ibid* 451.

[123] Record: vol 5, p. 452, paragraph 19.

CBI, which state unequivocally that functions of the management company include the investment management function, CIMSA denies (notwithstanding the fact that it adopted an outsource business model) that it outsourced functions of its business.

122. This contention is without merit. Firstly, it fails to recognise that in order for CGFM to delegate a specific function, it would have had to have that function in the first place. It cannot delegate something which it never had. Secondly, the UCITS regulations are clear. Investment management is a function of a management company. CGFM is licensed as a management company. And investment management trading activities is encompassed in the activity of investment management. Thirdly, CGFM, while admitting that it adopted an outsource business model and that it outsourced the investment management function, denies that the functions that it outsourced are functions of its business. In so doing, and in denying that the function of investment management is a function of CGFM's business, CIMSA nonetheless contends that the business of CGFM is the "*managed outsourcing of the investment management function in accordance with the terms of the licence*".[124]

*Primary operations of "that business"*

123. The Commissioner contends that CGFM does not meet all of the requirements of the definition of an FBE as the primary operations or/core functions of CGFM's investment business is not carried out from the office of the CFC in Ireland. This function has been outsourced to CIL and CAM.[125]

124. CIMSA on the other hand contends that CGFM's entire net income is indeed attributable to an FBE in Ireland since the primary operations of CGFM's business which constitutes the "*managed outsourcing of the investment management functions*" were

[124] Record: vol 18, p. 1769, paragraph 33.2.
[125] Record: vol 18, p. 1769, paragraphs 49 to 50.

conducted from that office, which was suitably staffed and equipped with facilities.[126]

125. The word "*primary*" is defined in the Collins English Dictionary as "*of the first importance*"; "*fundamental*"; "*basic*" *etc.*[127]

126. In accordance with the dictionary meaning of the word "*primary*", the phrase "*primary operations*" constitutes a reference to the "*main functions*" or the "*core functions*" or the "*principal activities*" of the business. In this regard, we submit that:

126.1. The meaning to be ascribed to the words "*primary operations*" should not be done in the abstract, but contextually, relative to the definition of an FBE, where the words are found.

126.2. The contextual approach requires that a meaning be ascribed to the words "*primary operations*" relative to the "*business*" of the CFC. This is so as the definition of an FBE speaks of the "*primary operations of that business*" (emphasis added) which is a direct reference to the "*business of the controlled foreign company*" (CFC) i.e. CGFM.

127. The business of the CFC is unquestionably that of investment. Accordingly, the determination of the "*primary operations*" of the business of the CFC requires a determination of what precisely constitutes the core functions of CGFM's investment business that it operates in Ireland. The Commissioner contends that the "*primary operations*" of CGFM is investment management for the reasons adumbrated upon below.

128. First, CGFM is licensed as an investment management company.[128] It obtained its

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[126] Record: vol 18, pp. 1766 - 1768, paragraph 26 - 28.
[127] At 1287. See also Chambers Concise Dictionary at page 948.
[128] Record: vol 18, p. 1763, paragraph 17 (rule 31 statement) read with record: vol 18, p. 1774, paragraph 60 (rule 32 statement).

licence under the relevant legislation in Ireland, viz the IIA. This alone indicates that the primary operations of CGFM is that of investments.

128.1. CIMSA, notwithstanding this common cause fact and the direct evidence given by the witnesses, seeks to draw a distinction between "*fund management*" and "*investment management*" in concluding that CGFM is a fund management company and not an investment management company.[129]

128.2. We respectfully submit that the distinction sought to be drawn is unwarranted and contrary to the evidence. The function of investment management, as per the licence, is a component of fund management, whether investment management is outsourced or not. Mr King testified that fund management includes investment management and that the investment management function, for which CGFM was responsible for, was sub-contracted to CIL and CAM.[130] In this regard, Mr King testified that CGFM is the "*investment manager*", involved in the day to day operations of the fund as a whole, and CIL and CAM, the "*sub-investment managers*", that takes responsibility for portfolio management.[131]

128.3. The function of investment management is thus a function that is integral to the investment management licence and constitutes a function of the holder of the investment management licence, CGFM.

129. Second, as per the memorandum of association of CGFM and confirmed by the Transfer Pricing Report, the principal objective of CGFM is to carry out investments. This also in itself signifies that the primary operations of CGFM are investments.

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[129] Heads of argument: pp. 14 - 16, paragraphs 37 - 41.

[130] Record: vol 15, p. 1466, line 24 to p.1467, line 19; record: vol 14, p. 1476, lines 12 to 15; record: vol 15, p. 1488, lines 6 to 10.

[131] Record: vol 15, p. 1464, line 13 to p.1465, line 8; record: vol 15, p. 1526, lines 8 to 13.

130. Third, the UCITS regulations pertinently refer to investment management as a "*core function*" of a management company.[132]

131. Fourth, notwithstanding the outsourcing of the core function of investment management to CIL and CAM, CGFM pays CIL and CAM a fee out of the fees derived by CGFM from the investment management function.[133] In terms of the investment management agreement entered into between CGFM and CAM[134] and CGFM and CIL[135] respectively, CIL and/or CAM receive a fee amounting to 50% of the net fund management fee received by CGFM for the fund management services that it performs to the Irish funds, plus 50% of any net performance fees, where applicable.[136] Thus, we submit, that notwithstanding the fact that the investment management function had been delegated to CIL and CAM, the fees in respect of that function was earned by CGFM which reinforces the fact that CGFM's business was that of conducting investments and that investment management was its primary operation.

132. We accordingly submit the primary operation or core function of CGFM in Ireland was that of investment management. It formed an integral part of the investment business of CGFM and of the investment management licence granted to by the CBI.

## [I] RELIEF SOUGHT

133. The Commissioner seeks an order in the following terms:

133.1. The application for leave to appeal is refused;

133.2. The additional income tax assessment raised by the Commissioner in respect

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[132] Record: vol 10: p. 885, paragraph 23(1)(e).
[133] Record: vol 3, p. 247, clause 9.1 (Investment Management Agreement entered into between CGFM and CAM).
[134] Record: vol 3, pp. 232 - 80.
[135] Record: vol 5, pp. 460 - 461.
[136] Record: vol 11, p. 1051, paragraph 3.2.1.

of CIMSA's 2012 years of assessment is confirmed; and

133.3. CIMSA is ordered to pay the costs of the application, including the costs of two counsel.

**RT WILLIAMS SC**

**H CASSIM**

Chambers

Cape Town

27 October 2023

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

**CCT Case No.: 47/2023**
**SCA Case No.: 1269/2021**
**Tax Court Case No.: 24596**

In the matter between:

| | |
|---|---|
| **CORONATION INVESTMENT MANAGEMENT SA (PROPRIETARY) LTD** | Applicant in the appeal/ Respondent in the cross-appeal |
| and | |
| **THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE** | Applicant in the cross-appeal/ Respondent in the appeal |

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## RESPONDENT'S PRACTICE NOTE

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## 1. NAMES OF PARTIES AND CASE NUMBER

These details appear in the heading.

## 2. NATURE OF THE PROCEEDINGS

This is an application for leave to appeal against the judgment of the Supreme Court of appeal ("*SCA*") dated 7 February 2023. The appeal to the SCA was against a judgment of the Tax Court in terms of section 133(2)(b) of the Tax Administration Act 28 of 2011.

## 3. ISSUES TO BE ARGUED

3.1. Whether the application for leave to appeal engages the jurisdiction of the court under section 167(3)(b)(ii) of the Constitution.

3.2. Whether Coronation Global Fund Managers (Ireland) Limited ("*CGFM*"), a controlled foreign company (CFC) of the applicant, met the requirements to have a FBE in Ireland for purposes of section 9D(9)(b) of the Income Tax Act, No. 58 of 1962 ("*the IT Act*"). This requires a consideration of whether those facts (which were largely common cause), supports the competing narratives of the Commissioner or the applicant on what constitutes, for purposes of the requirements of the FBE definition:

3.2.1. The "*business*" of CGFM in Dublin, Ireland; and

3.2.2. The "*primary operations of that* [CGFM's] *business*".

## 4. RELEVANT PORTIONS OF THE RECORD

5. The entire record should be read save for the following parts which in our opinion are unnecessary for determining the appeal:

5.1. Volume 6, pp. 538-580.

5.2. Volume 7, pp. 581-656.

5.3. Volume 8, pp. 691-786.

5.4. Volume 9, pp. 787-851.

## 6. ESTIMATED DURATION OF ARGUMENT

1 day.

## 7. SUMMARY OF THE ARGUMENT

7.1. CGFM is licensed by the Central Bank of Ireland ("*CBI*") as an investment management company having obtained an investment management licence.

7.2. CGFM's business is to invest moneys that it receives in terms of its investment guidelines and to obtain returns for its investors in excess of the fees charged to the investors.

7.3. The activities of a management company, whether such activities are delegated or not, are:

7.3.1. investment management;

7.3.2. administration; and

7.3.3. marketing.

7.4. The core or primary operation of an investment management company is investment management i.e., the managing of investments entrusted to it by clients.

7.5. Investment management is a primary operation of CGFM, having applied for and having obtained an investment management licence from the CBI.

7.6. CGFM outsources all its functions for which it is licensed as a management company, including its primary function of investment management.

7.7. The investment management function has been outsourced to offshore entities, namely CIL (in the UK) and CAM (in South Africa).

7.8. CGFM's primary function of investment management in terms of the investment management licence is accordingly *not* conducted by CGFM in

Ireland.

7.9. The question whether CGFM qualifies as an FBE, notwithstanding the outsourcing of its primary operations to offshore entities, must be answered with reference to the *proviso* to the definition of an FBE.

7.10. CGFM does *not* meet the requirements of an FBE as such functions are *not* outsourced to a company in Ireland where CGFM is located, as required in terms of the *proviso.*

7.11. Had the "*primary operations*" of the "*business*" of CGFM (investment management) been outsourced to a company that is subject to tax in Ireland where CGFM is located (*proviso* (aa)), within the same group of companies as CGFM (*proviso* (bb)) and to the extent that the structures, employees, equipment and facilities are located in Ireland where CGFM is located (*proviso* (cc)), it would have qualified as an FBE, as defined.

7.12. The respondent's description of what its "*business*" entails, is premised on elevating its "*managerial functions*" of collective portfolio management above its actual business i.e., investments. The managerial functions are ancillary functions and attaches to a management company irrespective of whether the activities of investment management, administration and marketing are conducted in-house or are outsourced.

7.13. The net income of CGFM is accordingly taxable in the hands of the respondent.

8. **AUTHORITIES WHICH WILL BE REFERRED TO DURING ARGUMENT**

8.1. *General Council of the Bar of South Africa v Jiba and Others* 2019 (8) BCLR 919 (CC)

8.2. *Paulsen and Another v Slip Knot Investments 777 (Pty) Limited* 2015 (3) SA 479 (CC)

8.3. *McCarthy Ltd v Gore NO* 2007 (6) SA 366 (SCA)

**R T WILLIAMS SC**

**H CASSIM**

Chambers

Cape Town

27 October 2023

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

**CCT Case No.: 47/2023**
**SCA Case No.: 1269/2021**
**Tax Court Case No.: 24596**

In the matter between:

| | |
|---|---|
| **CORONATION INVESTMENT MANAGEMENT** | Applicant in the appeal/ |
| **SA (PROPRIETARY) LTD** | Respondent in the cross-appeal |

and

| | |
|---|---|
| **THE COMMISSIONER FOR THE** | Applicant in the cross-appeal/ |
| **SOUTH AFRICAN REVENUE SERVICE** | Respondent in the appeal |

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## AUTHORITIES TO RESPONDENT'S HEADS OF ARGUMENT IN THE APPLICATION FOR LEAVE TO APPEAL

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**LEGISLATION**

1. Income Tax Act, No. 58 of 1962
2. The Tax Administration Act, No. 28 of 2011
3. European Investment Directive 93/22/EEC
4. Investment Intermediaries Act, 1995

**TEXTS**

5. De Koker and Williams *Silke on South African Income Tax* 5.44 at pp. 5-61 to 5-63

6. Olivier & Honiball *International Tax, A South African Perspective* 2011 (5th Ed) at paragraph 3.1, p. 561

7. Oguttu A *International Tax Law* , 1st Edition, paragraph 5.5, p. 139-140

8. Collins English Dictionary at 1287

9. Chambers Concise Dictionary at page 948

**CASES**

10. *Director of Public Prosecutions, Kwazulu-Natal v Ramdass* 2019 (2) SACR 1 (SCA)

11. *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA)

12. *Tshwane City v Blair Atholl Homeowners Association* 2019 (3) SA 398 (SCA)

13. *Smyth v Investec Bank Limited* 2018 (1) SA 494 (SCA)

14. *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* 1975 (4) SA 715 (A)

15. *General Council of the Bar of South Africa v Jiba and Others* 2019 (8) BCLR 919 (CC)

16. *Paulsen and Another v Slip Knot Investments 777 (Pty) Limited* 2015 (3) SA 479 (CC)

17. *De Beers Industrial Diamonds Division (Pty) Ltd v Ishizuka* 1980 (2) SA 191 (T)

18. *McCarthy Ltd v Gore NO* 2007 (6) SA 366 (SCA)

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

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|---|---|
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## FILING SHEET

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The applicant in the application for leave to cross-appeal hereby presents the following documents for service and filing:

1. Heads of argument;
2. Practice note; and
3. List of authorities.

**Dated** at **Cape Town** on this the **27th** day of **October 2023**.

**THE STATE ATTORNEY**

**Per :** _____

**Ms N Hendricks**

Attorneys for the applicant in the cross-appeal
4th Floor
22 Long Street
**CAPE TOWN**
Tel: 021 441 9200
Email:Nhendricks2@justice.gov.za
[Ref: 600/20/P23]
c/o
**THE STATE ATTORNEY**
Room 1320, 11th Floor
North State Building
95 Market Street, Cnr of Kruis Street
**JOHANNESBURG**
Tel: 011 330 7660
Email: Vdhulam@justice.gov.za
[Ref: VJ Dhulam]

**TO:** **THE REGISTRAR OF THE CONSTITUTIONAL COURT**
**BRAAMFONTEIN**

**AND TO:** **BOWMAN GILFILLAN INC**
Attorneys for the respondent in the cross-appeal
22 Bree Street
**CAPE TOWN**
Tel: 021 4807820
Fax: 021 48303200
Email: james.mckinnell@bowmanslaw.com
juliachoate@bowmanslaw.com
[Ref: J McKinnell/ld/1143062]

c/o

**BOWMAN GILFILLAN INC**

11 Alice Lane

Sandton

**JOHANNESBURG**

2196

Tel: 011 6699383

Email: faye.bozalek@bowmanslaw.com

[Ref: F Bozalek]

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

**CCT Case No.: 47/2023**
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In the matter between:

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| and | |
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| **SOUTH AFRICAN REVENUE SERVICE** | Respondent in the appeal |

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# APPLICANT'S HEADS OF ARGUMENT IN THE APPLICATION FOR LEAVE TO CROSS-APPEAL

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## Introduction

1. The applicant seeks leave to cross-appeal against the findings set forth in paragraphs [58] to [64] read with paragraph 2 (subparagraph 1 of the order) in paragraph [66] of the judgment of the Supreme Court of Appeal ("*the SCA*")[1] in so far as the appeal court disallowed the imposition of understatement and under-estimation penalties by the Commissioner.

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1 The SCA handed down judgment on 7 February 2023. The case is reported *sub nom Commissioner, South African Revenue Service v Coronation Investment Management SA (Pty) Ltd* in [2023] 2 All SA 44 (SCA); 2023 (3) SA 404 (SCA) and 85 SATC 413. Paragraphs [58] to [64] and [66] of the judgment are at record: vol 17 at pp. 1711 to 1713 and p. 1714.

2. For ease of reference the parties in the cross-appeal will be referred to as the Commissioner or CIMSA.

3. The principal relief sought in the cross-appeal is that the imposition of understatement and under-estimation penalties raised by the Commissioner in the assessment, is confirmed.[2]

4. The SCA erred in setting aside the understatement and under-estimation penalties for the reasons advanced below.

5. The background to the cross-appeal is addressed in the heads of argument filed by the Commissioner in opposition to the application for leave to appeal and is accordingly not recounted herein. These heads of argument address the following:

   5.1. The understatement penalty;

   5.2. The under-estimation penalty;

   5.3. The jurisdiction of the Constitutional Court to determine the cross-appeal;

   5.4. The Commissioner's prospects of success on appeal;

   5.5. Why the interests of justice support the grant of leave to cross-appeal;

**The understatement penalty**

6. The imposition of an understatement penalty is regulated in Part A of Chapter 16 of the Tax Administration Act, No. 28 of 2011 ("*the TAA*"). The Commissioner imposed an understatement penalty in respect of the imputed net income of CIMSA's 2012 year of assessment in terms of section 222(1) read with section 223(1) of the TAA on the basis

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[2] The notice of motion is in vol 19 of the record at pp. 1867 – 1870. As regards costs, the relief sought by the Commissioner is that the costs of the application for leave to cross-appeal shall be costs in the appeal (paragraph 3 of the notice of motion at p. 1868) and that the respondent pays the costs of the cross-appeal, including the costs of two counsel (*id*, paragraph 4).

that there had been a "*substantial understatement*", constituting a "*standard case*", which resulted in a penalty of 10% of the tax that would otherwise have been paid.

7. An "*understatement*" is defined in section 221 of the TAA to mean:

> "*any prejudice to SARS or the fiscus as a result of –*
>
> *(a) a default in rendering a return;*
>
> *(b) an omission from a return;*
>
> *(c) an incorrect statement in a return; or*
>
> (d) *if no return is required, the failure to pay the correct amount of 'tax'.*"

8. In terms of section 222(1) of the TAA, in the event of an understatement by the taxpayer, the taxpayer must, in addition to the tax payable for the relevant tax period, pay the understatement penalty determined under subsection (2) unless the understatement results from a *bona fide* inadvertent error.

9. A "*substantial understatement*" is defined in section 221 as a case where the prejudice to SARS or the fiscus exceeds the greater of 5% of the amount of tax properly chargeable or refundable for the relevant tax period, or R1 million.

10. The burden of proof is regulated in section 102 of the TAA. In terms of section 102(2) SARS bears the onus of establishing the facts upon which the penalty was imposed.

11. Ms Mohamed, who deposed to the affidavit in support of the Commissioner's application for leave to cross-appeal, explains why SARS has discharged this onus. This is so for three reasons principally.[3]

    11.1. Firstly, none of the net income of CGFM was taxed in the hands of

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[3] Record: vol 19, p. 1874, paragraph 14.

CIMSA and it therefore clearly exceeds 5% of the total amount of tax otherwise payable.

11.2. Second, in the 2012 year of assessment, CIMSA made an incorrect statement in its return by claiming the section 9D exemption.

11.3. Third, it was not necessary for SARS to show why it considered this to be a "*standard case*" as this is the default position in section 223(1) of the TAA.[4]

12. The onus thereupon shifted to CIMSA to establish why the understatement penalty should not be imposed.

13. The case pleaded by CIMSA in its rule 32 statement is that if there was an understatement at the time of the submission of the 2012 tax return, it was under the *bona fide* impression that CGFM had a valid FBE and it was therefore entitled to the exemption contained in section 9D(9)(b).[5] It then ascribes the understatement to a *bona fide* inadvertent error without furnishing any particularity as to how: (1) the error arose; and (2) the facts supporting that it was *bona fide* and inadvertent.[6]

14. The exchanges between the Commissioner and CIMSA prior to CIMSA filing it's rule 32 statement provides the relevant insight and context in relation to the position adopted by CIMSA for contending that the understatement is attributable to a *bona fide* inadvertent error.

14.1. In CIMSA's reply to the Commissioner's letter of audit findings[7], CIMSA stated, under the heading "*Understatement Penalties*", the following:

"*3.1 You have requested us to provide a statement setting out the circumstances prevailing at the time of the transaction and reasons why understatement penalties should not*

4 The standard case is regulated in the third column of the schedule contained in section 223(1) of the TAA.
5 This appears in paragraph 40 of the rule 32 statement at Record: vol 18, p. 1771.
6 *Ibid* paragraph 41.
7 Record: vol 8, p. 679.

*be imposed in respect of the disallowed FBE exemption.*

*3.2 There can be no understatement in respect of these amounts, as CIM is entitled to claim the FBE exemption for the reasons as set out above. CFM Implemented the arrangements in question after obtaining expert tax advice on the South African tax implications of the arrangements.*

*3.2 However, should it be held that CGFM did not constitute a FBE as defined and did not qualify for the exemption in terms of section 9D(9), it should be taken into account that CIM claimed this exemption based on independent, expert advice and reasonable grounds* …" (emphasis supplied).

14.2. In CIMSA's objection to the Commissioner's letter of assessment,[8] CIMSA confirms that it still holds the view that CGFM was entitled to the FBE exemption. In paragraph 7, under the heading "*Third Ground Of Objection: Understatement Penalties*", CIMSA stated the following:

"*7.4 At the time of the completion and submission of the returns, CIM and CGFM were under the bona fide impression that CGFM had a valid FBE and as such that CIM was entitled to the exemption contained in section 9D(9)(b) of the ITA. This view is still held by CIM.*"[9] (emphasis supplied).

15. It is thus clear that foundational to CIMSA's contention that CGFM qualified for the FBE exemption, was that "*expert tax advice*" had been obtained and that it "*implemented the arrangements in question*" in accordance with that tax advice.

16. Mr Snalam testified in cross examination that tax advice was obtained in South Africa from a "*well renowned tax adviser in South Africa, about any tax implications in 2007 for setting it [CGFM] up*".[10] The tax advice was in relation to the tax implications of setting up the

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8 Record: vol 1, pp. 2 to 19.
9 Record: vol 1, p. 16.
10 Record: vol 13 at p. 1224, line 7.

CFC in Dublin and that the tax advice would "*most definitely*" have been around the question of whether or not CIMSA was entitled to the FBE exemption.[11] The well renowned tax advisor was Mr Wally Horak. He confirmed under cross examination that the tax expert referred to in CIMSA's reply to the letter of assessment upon whom reliance was placed was Mr Horak, who was a co-signatory to the letter.[12] The tax opinion obtained from Mr Horak had not been furnished to SARS.[13] Mr Snalam testified that CIMSA utilised the services of Mr Wally Horak for "*tax guidance all along as well as setting up in terms of exchange control guidance in the late 90's that there were a number of things in flux, including Exchange Control Regulation, Tax Regulation and the like.*"[14] On questioning Mr Snalam why the opinion had not been furnished to SARS, Mr Snalam reaffirmed that CGFM had consulted with Mr Horak and stated that "*I'm not sure where the opinion is but I mean I'd – we'd have to go off back in the file, but I can assure you that we did consult with Wally Horak in terms of the arrangements.*"[15] Mr Snalam agreed that if there was an opinion which supported CIMSA, the prudent course of action would have been to place the opinion before SARS.[16] He was pertinently asked why the tax opinion had not been produced as part of the present case but stated that he was unsure why that was so.[17]

17. We submit that CIMSA, by placing sole reliance on the tax opinion obtained from Mr Horak, for contending that it claimed the exemption on "*reasonable grounds*", ought to have discovered the opinion, as without the opinion, the alleged reasonable grounds relied upon by it, have not been identified or established. To all intents and purposes, these reasonable grounds are non-existent. As Mr Snalam testified, he knew that SARS believed that there was a problem with CIMSA claiming the exemption, "*[B]ut there was*

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11 Record: vol 13 at p. 1224, lines 4 to 18.
12 Record: vol 8, p. 679.
13 Record: vol 14, p. 1311, lines 16 to 23.
14 Record: vol 14, p. 1307, line 23 to p.1309, line 12.
15 Record: vol 14, p. 1309, lines 10 to 16.
16 Record: vol 14, p. 1309, lines 17 to 21.
17 Record: vol 13 at p. 1226, lines 11 to 21.

*no doubt in our mind."*[18]

18. The Commissioner contends that on the facts of this case and the evidence adduced, CIMSA has failed to demonstrate the existence of a *bona fide* inadvertent error. Boqwana J considered what that meant and held as follows:[19]

> *"[43] Section 222 (1) provides that where there has been an understatement, the taxpayer must pay the understatement penalty determined unless the understatement results from a bona fide inadvertent error. … The use of 'must' denotes that once the requirements have been met, the penalty must be imposed. There is no definition of a bona fide inadvertent error.*
>
> *[44] According to the Oxford Dictionary the origin of the word 'bona fide' is Latin and literally means 'with good faith'. The word is also defined as 'genuine'; 'real'; 'without intention to deceive'. 'Inadvertent' is defined as 'not resulting from' or 'achieved through deliberate planning'. …synonyms for the word inadvertent: 'accidental' 'unintentional', 'unintended', 'unpremeditated', 'unplanned' and 'unwitting' …*
>
> *[45] It follows from the above that the bona fide inadvertent error has to be an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive."* (emphasis supplied).

19. The error is qualified by both adjectives and in order to avoid the imposition of the penalty, CIMSA had to establish that the error was (1) *bona fide* and (2) that it was inadvertent.

20. These requirements are considered in turn hereunder.

*Bona fides*

21. There is no room to find that CIMSA was *bona fide* in claiming the FBE exemption.

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[18] Record: vol 14, p. 1245, lines 20 to 25.
[19] See ITC 1890 79 SATC 62 at paragraphs [43] to [45].

The easiest and most obvious way to attempt to show *bona fides* was to produce the tax opinion which it claims to have obtained. CIMSA produced a record running into thousands of pages yet signally failed to include the opinion. This anomaly has not been addressed by CIMSA either in the record or in evidence. Unnecessary annexures have been appended to the application for leave to appeal such as the Moneyweb article[20] and a selective summary of the evidence of Mr King when the record speaks for itself,[21] yet the opinion was steadfastly withheld.

22. Not only was the opinion withheld, but reliance thereon in relation to the penalties has now been disavowed by CIMSA, by remarkably stating that "*CIMSA did not base its case in relation to penalties on the historical tax opinion to which Mr Snalam referred. Its case was premised on the factors identified in paragraph 22 above.*[22] This approach is disingenuous.

22.1. First, the fact that CIMSA decided to lead evidence in chief on the tax compliance work done by PricewaterhouseCoopers ("*PwC*") and the work done by Ernst and Young ("*EY*") as the external auditors does not detract from the fact that CIMSA "*implemented the arrangements in question*" in accordance with the tax opinion from Mr Horak.

22.2. Second, what is particularly astonishing is the fact that the evidence in chief of CIMSA avoided any questions pertaining to the tax opinion and did not even attempt to canvass the foundational basis relied upon by CIMSA (i.e., the tax opinion) in order to avoid the understatement penalties.

23. If the tax opinion supported CIMSA claiming the FBE exemption, then it ought to have been produced. Differently put, how else would CIMSA have shown that it made a *bona fide* error based on the opinion.

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20 Record: vol 17 at pp. 1736 to 1739.
21 Record: vol 18 at pp. 1816 to 1834.
22 Record: vol 19 at p. 1896, paragraph 23.

24. We point out that the production of the opinion, while going to the issue of *bona fides*, would not have been dispositive of that requirement and certainly not the requirement of inadvertence. At best, it may have established *bona fides*. We say at best since the existence of an opinion cannot be accepted without more. It may have been qualified, equivocal, *etc.* but the taxpayer nonetheless acted thereon. This could hardly be construed as acting in good faith.

25. Notably, in ITC 1890[23] the opinion was attached to the notice of objection and was therefore made available to SARS. In *Commissioner, South African Revenue Service v The Thistle Trust*[24] it was common cause that that the taxpayer had obtained an opinion.[25]

26. The failure to have produced the tax opinion suggests that it does not support claiming an FBE exemption or that it was subject to certain reservations and/or qualifications. Absent this, it is unthinkable that CIMSA would not have disclosed the tax opinion which would otherwise only serve to advance its case.

27. We also highlight the evidence of Mr Snalam that there was no error. It was put to him under cross-examination that nothing was done in error to which he responded: "*Not as far as we are concerned.*"[26] The denial of any error in effect puts paid to any description of the error such as *bona fide* and inadvertent. If there was no error, then the issue of CIMSA acting in good faith and without advertence falls away. Based on this evidence, there was no basis to find the existence of an error, as the SCA did.

28. Despite the unequivocal denial of any error, we nonetheless address the issue of inadvertence.

*Inadvertence*

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23 ITC 1890 79 SATC 62 at paragraph [28].
24 2023 (2) SA 120 (SCA).
25 At paragraph [28].
26 Record: vol 13 at p. 1227, lines 15 to 21.

29. There can be no question of "*inadvertence*" having arisen in the present matter for the following reasons.

30. First, inadvertence denotes an accident, something unplanned or unpremeditated. In Stroud, *Judicial Dictionary* (2nd Ed), inadvertence is described as the opposite of "*deliberate action*".

31. Second, CIMSA clearly knew and appreciated what it was doing when it claimed the FBE exemption. Mr Snalam's evidence in this regard is destructive of the notion of inadvertence. He testified that there was no doubt in their minds that they were entitled to the exemption. Mr Snalam agreed that whatever was inserted into the tax return was not done in error but was deliberately inserted because CIMSA believed that it was entitled to the exemption. Mr Snalam testified that: "*Ja, if deliberate is the word, then Coronation, I mean every line in the tax return was deliberately inserted.*"[27]

32. The position adopted by CIMSA was wrong in law and not supported by its rule 32 statement or the evidence led at the trial. The highwater mark of the rule 32 statement are the assertions pleaded in paragraphs 40 and 41 thereof.[28]

33. The matter was argued in the SCA on the basis that CIMSA must establish both good faith and inadvertence. The SCA found in paragraph [58][29] that SARS placed reliance on the non-disclosure of the tax opinion by CIMSA to draw a negative inference that it did not support CIMSA's claim for an FBE exemption and that a deliberate and conscious decision was taken to exclude the net income of CGFM.

34. SARS referred to the tax opinion only in the context of the "*bona fide*" requirement, not inadvertence and the submissions made by SARS in relation to the tax opinion were misconstrued by the SCA. These submissions did not relate to the inadvertent

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27 Record: vol 13 at p. 1245, line 20 to p.1246, line 23 and p. 1247, lines 15 to 21.
28 Record: vol 18 at p. 1771.
29 Record: vol 17 at p. 1712, lines 1 to 6.

enquiry, contrary to the SCA's findings in paragraph [58] of the judgment.[30]

35. The SCA did not consider the "*inadvertent*" requirement, other than on its incorrect understanding of SARS's submissions relating to the tax opinion as set forth in paragraph [58] of its judgment.[31]

36. The SCA held in paragraph [60] of the judgment,[32] that there was "*nothing to gainsay CIMSA's evidence that it submitted all its tax returns under the guidance of PricewaterhouseCoopers and that Ernst and Young were the external auditors of CGFM*". The SCA added that there was nothing to suggest that the "*tax returns were not submitted in the bona fide belief that CGFM may be eligible for a s 9D exemption*". The SCA referred to the good faith requirement three times in paragraph 60 and was clearly not concerned with the inadvertent requirement.

37. It also bears emphasis that the involvement of PwC and EY does not assist. CIMSA elected not to call anyone from these firms to testify and it is unclear how exactly their involvement satisfies the requirements of good faith and inadvertence, both of which had to be present. Further, Mr Horak rendered the tax opinion upon which CIMSA relied.

38. Had the SCA considered the matter with due regard to the facts and both jurisdictional requirements, then the only conclusion to which it could have come was that CIMSA had deliberately adopted a position and that inadvertence accordingly cannot and does not arise. There are many synonyms for inadvertence such as unintentional, unintended, accidental, inattention, thoughtlessness, to mention but a few. Boqwana J in ITC 1890 also gave a few synonyms for inadvertent in paragraph [44] of her judgment. Deliberate conduct such as that testified to by Mr Snalam is the very

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30 Record: *id.*
31 Record: vol 17 at p. 1712, lines 1 to 6.
32 Record: vol 17 at p. 1712, lines 15 to 17.

antithesis of inadvertent.

39. We submit that the *bona fide* inadvertent error exception arises where a taxpayer has accidentally or unintentionally inserted information into their tax return which turns out to be wrong. It cannot apply to a situation where a conscious and deliberate decision is taken to adopt a tax position that turns out to be wrong. This is clearly the case with CIMSA, which had applied its mind to its tax position and had every intention of claiming the amount in question.

40. Notably, CIMSA has now abandoned reliance on the tax opinion as regards its case in relation to penalties.[33] How it can do so when it relied on the opinion in support of the claim for the FBE exemption is unclear and at odds with the evidence led. It is impermissible, and indeed, unacceptable, for a litigant to prevaricate in this manner. CIMSA clearly realises that it has insurmountable difficulties.

41. The understatement penalty should therefore not have been set aside by the SCA.

**The under-estimation penalty**

42. The Commissioner imposed a penalty in respect of the under-estimation of provisional tax for the 2012 year of assessment. The penalty was imposed in terms of paragraph 20(1) of the Fourth Schedule to the Income Tax Act, No. 58 of 1962 ("*the IT Act*").

43. During the relevant year when CIMSA was assessed to tax (the 2012 tax year), paragraph 20 read as follows:

> *"1. If the actual taxable income, as finally determined under this Act, for the year of assessment in respect of which the final or last estimate of his/her taxable income is submitted in terms of paragraph 19(1)(a) by provisional taxpayer other than a company, or the estimate of its taxable income in respect of the period contemplated in paragraph 23(b) is submitted in terms*

[33] Record: vol 19 at p. 1896, paragraph 23.

*of paragraph 19(1)(b) by a company which is a provisional taxpayer, in respect of any year of assessment is –*

*(a) more than R1 million – such estimate is less than 80% of the amount of the actual taxable income the Commissioner may, if he/she is not satisfied that the amount of such estimate was seriously calculated with due regard to the factors having a bearing thereon or was not deliberately or negligently understated subject to the provision of subparagraph (3), impose, in addition to the normal tax chargeable in respect of the taxpayers taxable income for such year of assessment, an amount by way of additional tax up to 20% of the difference between the amount of normal tax as calculated in respect of such estimate and the amount of normal tax calculated, at the rates applicable in respect of such year of assessment, in respect of a taxable income equal to 80% of such actual taxable income".*

44. The effect of the aforegoing is that SARS may impose additional tax of up to 20% where CIMSA's actual taxable income is more than R1 million and it estimated its provisional tax at less than 80% of the amount of the actual taxable income.

45. We reiterate Mr Snalam's evidence that based on a tax opinion allegedly obtained from Mr Horak, that CGFM qualified as an FBE and that CIMSA did not have to include the net income of CGFM in its taxable income. Again, the importance of the opinion cannot be overstated.

46. In terms of paragraph 20(1), the Commissioner's discretion to remit the penalty is dependent on being satisfied that the estimate was "*seriously calculated with due regard to the factors having a bearing thereon or was not deliberately or negligently understated*".

47. Once again, the tax opinion is materially relevant to the Commissioner being satisfied in terms of paragraph 20(1) of the Fourth Schedule of the IT Act. The reliance placed on the "*external tax advisers*" is misguided and does not assist with establishing the

requirements of section 20(1).[34]

48. The tax opinion would have established that the amount estimated was indeed "*seriously calculated with due regard to the factors having a bearing thereon or was not deliberately or negligently understated*". Indeed, the evidence established that the foundational basis for adopting the tax position that CGFM qualified as a FBE was the opinion of Mr Horak.

49. The approach taken by the SCA is incorrect *apropos* CIMSA not having to produce the opinion.[35] The failure to have done so makes one question whether the opinion in fact exists or, if it does, whether it supports the FBE exemption claimed. This is demonstrated by the abandonment of any reliance thereon in these proceedings.

50. Reliance on the tax opinion in relation to penalties was not abandoned in the SCA. The only reasonable inference which the SCA ought to have drawn from the failure by CIMSA to produce the tax opinion was that it did not unreservedly support the tax position ultimately adopted by CIMSA in claiming the FBE exemption.

51. The SCA found in paragraph [60] that it was not incumbent upon CIMSA to produce the opinion. On this approach, the mere say-so of the taxpayer that it relied on a tax opinion that allegedly supported the tax position adopted by it, without ever producing it, compels the Commissioner to exercise his discretion in favour of the taxpayer to remit the penalty. This would be the case notwithstanding the fact, as in the present matter, that the Commissioner was not "*satisfied*" that the amount estimated was "*seriously calculated.*" The Commissioner must be satisfied before he can remit the penalty. He cannot do so on the mere say-so of a taxpayer that it obtained a favourable tax opinion. On the approach of the SCA, the discretion of the Commissioner is effectively removed.

52. The reasoning of the SCA is fundamentally flawed as regards the remission of the

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[34] Record: vol 19 at p. 1898, paragraph 31.
[35] Record: vol 17 at p. 1712, paragraph [60], lines 22-24.

penalty. Simply put, there were no grounds put up upon which the Commissioner could do so.

53. In the circumstances, we submit that the under-estimation penalty ought not to have been set aside by the SCA.

## The jurisdiction of the Constitutional Court

*Constitutional issue*

54. The Commissioner seeks to engage this court on two bases. Firstly, that it raises a constitutional issue[36] and second, that the matter raises an arguable point of law of general public importance.[37]

55. The South African Revenue Service Act, No. 34 of 1997 ("*the SARS Act*") mandates SARS, amongst other things, to collect all revenue due and to ensure optimal compliance with tax and customs legislation.

56. The duty to impose and collect tax, to pay it into the National Revenue Fund and the withdrawal and distribution of such funds in accordance with the Constitution and legislation regulating these matters clearly raises a constitutional issue which would engage this court's jurisdiction in terms of section 167(3)(b)(i).

57. The imposition and collection of taxes by SARS is fundamental to the effective running of the State and it is therefore imperative that SARS achieves its objectives outlined in the various tax legislation.[38]

58. The setting aside of the penalties by the SCA effectively deprives SARS of achieving its Constitutional and statutory mandates. The imposition of penalties has been legislatively entrenched for good reason and is aimed at discouraging taxpayers from

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36 Record: vol 19 at p. 1882, paragraph 43 to p. 1884, paragraph 50.
37 Record: vol 19 at p. 1884, paragraph 51 to p. 1885, paragraph 58.
38 Record: vol 19 at p. 1883, paragraphs 45 to 47.

engaging in conduct that prejudices the fiscus.

59. The setting aside of the penalties by the SCA has far reaching consequences not only for the Commissioner but everyone dependent on the National Revenue Fund.

60. This clearly raises a constitutional issue.

*The matter raises an arguable point of law of general public importance*

61. In terms of section 167(3)(b)(ii) of the Constitution this court may grant leave to appeal if the matter raises an arguable point of law of general public importance which ought to be considered by the court.

62. The Commissioner submits that the setting aside of the understatement and under-estimation penalties by the SCA falls squarely within the ambit of section 167(3)(b)(ii).

63. As pointed out by Ms Mohamed, the court erred in the application of the test in that it only considered the good faith requirement, not inadvertence. It applied the onus incorrectly and the tax opinion was not dispositive of the "*inadvertent*" requirement.[39] It also did not take due cognisance to Mr Snalam's evidence that there was no error.

64. The ramifications of the SCA's decision are wide-spread and potentially apply to every taxpayer, as understatement penalties and under-estimation penalties invariably feature in tax assessments raised by SARS. This is clearly a matter of general public importance and not confined to the dispute between CIMSA and the Commissioner. Moreover, this is not the only matter currently before the Constitutional Court on the issue of the imposition of an understatement penalty. A conditional cross-appeal is pending in the *Thistle* case.

65. In the circumstances, a proper case been made out for the grant of leave to appeal in

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[39] Record: vol 19 at pp. 1884 to 1885, paragraphs 53 to55.

terms of section 167(3)(b)(ii) of the Constitution.

**Prospects of success on appeal**

66. CIMSA claimed an exemption to which it was not entitled. It understated its tax position (as defined in the TAA). There was clearly an understatement and it is liable to pay the understatement penalty unless it is able to satisfy the Commissioner to the contrary by establishing a *"bona fide inadvertent error."* It also under-estimated its provisional tax and is similarly liable to pay this penalty.

67. It was unreasonable for CIMSA to set about a deliberate course of conduct based on an opinion which to date has not been produced. More importantly, after several years of litigation, CIMSA has now abandoned any reliance on the opinion in respect of the penalties imposed. This is wholly inimical to the case presented by it during the ADR process before the commencement of proceedings in the Tax Court. It also constitutes a *volte face* on the evidence adduced during the trial. The most startling aspect, however, is the failure to furnish any explanation for this inconsistent conduct. At the very least, CIMSA should have taken this court into its confidence.

68. On the evidence adduced in the Tax Court there was no basis for either penalty to be remitted and the SCA was clearly wrong to make such an order. These factors support this court granting leave to appeal.

69. For all of the reasons outlined above, the cross-appeal should succeed.

**The interests of justice**

70. The interests of justice also support this court granting leave to cross-appeal. The penalties were properly imposed by the Commissioner and there was no basis for them to be set aside by the SCA.

71. The setting aside of the penalties in these circumstances prevents SARS from

exercising its statutory and Constitutional obligations and will have a negative impact on the performance of its duties.

72. It is fundamentally important that the Constitutional Court pronounces on the interpretation of a *bona fide* inadvertent error. This is so notwithstanding the fact that Mr Snalam conceded that there was no error.

73. It is in the interests of both taxpayers and the Commissioner that finality is obtained.

74. These penalties account for a substantial portion of the revenue collected by SARS and should not be set aside without a sound basis to do so.

75. The SCA clearly erred in its approach to the issue of penalties and the Commissioner has been left with no option other than to bring this cross-appeal to remedy the situation. This is but one matter where the Commissioner stands to lose millions of Rands wrongly.

**Conclusion**

76. The Commissioner will accordingly ask for an order in the following terms:

76.1. The Commissioner is granted leave to cross-appeal.

76.2. The cross-appeal is upheld.

76.3. The applicant is directed to pay the costs of the application for leave to cross-appeal and the costs of the appeal, including the costs of two counsel.

**RT WILLIAMS SC**

**H CASSIM**

Chambers

Cape Town

27 October 2023

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

**CCT Case No.: 47/2023**
**SCA Case No.: 1269/2021**
**Tax Court Case No.: 24596**

In the matter between:

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|---|---|
| **CORONATION INVESTMENT MANAGEMENT** | Applicant in the appeal/ |
| **SA (PROPRIETARY) LTD** | Respondent in the cross-appeal |
| and | |
| **THE COMMISSIONER FOR THE** | Applicant in the cross-appeal/ |
| **SOUTH AFRICAN REVENUE SERVICE** | Respondent in the appeal |

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**PRACTICE NOTE OF THE APPLCANT IN THE APPLICATION FOR LEAVE TO CROSS-APPEAL**

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## 1. NAMES OF PARTIES AND CASE NUMBER

This appears from the heading.

## 2. NATURE OF THE PROCEEDINGS

The applicant seeks leave to cross-appeal against the findings in paragraphs [58] to [64] read with paragraph 2 (subparagraph 1 of the order) in paragraph [66] of the judgment of the Supreme Court of Appeal ("*the SCA*") delivered on 7 February 2023 in so far as the appeal court disallowed the imposition of understatement and under-estimation penalties by the Commissioner.

## 3. ISSUES TO BE ARGUED

3.1. Whether the application for leave to appeal engages the jurisdiction of this court in terms of sections 167(3)(b)(i) and (ii) of the Constitution.

3.2. The argument in the appeal brought by the applicant in its application for leave to appeal (hereinafter referred to as "*CIMSA*") will relate to whether Coronation Global Fund Managers (Ireland) Limited ("*CGFM*"), a controlled foreign company (CFC) of the applicant, met the requirements to have a FBE in Ireland for purposes of section 9D(9)(b) of the Income Tax Act, No. 58 of 1962 ("*the IT Act*").

3.3. The applicant in the application for leave to cross-appeal (hereinafter referred to as "*the Commissioner*") contends that the SCA erred in setting aside the understatement and under-estimation penalties for the reasons adumbrated upon hereunder.

## 4. RELEVANT PORTIONS OF THE RECORD

The entire record should be read save for the following parts which in our opinion are unnecessary for determining the appeal:

4.1. Volume 6, pp. 538-580.

4.2. Volume 7, pp. 581-656.

4.3. Volume 8, pp. 691-786.

4.4. Volume 9, pp. 787-851.

## 5. ESTIMATED DURATION OF ARGUMENT

1 day for both applications and the merits should leave be granted.

## 6. SUMMARY OF THE ARGUMENT

The understatement penalty

6.1. The imposition of an understatement penalty is regulated in Part A of Chapter 16 of the Tax Administration Act, No. 28 of 2011 ("*the TAA*"). The Commissioner imposed an understatement penalty in respect of the imputed net income of CIMSA's 2012 year of assessment in terms of section 222(1) read with section 223(1) of the TAA on the basis that there had been a "*substantial understatement*", constituting a "*standard case*", which resulted in a penalty of 10% of the tax that would otherwise have been paid.

6.2. An "*understatement*" is defined in section 221 of the TAA to mean amongst other things any prejudice to the fiscus as a result of "(c) *an incorrect statement in a return*"

6.3. In terms of section 222(1) of the TAA, in the event of an understatement by the taxpayer, the taxpayer must, in addition to the tax payable for the relevant tax period, pay the understatement penalty determined under subsection (2) unless the understatement results from a *bona fide* inadvertent error. In terms of section 102(2) SARS bears the onus of establishing the facts upon which the penalty was imposed and this was duly established

6.4. CIMSA has failed to establish that the understatement penalty was wrongly imposed. The case pleaded by CIMSA in its rule 32 statement is that if there was an understatement at the time of the submission of the 2012 tax return, it was under the *bona fide* impression that CGFM had a valid FBE and it was therefore entitled to the exemption contained in section 9D(9)(b). It then

ascribes the understatement to a *bona fide* inadvertent error without furnishing any particularity as to how: (1) the error arose; and (2) the facts supporting that it was *bona fide* and inadvertent.

6.5. In the correspondence exchanged between CIMSA and the Commissioner, CIMSA stated "…*it should be taken into account that CIM claimed this exemption based on independent, expert advice and reasonable grounds* …".

6.6. CIMSA, by placing sole reliance on the tax opinion obtained from the tax expert identified as Mr Horak, for contending that it claimed the exemption on "*reasonable grounds*", ought to have discovered the opinion. Without the opinion, the alleged reasonable grounds relied upon by it, have not been identified or established.

6.7. CIMSA has failed to establish an error. On the evidence of Mr Snalam, there was no error. This effectively rendered it unnecessary to consider the requirements of *bona fides* and inadvertence since they qualify the error, which on CIMSA's version, did not exist.

6.8. In any event, neither *bona fides* nor inadvertence were established by CIMSA. The most obvious way to attempt to show *bona fides* was to produce the tax opinion which it claimed to have obtained and acted upon. The production of the opinion, while going to the issue of *bona fides*, would not have been dispositive of that requirement and certainly not the requirement of inadvertence. At best, it may have established *bona fides*. The opinion may have been qualified, equivocal, *etc.* but the taxpayer nonetheless acted thereon. This would not constitute good faith.

6.9. Not only was the opinion withheld, but reliance thereon in relation to the

penalties has now been disavowed by CIMSA.

6.10. There can be no question of "*inadvertence*" having arisen in the present matter. Inadvertence denotes an accident, something unplanned or unpremeditated. In Stroud, *Judicial Dictionary* (2nd Ed), inadvertence is described as the opposite of "*deliberate action*".

6.11. CIMSA clearly knew and appreciated what it was doing when it claimed the FBE exemption. Mr Snalam's evidence in this regard is destructive of the notion of inadvertence. He testified that there was no doubt in their minds that they were entitled to the exemption. Mr Snalam agreed that whatever was inserted into the tax return was not done in error but was deliberately inserted because CIMSA believed that it was entitled to the exemption. Mr Snalam testified that: "*Ja, if deliberate is the word, then Coronation, I mean every line in the tax return was deliberately inserted.*"

6.12. This deliberate conduct is wholly at odds with inadvertent conduct. CIMSA has failed to demonstrate a *bona fide* inadvertent error in the circumstances.

6.13. We point out that the matter was argued in the SCA on the basis that CIMSA must establish both good faith and inadvertence. The SCA found in paragraph [58] that SARS placed reliance on the non-disclosure of the tax opinion by CIMSA to draw a negative inference that it did not support CIMSA's claim for an FBE exemption and that a deliberate and conscious decision was taken to exclude the net income of CGFM.

6.14. SARS referred to the tax opinion only in the context of the "*bona fide*" requirement, not inadvertence and the submissions made by SARS in relation to the tax opinion were misconstrued by the SCA. These

submissions did not relate to the inadvertent enquiry, contrary to the SCA's findings in paragraph [58] of the judgment.

6.15. The SCA did not consider the "*inadvertent*" requirement, other than on its incorrect understanding of SARS's submissions relating to the tax opinion as set forth in paragraph [58] of its judgment.

The under-estimation penalty

6.16. The Commissioner imposed a penalty in respect of the under-estimation of provisional tax for the 2012 year of assessment, in terms of paragraph 20(1) of the Fourth Schedule to the Income Tax Act, No. 58 of 1962 ("*the IT Act*").

6.17. In terms of paragraph 20(1), the Commissioner's discretion to remit the penalty is dependent on being satisfied that the estimate was "*seriously calculated with due regard to the factors having a bearing thereon or was not deliberately or negligently understated*".

6.18. The tax opinion is materially relevant to the Commissioner being satisfied in terms of paragraph 20(1) of the Fourth Schedule of the IT Act. The tax opinion would have established that the amount estimated was indeed "*seriously calculated with due regard to the factors having a bearing thereon or was not deliberately or negligently understated*". Indeed, the evidence established that the foundational basis for adopting the tax position that CGFM qualified as a FBE was the opinion of Mr Horak.

6.19. The SCA found in paragraph [60] that it was not incumbent upon CIMSA to produce the opinion. On this approach, the mere say-so of the taxpayer that it relied on a tax opinion that allegedly supported the tax position

adopted by it, without ever producing it, compels the Commissioner to exercise his discretion in favour of the taxpayer to remit the penalty. The discretion of the Commissioner is effectively eroded on the reasoning adopted by the SCA. This cannot be correct.

6.20. The under-estimation penalty ought not to have been set aside by the SCA.

## 7. AUTHORITIES WHICH WILL BE REFERRED TO DURING ARGUMENT

7.1. ITC 1890 79 SATC 62

**R T WILLIAMS SC**

**H CASSIM**

Chambers

Cape Town

27 October 2023

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

**CCT Case No.: 47/2023**
**SCA Case No.: 1269/2021**
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In the matter between:

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| **CORONATION INVESTMENT MANAGEMENT** | Applicant in the appeal/ |
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and

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|---|---|
| **THE COMMISSIONER FOR THE** | Applicant in the cross-appeal/ |
| **SOUTH AFRICAN REVENUE SERVICE** | Respondent in the appeal |

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**AUTHORITIES TO APPLICANT'S HEADS OF ARGUMENT IN THE APPLICATION FOR LEAVE TO CROSS-APPEAL**

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**LEGISLATION**

1. The Tax Administration Act, No. 28 of 2011

2. Income Tax Act, No. 58 of 1962

3. The South African Revenue Service Act, No. 34 of 1997

**TEXTS**

4. Stroud, *Judicial Dictionary* (2nd Ed)

**CASES**

5. ITC 1890 79 SATC 62

6. *Commissioner, South African Revenue Service v The Thistle Trust* 2023 (2) SA 120 (SCA)

**IN THE CONSTITUTIONAL COURT OF SOUTH AFRICA**

CC Case No: 47/2023

SCA Case No: 1269/2021

In the matter between:

**CORONATION INVESTMENT MANAGEMENT SA (PROPRIETARY) LIMITED** Applicant / Respondent in application for leave to cross-appeal

and

**THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE** Respondent / Applicant in application for leave to cross-appeal

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**CORONATION'S WRITTEN SUBMISSIONS IN THE APPLICATION FOR LEAVE TO CROSS-APPEAL**

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## A. INTRODUCTION

1. The Supreme Court of Appeal ("**SCA**") upheld the additional assessment imposed by the respondent ("**SARS**") on the applicant ("**CIMSA**") under section 9D(2)(*a*) of the Income Tax Act 58 of 1962 ("**the ITA**"), insofar as it related to tax and interest.

2. The SCA, however, declined to reinstate either of the penalties imposed by SARS in the additional assessment, namely:

   2.1 the understatement penalty imposed under Chapter 16 of the Tax Administration Act 28 of 2011 ("**the TAA**") ("**the understatement penalty**"); and

   2.2 the penalty for under-estimation of provisional tax imposed under paragraph 20 of the Fourth Schedule to the ITA ("**the under-estimation penalty**").

3. CIMSA opposes SARS's application for leave to cross-appeal to this Court against the SCA's decision in relation to penalties. CIMSA contends that SARS' application fails to engage this Court's jurisdiction, and in any event that the cross-appeal should fail.

4. The cross-appeal only becomes relevant if CIMSA's intended appeal were to be unsuccessful, and the imposition of tax under section 9D(2)(*a*) of the ITA were accordingly to be confirmed. The following submissions are made on that premise, although for the reasons set out in its argument in the application for leave to appeal, CIMSA submits that it was not properly subject to tax on the amount equal to the "net income" of Coronation Global Fund Managers (Ireland) Limited ("**CGFM**") as contemplated in section 9D(2A) of the ITA in the 2012 year of assessment.

## B. MATERIAL FACTS

5. Both the understatement and under-estimation penalties are premised upon what was contained in CIMSA's statutory tax returns for the 2012 year of assessment, and more particularly upon the fact that CIMSA claimed the "*foreign business establishment*" ("**FBE**") exemption in that year and paid tax on that basis.

6. The relevant facts pertaining to the preparation and submission of CIMSA's annual tax returns were undisputed. We summarise those facts below.

7. John Ashley Snalam ("**Mr Snalam**"), one of the founders of the Coronation Group, gave evidence on the manner in which CIMSA's annual tax returns were completed and submitted.

8. Mr Snalam testified that CIMSA prepared and submitted its tax returns under the guidance of PricewaterhouseCoopers ("**PwC**"), who assisted it with all tax compliance issues including the submission of returns for all the companies within the Group.[1] CIMSA's tax returns were all compiled with the input of the PwC Tax Department.[2]

9. In addition, Ernst & Young ("**EY**"), the statutory auditors of CIMSA, considered CIMSA's tax return as part of their audit and to enable them to opine on the fair presentation of the annual financial statements.[3] The EY tax department ensured that it understood and concurred with the tax charged as reflected in the interim statements of the various

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[1] Record, Vol 13, p 1213, lines 13 – 23.

[2] Record, Vol 13, p 1213, lines 13 – 23.

[3] Record, Vol 13, p 1213, line 24 – p 1214, line 9.

companies.[4]

10. Both PwC and EY were comfortable that CGFM's business qualified for the FBE exemption.[5]

11. From the time that the controlled foreign company ("**CFC**") legislation was introduced, CIMSA was of the clear view that it qualified for the FBE exemption.[6] That has remained its view.[7]

12. Prior to the audit conducted by SARS in 2015, leading to the issue of the additional assessment in 2017, no queries pertaining to the FBE exemption had been raised by SARS, PwC or EY.[8] This despite the fact that CGFM had been operating since 1997 and that CIMSA had consistently filed the requisite IT10A form in relation to CGFM, as one of the annexures to its tax return.[9] This is a standard form required by SARS to be filed by a South African taxpayer in respect of any CFC.[10] If a taxpayer claims the FBE exemption, it will reflect this in its IT10A form. The IT10A form for CGFM in respect of the 2012 year was provided in evidence.[11]

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[4] Record, Vol 13, p 1214, lines 6 – 12.

[5] Record, Vol 13, p 1216, line 17 – p 1217, line 4.

[6] This would include the FBE exemption and its predecessor, the "*business establishment*" exemption, which applied up until 2006.

[7] Record, Vol 13, p 1216, lines 8 – 16.

[8] Record, Vol 13, p 1216, line 17 – p 1217, line 4.

[9] Record, Vol 13, p 1214, line 22 – p 1216, line 20.

[10] Record, Vol 13, p 1214, line 22 – p 1215, line 4.

[11] Record, Vol 8, pp 713-715. The FBE exemption is claimed at Record, Vol 8, p 714, lines 25-30.

13. Although Mr Snalam could not definitively recall that all of CIMSA's relevant tax returns prior to the 2012 tax year claimed the FBE exemption[12], he confirmed that nothing that SARS said in its audit changed CIMSA's mind in terms of the validity of the exemption for it.[13]

14. At the time of the completion and submission of the returns, CIMSA was therefore under the *bona fide* impression that CGFM had a valid FBE and as such that CIMSA was entitled to the exemption contained in section 9D(9)(b) of the ITA. This view is still held by CIMSA, and it has continued to claim the FBE exemption.[14]

15. In SARS' letter of audit findings dated 11 October 2016, SARS had requested that CIMSA provide a statement setting out the circumstances prevailing at the time of the transaction "*in order to make a reasonable and considered determination of the appropriate penalty to be applied in terms of section 223 of the TA Act*". SARS also requested CIMSA to set out its contentions in respect of the applicable behaviours (as provided for in the penalty table in section 223) "*for which the Commissioner must have regard in considering the penalty provisions*".[15] The "*penalty table*" is contained in section 223(1) of the TAA ("**USP table**"), a copy of which is set out below:

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[12] Record, Vol 13, p 1244, line 18 – p 1245, line 3.

[13] Record, Vol 13, p 1246, lines 10 – 16.

[14] Record, Vol 14, p 1307, lines 10 – 13.

[15] Record, Vol 7, p 671, lines 8 – 13.

| 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|
| *Item* | *Behaviour* | *Standard case* | *If obstructive, or if it is a 'repeat case'* | *Voluntary disclosure after notification of audit or criminal investigation* | *Voluntary disclosure before notification of audit or criminal investigation* |
| (i) | 'Substantial understatement' | 10% | 20% | 5% | 0% |
| (ii) | Reasonable care not taken in completing return | 25% | 50% | 15% | 0% |
| (iii) | No reasonable grounds for 'tax position' taken | 50% | 75% | 25% | 0% |
| (iv) | 'Impermissible avoidance arrangement' | 75% | 100% | 35% | 0% |
| (v) | Gross negligence | 100% | 125% | 50% | 5% |
| (vi) | Intentional tax evasion | 150% | 200% | 75% | 10% |

16. CIMSA submitted in response that, should it be held that CGFM did not have a FBE as defined and did not qualify for the FBE exemption, it could not be said that (*i*) CIMSA did not take reasonable care in completing its tax returns[16], (*ii*) there were no reasonable grounds for the tax position taken[17], (*iii*) CIMSA was grossly negligent[18], or (*iv*) there was intentional tax evasion.[19] This was on the basis that CIMSA claimed the FBE exemption based on independent, expert advice and reasonable grounds.[20]

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[16] Item (ii) of the USP table, for which an understatement penalty of 25% is imposed for a "*standard case*".

[17] Item (iii) of the USP table, for which an understatement penalty of 50% is imposed for a "*standard case*".

[18] Item (v) of the USP table, for which an understatement penalty of 100% is imposed for a "*standard case*".

[19] Item (vi) of the USP table, for which an understatement penalty of 150% is imposed for a "*standard case*".

[20] Record, Vol 8, p 679, para 3.3.

17. SARS did not impose an understatement penalty based on any of those identified behaviours being applicable. It imposed a 10% understatement penalty based on a "*standard case*" of a "*substantial understatement*".

18. CIMSA's objection, appeal and Rule 32 statement addressed the imposition of understatement penalties on this basis.

19. SARS had contended, in its Rule 31 statement, merely that there had been a "*substantial understatement*" and therefore that the understatement penalty had been correctly imposed.[21] It did not plead that the understatement had not resulted from a *bona fide* inadvertent error.

20. CIMSA had, however, specifically pleaded that if it was held that there was an understatement, "*[CIMSA] was under the bona fide impression that CGFM had a valid FBE and as such that [CIMSA] was entitled to the exemption contained in section 9D(9)(b) of the ITA*". It went on to plead that the understatement resulted from a *bona fide* inadvertent error.[22]

21. As regards the under-estimation penalty, paragraph 20(2) of the Fourth Schedule (as it read in the 2012 year of assessment) provides that the Commissioner may impose an under-estimation penalty where he is not satisfied that the estimate on which provisional tax was paid "*was seriously calculated with due regard to the factors having a bearing thereon or was not deliberately or negligently understated*".

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[21] Record, Vol 18, pp 1755 – 1756, paras 51 to 54.4.

[22] Record, Vol 18, p 1771, paras 40 – 41.

22. In the pre-assessment correspondence, CIMSA was not asked to provide reasons as to why this penalty should not be remitted.[23]

23. However, in the Rule 31 statement, SARS pleaded that CIMSA had not provided it with "*acceptable facts and circumstances to warrant the remission of the penalty relating to the under estimation of provisional tax*".[24] In response, CIMSA pleaded that on the last day of its 2012 tax year it was of the view that "*it would not have to include the net income of CGFM in its taxable income for that year*" and estimated its taxable income in accordance with that *bona fide* belief. Accordingly, any under-estimation could not be a result of a failure to seriously calculate the estimate, or of negligence or deliberate conduct.[25]

## C. LEAVE TO CROSS-APPEAL SHOULD BE REFUSED

24. SARS contends that this Court has jurisdiction to hear its cross-appeal on the grounds that it raises both:

- a constitutional issue;[26] and
- an arguable point of law of general public importance as envisaged in section 167(3)(*b*)(ii) of the Constitution.[27]

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[23] Record, Vol 7, p 671.

[24] Record, Vol 18, p 1756 para 57.

[25] Record, Vol 18, p 1772 paras 46 – 47.

[26] Record, Vol 19, pp 1882 – 1884 paras 43 – 50.

[27] Record, Vol 19, pp. 1884 – 1885 paras 51 – 58. See also SARS' heads of Argument ("**SARS HOA**"), p 15, para 54.

25. We submit that SARS' cross-appeal does not raise either a constitutional issue or an arguable point of law, and furthermore that the interests of justice do not support granting leave to cross-appeal. We elaborate below on the reasons for this submission.

**No constitutional issue**

26. SARS contends that the cross-appeal raises a constitutional issue because it involves "*the duty to impose and collect tax*", and section 213(1) of the Constitution states that all money received by national government must be paid into the National Revenue Fund, save where excluded by an Act of Parliament.[28] SARS says that the setting aside of penalties "*effectively deprives SARS of achieving its Constitutional and statutory mandates*".[29]

27. If SARS were correct in this submission, then every tax dispute that serves before a Court would necessarily raise a constitutional issue, whether it pertained to the merits of the dispute, or questions of tax liability and collection, penalties or interest. The imposition and collection of tax presupposes that the tax is owing (which involves issues of both fact and law). If the mere duty to impose and collect tax gave rise to a constitutional issue, this would immediately draw into the constitutional net the merits of <u>all</u> tax disputes.

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[28] SARS HOA, p 15, para 55 – p 16, para 59 and Record, Vol 19, p 1882, para 43 – p 1884, paragraph 50.

[29] Record, Vol 19, p. 1883, para 48.

28. SARS in its heads of argument does not refer to any authority in support of this contention, and we submit that none exists. Whether CIMSA was properly assessed for penalties is not dependent on the interpretation or application of any provision of the Constitution, but rather on the interpretation of the applicable tax legislation.

29. The mere fact that section 213(1) of the Constitution provides for revenue to be paid into the National Revenue Fund does not transmogrify all tax disputes into constitutional issues, just as, for example, the constitutional right of access to Courts does not make every civil litigation matter a constitutional issue.

30. The first ground of jurisdiction contended for by SARS can therefore not be sustained.

**No arguable point of law of general public importance**

31. This Court may only entertain the cross-appeal if it were to find that it raises an arguable point of law of general public importance which this Court should consider (which implies that it is in the interests of justice for it to do so). But on this ground, SARS likewise fails to establish jurisdiction.

***Arguable point of law***

32. SARS' cross-appeal does not raise an arguable point of law. On its own showing, there is no dispute about the applicable legal test, but only a dispute as to whether the SCA correctly applied the law to the facts.

33. As regards the understatement penalty: in its application for leave to cross-appeal[30] and its heads of argument,[31] SARS quotes extensively from the judgment of Boqwana J (as she then was) in *ITC 1890* 79 SATC 62. In particular, SARS quotes the learned Judge's conclusion that a "*bona fide inadvertent error*" is:

> *"an innocent misstatement by a taxpayer in his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive".*

34. Nowhere in SARS' heads of argument nor its application for leave to cross-appeal is it suggested that *ITC 1890* is incorrect in its interpretation of the requirement. Indeed, SARS endorses the judgment.[32] This makes it plain that the dispute is one of fact only.

35. In the application for leave to cross-appeal, SARS gives three reasons for why this Court has jurisdiction. They are: (*i*) that the SCA "*erred in its application of the test*"; (*ii*) that "*the onus was not correctly applied*"; and (*iii*) that the tax opinion "*was not dispositive of the 'inadvertent' requirement*".[33] None of these complaints raises a legal dispute about the applicable test. They effectively contend that the SCA did not apply the test correctly. That does not engage this Court's jurisdiction.

36. This is reinforced in SARS' concluding submission in its heads of argument that "*[o]n the evidence adduced in the Tax Court there was no basis for either penalty to be remitted and*

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[30] Record, Vol 19 p 1875 para 16.

[31] SARS HOA, para 18.

[32] Record, Vol 19 pp 1875 – 1876 paras 16 – 17.

[33] Record Vol 19, pp 1884 – 1185 paras 53 – 55.

*the SCA was clearly wrong to make such an order*".[34] When it comes to the imposition of understatement penalties, SARS argues that "*on the facts of this case and the evidence adduced, CIMSA has failed to demonstrate the existence of a bona fide inadvertent error*"[35] and that "*[b]ased on this evidence, there was no basis to find the existence of an error, as the SCA did*"[36] (emphasis supplied).

37. The same conclusion arises in relation to the SCA's decision regarding the under-estimation penalty originally imposed under paragraph 20(1)(a) of the Fourth Schedule to the ITA (as it read in the year in question).

38. In its application for leave to cross-appeal and in its heads of argument, SARS does not present any argument pertaining to the proper interpretation of paragraph 20(1)(a), nor does it suggest that the SCA reached an incorrect conclusion as to the meaning or ambit of that provision.

39. On the contrary, SARS' argument comes down to a single contention: that in the absence of the production of the tax opinion, the SCA should have drawn an adverse inference and could not properly have concluded that the estimate was seriously calculated and was not deliberately or negligently understated, nor could it properly have exercised a discretion in relation to the imposition of the penalty.[37] SARS says that "*[s]imply put, there were no grounds put up upon which the Commissioner could [remit the penalty]*."[38] These

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[34] SARS HOA, p 17, para 68.

[35] SARS HOA, p 7, para 18.

[36] SARS HOA, p 9, para 27.

[37] SARS HOA paras 47 – 51.

[38] SARS HOA para 52, emphasis supplied.

arguments go to the judicial assessment of evidence, not to a dispute of law.

40. Hence in regard to the under-estimation penalty, SARS' case raises no arguable question of law which this Court should determine.

***General public* importance**

41. In the absence of an arguable question of law, the issue of general public importance plainly does not arise.

42. In any event, the case turned on the specific facts of CIMSA's case and the circumstances in which it had completed its relevant tax returns and claimed the FBE exemption.

43. The questions as to whether an adverse inference as to the corporate state of mind of CIMSA should have been drawn involving a tax opinion that was referred to in evidence but not provided, and whether CIMSA in claiming the FBE exemption acted in good faith and without the intention to deceive, are heavily fact-bound and do not engage the interests of any person other than SARS and CIMSA.

**Interests of justice**

44. The interests of justice requirement for leave to appeal typically invokes the question of prospects of success. For the reasons set out below, we respectfully submit that there are no reasonable prospects that this Court would reverse or alter the decision of the SCA.

**Conclusion**

45. For all the reasons set out above, we submit that leave to cross-appeal should not be granted in terms of section 167(3)(*b*)(i) or section 167(3)(*b*)(ii) of the Constitution.

## D. THE CROSS-APPEAL SHOULD BE DISMISSED

46. In the event that leave to cross-appeal were to be granted, we submit that the cross-appeal should be dismissed.

**Understatement penalty**

47. SARS' contention that the SCA erred in not imposing the understatement penalty is heavily based on a contention that CIMSA did not disclose to SARS, or to the tax court, an opinion regarding the tax implications of setting up CGFM in Ireland, and that an adverse inference should be drawn from this that the advice received was negative.

48. The tax advice taken by CIMSA at the time of setting up CGFM in Ireland in 1997 was not the centrepiece of CIMSA's case as regards the legitimacy of the understatement penalty. It will be recalled that this penalty arose in the context of the submission of the income tax return in the tax period in question (in this case, the 2012 return). To that end, CIMSA provided, through Mr Snalam, the evidence referred to in paragraphs 11 to 14 above, which pertained directly to the external advice and confirmations provided by tax professionals in PwC and EY in the specific context of the filing of returns. This was bolstered by the fact that the claiming of the FBE exemption had, over the years, never been questioned by SARS or any advisor.

49. None of this evidence was challenged by SARS. It was never put to Mr Snalam that CIMSA had ever received advice that it was not entitled to the FBE exemption, nor even that its entitlement had been questioned. It was never suggested that CIMSA had any reason not to believe, as the evidence showed it did, that it was so entitled.

50. This was, we submit, correctly recognised by the SCA in making the finding that:

> "*There is nothing to gainsay CIMSA's evidence that it prepared and submitted all its tax returns under the guidance of PricewaterhouseCoopers, and that Ernst & Young were the external auditors of CGFM. Nor is there anything to suggest that CIMSA's tax returns were not submitted in the bona fide belief that CGFM may be eligible for a s 9D exemption. The fact that this Court has now found that this course is not open to it, does not in any manner reflect on the bona fides of CIMSA, any more than it reflects on the bona fides of any losing party in litigation.*"[39]

51. The SARS affidavit in support of the application to cross-appeal does not engage in any way with the substantial evidence that demonstrates that CIMSA was acting in good faith and did not deliberately misstate its tax liability or act with the intention to deceive – which is the test as formulated in *ITC 1890*, on which SARS relies.

52. In its heads of argument, however, SARS places heavy reliance on Mr Snalam's evidence about having received South African tax advice in setting up CGFM in Ireland, and contends for an adverse inference to be drawn from the fact that that advice was not discovered.[40]

53. In this regard, in terms of section 102(2) of the TAA, SARS bears the *onus* of proving the facts on which it based the imposition of an understatement penalty. There are two requirements for the penalty to apply: (*i*) there must be an understatement as defined; and

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[39] Record, Vol 17, p 1712, para [60].

[40] SARS HOA paras 21 – 26.

(*ii*) such understatement must not result from a *bona fide* inadvertent error.

54. It is therefore incorrect for SARS to contend that it is merely required to prove that there was an understatement, and that thereafter the *onus* shifts to CIMSA to establish why the understatement penalty should not be imposed.[41] CIMSA's state of mind and behaviour in claiming the exemption is also part of the factual matrix that must be established.

55. As stated by the SCA[42], it was not incumbent on CIMSA to disclose a tax opinion that it had obtained, any more than it would be on any other party that litigates on the basis of a procured legal opinion. At no point during the dispute process, whether before or during the hearing itself, did SARS call for the tax opinion to be provided, as may be expected of a party bearing an *onus*.

56. Notably, SARS did not call for CIMSA to provide such opinion upon receipt of CIMSA's reply to SARS' letter of audit findings, which was the only occasion on which CIMSA stated that it had obtained expert tax advice as a basis to argue against the imposition of understatement penalties.[43] Instead, SARS plainly accepted CIMSA's submissions and refrained from levying understatement penalties with higher percentages for the behaviours CIMSA had identified as inapplicable due to its reliance on independent expert guidance, instead imposing understatement penalties of only 10% solely for a "*substantial understatement*".

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[41] SARS HOA, p 4, para 12.

[42] Record, Vol 17, p 1712, para [60].

[43] Record, Vol 8 p 679.

57. In other words, SARS plainly accepted that CIMSA had relied on external expert advice in claiming the FBE exemption in its annual income tax returns. If it had not, it would presumably have sought to apply one of the other listed behaviours.

58. Accordingly, it was not necessary for CIMSA to provide any further proof of its reliance on expert advice as a basis for addressing the understatement penalty. It nevertheless continued to aver that this was the case.

59. As already shown, the primary case put up by CIMSA in relation to this issue was that in completing and filing its returns (which was the place where any understatement would have occurred), it had relied on the advice and confirmation of external experts in the form of PwC and EY. This is consistent with the statement in the reply to SARS' letter of audit findings that CIMSA claimed the exemption "*based on independent, expert advice and reasonable grounds*."[44]

60. The evidence given in relation to a tax opinion arose incidentally as a result of Mr Snalam responding to the following question by SARS' counsel: "*Now we agree that when you're dealing with a foreign company like CGFM, there are tax implications. What advice did you seek in that regard*?"

61. Mr Snalam's evidence in response to that question related to the establishment of CGFM in Dublin: "*in setting that up, we would've taken – we did take tax advice from a well-renowned tax advisor in South Africa, about any tax implications in 2007 for setting it*

[44] Record, Vol 8, p 679, para 3.2.

*up*".[45] While he was asked as to why that advice had not been placed before the Court, and said he was not sure[46], at no stage was it put to him that the advice received was adverse, or that CIMSA deliberately claimed the FBE exemption with the intention to deceive SARS.

62. In any event, such advice, which plainly would have pre-dated the 2006 amendment to the ITA to introduce the FBE definition in its current form, would not be as pertinent to the decision to claim the FBE exemption in the 2012 returns as the advice of PwC and EY received annually, and the absence of any prior questioning of that tax treatment.

63. It is accordingly incorrect for SARS to allege (in response to CIMSA's statement[47] that it based its case on penalties on factors such as the PwC and EY advice) that "*after several years of litigation, CIMSA has now abandoned any reliance on the opinion in respect of the penalties imposed*" and that this "*is wholly inimical to the case presented by it during the ADR process[48] before the commencement of proceedings in the Tax Court*" and "*constitutes a volte face on the evidence adduced during the trial*".[49]

64. On the contrary, CIMSA has been consistent in its approach.

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[45] Record, Vol 13, p. 1224 lines 3 – 9. The reference to 2007 was clearly an error, as CGFM was set up in 1997 as was common cause.

[46] Record, Vol 13, p 1226, lines 18 - 20.

[47] Record, Vol 19, p 1896, para 23.

[48] It is unclear what SARS means by this. There was no evidence of an alternative dispute resolution process preceding litigation, which would in any event be without prejudice and confidential.

[49] SARS HOA, p 17, para 67.

65. It is also incorrect for SARS to contend that CIMSA placed "*sole reliance on the tax opinion obtained from Mr Horak, for contending that it claimed the exemption on 'reasonable grounds'*".[50] This is not a fair reflection of the unchallenged evidence presented, as set out above.

66. It is opportune, at this point, to address SARS' argument that CIMSA cannot properly rely upon an error having occurred because Mr Snalam testified that the claiming of the FBE exemption was not an error as far as CIMSA was concerned. SARS contends that this is fatal to the challenge to the understatement penalty.[51]

67. CIMSA, which has at all times maintained that it was entitled to the FBE exemption, will obviously disagree that its reliance on that exemption was erroneous. But the question of understatement penalties only arises if the Court were to uphold the additional assessment. Such a finding would mean, by definition, that the claiming of the FBE exemption was erroneous. Mr Snalam's view as to whether there was an error is, in that context, irrelevant.

68. Finally, we address SARS' assertion that in reaching its decision, the SCA "*was clearly not concerned with the inadvertent requirement*"[52] and that "*the SCA only considered the good faith requirement, not that of inadvertence*" [53] in relation to the understatement penalty. That assertion, it is submitted, is also erroneous.

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[50] SARS HOA, p 6, para 17.

[51] SARS HOA, p. 9, para 27.

[52] SARS HOA, p 11, para 36.

[53] Record, Vol 19, p 1878, para 26.

69. In paragraph [61] of its judgment,[54] the SCA referred with obvious approval to the *Thistle Trust* case, where SARS' contention that the deliberate adoption of a tax position could not give rise to a *bona fide* inadvertent error was conceded to be incorrect, and this was endorsed by the SCA. The contention that the SCA in the present case did not consider the "*inadvertence*" requirement is therefore incorrect.

70. In any event, as stated above, SARS itself relies on the definition of "*bona fide inadvertent error*" as adopted in ITC 1890 79 SATC 162.[55] The court in that case interpreted "*inadvertence*" as equating to "*without intention to deceive.*"[56] SARS' argument that "*inadvertence*" involves only a "*slip of the pen*"[57] as opposed to a tax position deliberately (but incorrectly) adopted, is plainly inconsistent with the very judgment on which it otherwise relies, and also with two judgments of the SCA (*Thistle Trust* and the present case). One can imagine that the taking of an incorrect tax position that one knows or even suspects to be wrong may not be accepted as an "*inadvertent*" error, but those are not the facts of the present case. The error in this case, if it exists, was plainly (on the evidence) unintentional or unwitting (synonyms referred to by Boqwana J in *ITC 1890*).

71. It is therefore submitted that SARS' averments do not support its allegation that CIMSA was not *bona fide* in claiming the FBE exemption, nor that its claiming of the FBE exemption, if proved to be an error, was not inadvertent in the light of all the facts already

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[54] Record, Vol 17, p 1713, para [61].

[55] SARS HOA, p 7, para 18 and Record, Vol 19, p 1875, para 16.

[56] At para [45].

[57] Record, Vol 19, p 1878, para 28.

referred to above.

72. Accordingly, any "*understatement*" as defined in section 221 of the TAA that exists as a result of CIMSA unwittingly relying on the FBE exemption constitutes a *bona fide* inadvertent error.

73. We therefore submit that SARS' s cross-appeal in relation to the understatement penalty should be dismissed.

**Under-estimation penalty**

74. When it comes to the imposition of an under-estimation penalty, SARS was vested with a discretion in terms of paragraph 20(1) of the Fourth Schedule to the ITA, as it read at the time. The SCA was vested with the same discretion on appeal.[58] This Court has held that it will not interfere with the exercise of a true discretion by a lower court unless it is satisfied that the discretion was not exercised "*judicially, or that it had been influenced by wrong principles or a misdirection on the facts, or that it had reached a decision which in the result could not reasonably have been made by a court properly directing itself to all the relevant facts and principles".*[59] SARS does not even attempt to make out a case that the SCA exercised its discretion irregularly. For this reason alone, SARS' cross-appeal in relation to the under-estimation penalty does not get out of the starting blocks.

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[58] *Africa Cash and Carry (Pty) Limited v Commissioner, SARS* 2020 (2) SA 19 (SCA) in para [52]; Commissioner *for Inland Revenue v Da Costa* 1985 (3) SA 768 (A) at 774G-J.

[59] *National Coalition for Gay and Lesbian Equality and Others v Minister of Home Affairs and Others* 2000 (2) SA 1 (CC) *para* 11.

75. In any event, the test for imposing an under-estimation penalty does not involve the absence of a "*bona fide inadvertent error*" but rather whether the provisional tax liability was "*seriously calculated with due regard to the factors having a bearing thereon or was not deliberately or negligently understated*".

76. SARS' sole argument to the effect that these requirements were not met, and that the under-estimation penalty should therefore be imposed, again involves the alleged non-disclosure of the tax advice received in setting up CGFM in Ireland, to which Mr Snalam testified.[60]

77. We reiterate that this was not the core of CIMSA's evidence in relation to the penalties aspect. Leaving aside the fact that the SCA correctly held that a litigant cannot be criticised for not disclosing an opinion, the absence of such advice as an exhibit before the Court cannot undermine the evidence (which the SCA accepted) as to CIMSA's actual belief that it was entitled to the FBE exemption, supported by its external tax advisors (PwC) and auditors (EY).

78. There is then no reason to conclude that CIMSA did not seriously calculate its provisional tax liability (having regard to the FBE exemption which it would claim), or was deliberate or negligent in understating it. A cross-appeal on that ground is destined to fail.

**Conclusion**

79. For all the reasons given above, we submit that the SCA correctly disallowed the imposition of understatement and under-estimation penalties on CIMSA.

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[60] SARS HOA, paras 45 – 52.

## E. RELIEF SOUGHT

80. CIMSA asks for an order in the following terms:

*(a)* *The application for leave to cross-appeal is dismissed;*

*(b)* *The applicant in the application for leave to cross-appeal is directed to pay the costs of the application for leave to cross-appeal and the costs of the cross-appeal, including the costs of two counsel.*

Alternatively:

*(a)* *The cross-appeal is dismissed;*

*(b)* *The applicant in the cross-appeal is directed to pay the costs of the application for leave to cross-appeal and the costs of the cross-appeal, including the costs of two counsel.*

**ALFRED COCKRELL SC**
**MICHAEL JANISCH SC**
**CAROLINE ROGERS**
**VITIMA JERE**

Counsel for applicant
Chambers, Cape Town
10 November 2023