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IN THE TAX COURT

[HELD AT CAPE TOWN]

Case No: VAT 1247

In the matter between:

CLDC Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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JUDGMENT

Introduction

[1] This is an appeal against an assessment by the respondent, the Commissioner for the South African Revenue Service ('SARS'), issued against the appellant, the CLDC, in respect of liability for Value-Added Tax ('VAT') in terms of s 22(3) of the Value-Added Tax Act 89 of 1991 ('the Act').

[2] In 2008, C (Pty) Ltd ('C') became the sole shareholder of the appellant, which became its wholly owned subsidiary. During 2009 the

appellant made land owned by it available to C. On the land, C undertook the development of residential property units in a development known as 'The Quadrant' and commercial property in Library Gardens, Claremont, Cape Town. By agreement between C and the appellant during the development process, C funded the appellant's cash flow requirements on loan account via inter-company shareholder loans to avoid external finance to fund business operations being obtained.

[3] On 2 April 2009 C issued tax invoice number 152 ('the invoice') to the appellant in respect of a taxable supply of R82 095 000, inclusive of VAT at the rate of 14%, in respect of the development of the residential component of phase 2 of the Quadrant development, including the pool, gym and other infrastructure. There is no dispute that C was obliged to invoice the appellant for VAT in terms of section 15 of the Act. Following receipt of the invoice, the appellant claimed an input tax deduction in respect of the VAT in the amount of R10 081 842.10 and received payment of this amount from SARS. After the appellant had paid the input tax it received from SARS to C by way of a cash payment, C paid the output tax to SARS in the same amount. The remaining liability due to C in terms of the invoice, being R72 013 158.00, was credited to the loan account of C in the books of the appellant, in accordance with the funding arrangement between the two companies. SARS was not out of pocket in that the invoice gave rise to output tax obligations on the part of C and enabled the appellant to claim an input tax deduction equal to the amount for which C was obliged to account to SARS.

[4] Both C and the appellant considered that the liability under the invoice had been paid after C's loan account was credited. The February 2010 annual financial statements of the appellant and C recorded the amount as neither a current liability nor current asset. In the appellant's financial statements it was converted to a long-term debt, while in C's financial statements it was dealt with as a non-current asset on the understanding that the long-term debt liability would be paid as and when the development properties were sold through increasing and decreasing the loan accounts between the two

companies. Given the agreed funding arrangement, the amount could not have been claimed by C as a bad debt for VAT purposes, or any other purpose. Had the appellant been required to pay C the amount invoiced, it would have had to borrow the funds from C to do so, in which case C's loan account in the books of the appellant would have been credited with the same amount.

[5] An audit conducted by SARS in 2013, four years after the invoice was raised, determined that the consideration in respect of the service was not paid in a period of 12 months after the expiry of the tax period in which the input tax was claimed as required by the provisions of s 22(3) of the Act. Section 22(3) provides that:

> 'Where a vendor who is required to account for tax payable on an invoice basis in terms of section 15 –
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> (a) has made a deduction of input tax in terms of section 16(3) in respect of a taxable supply of goods or services made to him; and
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> (b) has, within a period of 12 months after the enquiry of the tax period within which such deduction was made, not paid the full consideration in respect of such supply,
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> an amount equal to the tax fraction, as applicable at the time of such deduction, of that portion of the consideration which has not been paid shall be deemed to be tax charged in respect of a taxable supply made in the tax period following the expiry of the period of 12 months [...]'

[6] The effect of this provision is that where a vendor has claimed an input tax deduction on the basis of a tax invoice, but has not made payment of the relevant consideration within a period of twelve months, the transaction is effectively reversed, which has the result of counteracting the benefit of the input tax previously deducted because the consideration has not been paid.

[7] The Act was amended with effect from 10 January 2012 through the addition of subsection 22(3A) into the statute, which provides that:

> 'Subject to section (6)(a), subsection (3) shall not be applicable in respect of a taxable supply made by a vendor which is a member of a group of companies, to another vendor which is a member of the same group of companies for as long as both vendors are members of the same group of companies.'

[8] While s 22(3A) has no bearing on the current matter given that it arose after the tax period in issue in this matter, it is noteworthy that the effect

of this insertion into the Act is that s 22(3) does not apply where the supplier and recipient in question are both members of the same group of companies.

Evidence

[9] Both parties elected to present oral evidence at the hearing of the appeal, as they were entitled to do. Mr Gary Moore, the managing director of C and a director of the appellant, confirmed that C is the holding development company, sole shareholder and sole funder of the appellant and that the invoice raised by C reflected the total development cost of the project. His evidence was that it had been agreed that the appellant would receive funds by a loan account from C, that C's invoice would be settled by crediting its loan account and that this was intended as payment. For this reason, he signed C's financial statements of 28 February 2010 in which sundry creditors were recorded as nil. This was confirmed by Mr Emmerson Brett McCracken, who provides accounting services to the appellant and C; and the auditor of both companies, Mr Selwyn Mark Solomon. Mr McCracken stated that once the liability was recorded as a long-term liability in the books of the appellant it was no longer current and was no longer a debt. Mr Solomon's evidence was that commercially speaking payment of the invoice had been made in a practical manner which was 'very common' for group companies, through crediting of the loan account in circumstances in which C funded the entire operation with a loan liability remaining in a different form.

[10] The evidence of Mr Leonard Williams, who undertook the assessment for SARS, was that there was no evidence that payment of the invoice had been made and that in spite of there being no loss to the *fiscus*, the provisions of s 22(3) were not discretionary. With no payment made, s 22(3) had not been complied with and the assessment was accordingly made on this basis.

Evaluation

[11] The appeal in this matter turns on whether, having regard to the provisions of s 22(3), the crediting of a loan account constitutes payment of full "consideration" within a period of 12 months after the appellant claimed an input tax deduction for the VAT component of the invoice raised by C as a related company or not.

[12] Section 1 of the Act provides that -

> '"**consideration**", in relation to the supply of goods or services to any person, includes any payment made or to be made (including any deposit on any returnable container and tax), whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services, whether by that person or by any other person, but does not include…'

[13] It is the appellant's case that the crediting of C's loan account by the appellant in the context of the funding arrangement between these two group companies constituted "*payment made*" "*in respect of*" and "*in response to…the supply*" of the "*goods or services*" reflected in the invoice given that it was funded by C via agreed inter-company loan accounts. In addition, it is material that both the appellant and C consider the crediting of the loan account to constitute payment given the funding arrangement agreed between the two group companies.

[14] SARS takes a different view of the matter, on the basis that given the definition of an "invoice" in the Act, being a document notifying of an obligation to make payment, the effect of the tax invoice issued was that the appellant was obliged to pay the amount invoiced to C. Recording the amount in the loan account of C in the books of the appellant and as a non-current liability, as was contended for SARS, did not constitute "payment" of the full consideration in that it remained a debt on the books, justifying the provisions of s 22(3) being invoked.

[15] As was stated in *Commissioner, South African Revenue Service v Capstone 556 (Pty) Ltd,*[1] a commercial meaning should be given to statutory concepts. In that matter the remarks of Lord Hoffmann in *MacNiven (Inspector*

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[1] 2016 (4) SA 341 (SCA) at para 34.

of Taxes) v Westmoreland investments Ltd[2] were approved of in which it was stated that:

> '*The innovation in the Ramsay case was to give the statutory concepts of "disposal" and "loss" a commercial meaning. Then new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts, so that in the case of a concept such as a "disposal", the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a preplanned series of transactions*.'

[16] Van der Merwe AJA stated in *Capstone* that:

> '*If the receipt or accrual arises from detailed commercial transaction, the transaction must be considered in its entirety from a commercial perspective and not be broken into component parts or subjected to narrow legalistic scrutiny*.'[3]

[17] The commercial transaction in the current matter arose within the context of an agreed funding arrangement between the appellant and C as group companies, confirmed by the appellant's witnesses. The legitimacy of this agreement could not be called into question.[4]

[18] Given this funding arrangement, had C's loan account not been credited in the manner it was, C would have been required to advance funds to the appellant in order for its own invoice to be settled. C could not have sued the appellant for a cash payment of the invoice, nor could it have claimed the amount in question as a bad debt for VAT or other tax purposes given the funding arrangement in place. It follows that both C and the appellant did not expect that C would be be paid in cash for the relevant supply, as was confirmed by the appellant's witnesses in evidence. What was rather contemplated was that the invoice would be settled by crediting the loan account of the holding company C in the books of the appellant as its wholly-owned subsidiary.

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[2] [2001] 1 All ER 865 at para 32.
[3] *Capstone* n 1 at para 34.
[4] See *Anglo Platinum Management Services (Pty) Ltd v Commissioner, SARS* 2016 (3) SA 406 (SCA) at para 34.

[19] Crediting the loan account did not however extinguish the appellant's liability to C. What it did was to move the liability from a current one to a long-term liability in the books of the appellant. This distinguished what the appellant owed on loan account from what is had owed on the invoice, with the loan account –

> '*…the formal record in the company's ledger of credits and debits relating to moneys lent to the company; but in its usual business connotation it is the shareholder's claim against the company for the amount standing to his credit on loan account.'*. [5]

[20] The dispute turns on whether in adjusting the liability to a long-term one, the appellant complied with s 22(3)(b) insofar as it "paid the full consideration in respect of such supply" which was the subject of the invoice it received from C. The appellant relied on the decision of Commissioner, *SARS v Scribante Construction (Pty) Ltd*[6] in which a dividend declared at interest, which was credited to shareholders' loan accounts with the company was found to constitute a payment by the company to the shareholders and as an actual deposit. In that matter the Court stated that:

> '*I have already referred to the contested practice of the shareholders in using the company as banker. In that context the crediting of the loan accounts constituted an actual payment as if the dividends had been deposited into an account held by a shareholder at a banking institution*.'[7]

[21] Similarly, but again in a different context, in *Commissioner for Inland Revenue v Guiseppe Brollo Properties (Pty) Ltd* [8] it was found that the crediting of a dividend debt to a shareholder's loan account '*did not alter the fact that the loan account liability was incurred with the purpose of discharging the dividend debt and it is that purpose which continued to be overriding'*.[9] This was so in that -

> '*…the dividend debt was simply credited to the interest-bearing loan account of Hume Ltd with the taxpayer, presumably with the consent,*

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[5] *Burman v Commissioner for Inland Revenue* 1991 (1) SA 533 (A) at 545C.
[6] 2002 (4) SA 835 (SCA) at para 8.
[7] *Ibid* at para 8.
[8] 1994 (2) SA 147 (A).
[9] *Ibid* at 154H.

> *express or tacit, of Hume Ltd. The result was that the dividend debt... was converted into an interest-bearing indebtedness on loan account...*'.[10]

[22] However, in *ITC 1768,*[11] a decision referred to by counsel for SARS which concerned payment under s 16(3)(a)(ii) of the Act, relating to the supply of second hand goods, it was found that where a party did not intend to discharge an obligation to another, nor enrich him or impoverish himself, there had not been payment within the meaning of the s16(3)(a)(ii), nor did the crediting of a loan account achieve such payment within the meaning of that provision.[12]

[23] While none of the decisions referred to considered whether the crediting of a loan account in circumstances such as arise in this matter constitutes payment of an invoice raised, it appears to me that as in *Guiseppe Brollo Properties* the enquiry turns on the overriding purpose of the loan account liability incurred. The undisputed evidence for the appellant in this matter is that the purpose of the loan liability incurred was to discharge the invoice debt. The result was, in the words of counsel for the appellant, that what was owing by the appellant under the loan account was a different "animal" to what was owing under the invoice. In issue then is with this being the purpose whether the conversion of the liability from one arising from an invoice into a loan liability constitutes payment of consideration for purposes of s 22(3).

[24] In relation to the supply of goods and services to any person "consideration" includes "any payment made or to be made" whether "in money or otherwise, or any act or forbearance". To the extent that payment amounts to the discharge of an obligation to another, there is no reason as to why an obligation under an invoice may not be discharged through the creation of another liability such as one under a loan. As much was accepted in *Scribante Construction* in which it was accepted that it was permissible for payment of a dividend declared, at interest, to take the form of a credit to

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[10] *Ibid* at 150I-151A.
[11] 66 SATC 151.
[12] *Ibid* at 157F-G.

shareholders' loan accounts. The effect is to discharge one obligation through the creation of another. I am not persuaded that it is a requirement of payment that there be an enrichment or impoverishment in the manner contemplated by Melunsky J in *ITC 1768*, although quite clearly there may exist distinct instances of gain and loss in the discharge of one liability and the creation of a different liability on the facts of any matter.

[25] From the explanatory memorandum to the Taxation Laws Amendment Bill, 1996 it is apparent that subsections (3), (4) and (5) were introduced into s 22 with a specific aim. What was intended by the inclusion of these subsections was to rectify the position in relation to irrecoverable debts insofar as a vendor who accounts for VAT on an invoice basis and writes off a bad debt is entitled to an input tax deduction equal to the tax fraction of the irrecoverable amount written off. It was the prejudice to the *fiscus* which motivated the amendments in that it allowed the opportunity for deliberate manipulation by creating bad debts with a view to creating a tax benefit. It follows that the introduction of s 22(3) was aimed at preventing such deliberate manipulation and was not aimed at circumstances such as arise in the current matter, in order to bar an invoice from being considered paid through the creation of a loan account liability where a funding arrangement exists between group companies.

[26] On the facts before this Court, there has been no such deliberate manipulation in creating a bad debt with a view to creating a tax benefit either by the appellant or C. The fact that in 2012 s 22(3A) was introduced so as to provide expressly that subsection (3) would not be applicable to in respect of a taxable supply made by a vendor which is a member of a group of companies, to another vendor which is a member of the same group of companies supports the interpretation as to the purpose of s 22(3) as one aimed at deliberate manipulation and not one aimed at *bona fide* transactions between companies within a group in circumstances in which there is no loss to the *fiscus*.

[27] It follows therefore that the crediting of C's loan account by the appellant in the context of the funding arrangement between the two companies

amounted to payment of "consideration" in relation to the supply of goods and services invoiced. It was not required of C to make a cash payment to the appellant in order to enable the appellant to settle the invoice with C in cash and had this occurred the conduct would have risked accusations of the 'round-trip financing' in s 80D of the Income Tax Act 58 of 1962 of which the legislature disapproves. Precisely the same outcome was achieved given the funding arrangements between parties through the crediting of C's loan account in the books of the appellant in circumstances in which there had been no deliberate manipulation.

[28] The appeal should therefore succeed given that the jurisdictional fact required for the application of section 22(3), being non-payment of the consideration within 12 months was not satisfied. It is only reasonable that costs follow the result.

Order

[29] For these reasons it is ordered as follows:

1. The appeal succeeds with costs.

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K M SAVAGE

President

5 September 2016

EHSAAN NAGIA

Assessor

SUNEL LOUW

Assessor

Appearances:

For appellant:	T S Emslie SC
	Instructed by Shepstone & Wylie
For respondent:	S Mahomed
	Instructed by the State Attorney