IN THE KWAZULU-NATAL HIGH COURT, PIETERMARITZBURG
REPUBLIC OF SOUTH AFRICA

CASE NO. AR 225/08

In the matter between:

DIESEL TRACKER CC APPELLANT

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICES RESPONDENT

APPEAL JUDGMENT Delivered on 27 August 2009

SWAIN J

[1] This is an appeal against the Judgment of Levinsohn D J P sitting in the Durban Tax Court, in which a determination by the respondent that the sale transaction between the appellant and one Roux was a "scheme" within the meaning of Section 73 (1) of the Value Added Tax Act 89 of 1991 (The VAT Act), was upheld.

[2] The background facts relevant to this appeal which are common cause, are set out in paragraphs 3 – 18 of the judgment of the Court *a quo*, and need not be repeated.

[3] As a consequence of the determination by the respondent, a claim for notional input tax in terms of the VAT Act by the appellant, in the amount of R1,847,891.53 was disallowed by the respondent, who in addition levied a penalty of one hundred percent additional tax.

[4] The crucial issue is whether the appellant discharged the onus of showing that the respondent was wrong in concluding that the sale transaction was a scheme to obtain a tax benefit, within the meaning of Section 73 of the VAT Act. The Court *a quo* concluded that the appellant had failed in this endeavour, and it is this conclusion which is challenged on appeal.

[5] The essence of the enquiry in terms of Section 73 of the VAT Act into any "scheme", which in this case is the said sale transaction, is whether:

[5.1] The sale was entered into, or carried out by means, or in a manner, "which would not normally be employed for bona fide business purposes, other than the obtaining of a tax benefit" or

[5.2] "has created rights or obligations which would not normally be created, between persons dealing at arm's length" and

[5.3] was entered into, or carried out solely or mainly for the purposes of obtaining a tax benefit.

[6] The rebuttable presumption contained in Section 73 (3), has the effect that once it is proved that the scheme concerned, does or would result in a tax benefit, then it is presumed that the scheme was entered into, or carried out, solely or mainly, for the purpose of obtaining such tax benefit.

[7] It is common cause that the sale transaction did produce a tax benefit, in the form of notional input tax and consequently the appellant bore the onus of proving that the sale was not concluded, solely or mainly, for the purposes of obtaining the notional input tax.

[8] The following evidence is relevant to determine whether, due regard being had to the substance of the sale agreement, it was entered into, or carried out by means, or in a manner, normally employed for *bona fide* business purposes, other than obtaining the tax benefit.

[9] Roux testified that Executive Helicopters (Pty) Ltd (Executive) wished to buy all of the helicopter spares and were prepared to offer one thousand shares in Tantco Global (Pty) Ltd. (Tantco), plus a ship and a submarine in return. He however refused to sell all of the spares to Executive, and wanted to sell a parcel of the spares to the appellant. He said to Executive that they could then buy these remaining spares from the appellant.

[10] The explanation advanced by Roux for his conduct, was that he wanted shares in the appellant. All of the members' shares were held equally by his two daughters Hilda McGovern and Myra Engelbrecht. He "desperately" wanted shares in the appellant because he was the patent holder of the device marketed by the appellant and "this thing was slipping out of my hands". The "main purpose" for him in the deal "was to get thirty percent of the shares back from Diesel Tracker" and his "whole life was" that he wanted the shares back because of the device he had developed and he saw the potential of this. It was "the most important thing" for him to get the shares and "this was the only way" for him to get the shares, namely by offering the ship and submarine to his daughters in return for shares in the appellant.

[11] In addition, Roux maintained that the only benefit for him in the appellant at the outset was that he "had a job" and "I was not happy but I had no choice at this stage" and at that stage he "had no members' interest in Diesel Tracker. I would have worked for my own family".

[12] McGovern said that her father, Roux "wanted back into the business" and "I think he saw that it was very important for him to get back into the business" and "we didn't want him in the business" and "it was Engelbrecht and my business We had an agreement with Mr. Roux that he was going to work for us".

[13] The picture that is painted by this evidence is of a desperate Roux trying to acquire a members' interest in the appellant, so that he might share in the spoils which would flow from the exploitation and marketing of the device, which was after all, his brainchild. Frustrating this legitimate desire were his two daughters, who did not want him in the business of the appellant, and obdurately refused to allow any members' interest in favour of Roux. Roux was therefore compelled to overcome their reluctance and resistance, by offering them a deal which was so good they could not refuse.

[14] All of this evidence is however directly contradicted by the exchange of the following correspondence between the respondent and the appellant. On 20 March 2006 the respondent wrote to the appellant requesting, *inter alia*, the following information.

"According to the Business Plan that Diesel Tracker CC submitted together with their application for VAT registration, the diesel tracker unit, which will be sold / installed by the CC, was designed and developed by Adriaan Roux. Please explain why Mr. Roux then had to **purchase** 15% of the shareholding in this CC if it is **his product** that will be sold / installed by the CC **(in writing)**".

The reply by the appellant to this query dated 31 March 2006 is as follows:

"Mr. AJ Roux designed the Diesel Tracker Unit and in fact the patent rights are registered in Mr. AJ Roux's name as per Annexure E:1-3. The rights for the production, sales and marketing were acquired by Diesel Tracker cc at no cost due to the fact that Mr. AJ Roux was unable to finance and support the future research, development, marketing and sales of the Diesel Tracker Unit. Mr. AJ Roux would be issued 15% shareholding in the member's interest in the cc at no cost. It was further agreed that Mr. AJ Roux would be responsible for overseeing the entire project in the General Manager capacity and be paid a salary, but only once income was generated from the Diesel Tracker Unit. These arrangements were agreed to verbally.

The members of Diesel Tracker cc furthered and financed the project and sought other means of financing the project. The transaction for the purchase of the ship and submarine evolved over a period of some 9 months until it was finalised and in so doing a further 15% shareholding of member's interest in the cc was negotiated with Mr. AJ Roux as payment for the spares sold to Executive Helicopters making Mr AJ Roux's shareholding a total of 30%".

[15] Before examining the ramifications of this contradiction, it is necessary to deal with the context and manner in which the letter, written on behalf of the appellant, was raised in evidence in the Court *a quo*.

[16] Under cross-examination, McGovern, after explaining that Roux wanted to get back into the business of the appellant, said the following:

"I know that you are going to show me a letter now saying that in the beginning we said it was a verbal agreement that we would give him 15% of the business.

That was right at the beginning. When the ship and the submarine came up, we put everything together it was a new contract and we decided that he can buy 30% shares of Diesel Tracker".

[17] The contents of the letter, which formed part of the bundle of documents placed before the Court *a quo*, were however not referred to and neither McGovern nor Roux were asked to explain its contents. Mr. Louw, S.C., who together with Mr. Ellis, appeared for the appellant, submitted that the fact that McGovern spontaneously referred to the letter was an indication of her honesty. However, the contents of the letter, read together with her attempted explanation of its contents, albeit cryptic, leads me to a different conclusion.

[18] The contents of the letter flatly contradicts the evidence of Roux in a number of respects, namely that he was desperate to obtain a members' interest in the appellant and this was his motivation for diverting the sale of a portion of the helicopter spares, via the appellant to Executive. The letter also contradicts his evidence that all he had was a job in the appellant and was reduced to the position of working for his family, which he was unhappy about. According to the correspondence, he was in fact entitled at all times to a gratuitous members' interest of fifteen percent.

[19] McGovern did not dispute the accuracy of the letter, but sought to explain its contents by saying that was the arrangement in the beginning, which was overtaken by the later agreement to sell

Roux a thirty percent members' interest. This however is not what the letter clearly conveys, which is that Roux was entitled to a fifteen percent members' interest gratuitously, the transaction for the purchase of the ship and submarine evolved over a period of nine months, and "In so doing a further 15% shareholding of member's interest in the cc was negotiated with Mr. AJ Roux as payment for the spares sold to Executive Helicopters making Mr. AJ Roux's shareholding a total of 30%". There was no agreement to sell Roux a thirty percent members' interest in return for the spares, according to the correspondence. The agreement was for the sale of only a fifteen percent members' interest.

[20] The response of Mr. Louw, S.C., to this contradiction was to submit that sight must not be lost of the bigger picture, namely that the main objective of the appellant was the development and marketing of the device and the ship and submarine were acquired to achieve that objective. Their hire would generate a much needed source of income to develop and market the device.

[21] However, the irresistible inference is that Roux and McGovern have been untruthful regarding the expressed motivation of Roux, for selling a portion of the spares to the appellant, as well as the details of the sale. Why would Roux and McGovern wish to misrepresent what Roux's motivation was? If Roux's motivation in concluding the deal was solely, or mainly, the objective contended for by Mr. Louw, S.C., there would be no need for any deception. The purpose of the deception must have been to mask what the

true or main purpose was, namely the acquisition by the appellant of an entitlement to payment of the notional input tax.

[22] I am fortified in this view by a number of other aspects of the sale, which leads me to the conclusion that the sale was not one which would normally be employed for *bona fide* business purposes. They also lead me to conclude that the sale created rights or obligations, which would not normally be created, between persons dealing at arm's length.

[23] Roux stated that the sale price for the spares of R15 million was based upon the valuation of R47 million for the ship and submarine. In other words, the thirty percent members' interest that Roux acquired in return for the spares, had a value of R15 million. McGovern confirmed that the value of the assets of the appellant, when the thirty percent members' interest was sold to Roux, was R47 million. Consequently, the sale price of the spares sold by Roux to the appellant was not determined by reference to the inventory of spares and their valuation, carried out by Fouche of News Air Lease SA CC. The sale price of the spares was determined by the value of the ship and the submarine, which the appellant would acquire by the subsequent sale of the same spares to Executive. The disparity in the fictional value of the spares on the one hand, and the true value of the ship and the submarine on the other, bartered by the appellant and Executive, is strikingly apparent. Why would Executive be prepared to exchange a ship and a submarine valued at R47 million for spares "valued" at R15 million? The answer is obvious. Executive obviously did not care

how the assets they were prepared to barter for all of the spares, were divided between Roux and the appellant. Provided they acquired all of the spares, it was clearly irrelevant to Executive that the Tantco Global shares, upon which no fixed value could be placed at the time, because the mine was not operational, were exchanged for spares valued at R97.5 million, whereas a ship and submarine worth R47 million were exchanged for spares only "valued" at R15 million.

[24] In my view, seen in the above context, the sale transaction was not one which would normally be employed for *bona fide* business purposes, other than to obtain the notional input tax. Clearly Roux and the appellant were not dealing with each other at arm's length and the rights and obligations they created exhibit this characteristic. Why would Roux forego his right to a gratuitous fifteen percent members' interest in the appellant and replace it with an obligation to pay for a thirty percent interest, the purchase price for which was R15 million worth of spares, the value of which was determined by assets the appellant would subsequently acquire, if the transaction was at arm's length?

[25] The evidence given by Roux and McGovern as to what their knowledge was of the issue of notional input tax, at the time the deal was concluded, is cause for concern. McGovern, when asked by Levinsohn DJP whether anybody had thought of this at the time, initially stated "I don't know if we knew about that, that wasn't our main purpose" but when pressed, stated that she did not know about it. Roux, when asked by Levinsohn DJP whether Roux thought about

the VAT implications of not being a registered vendor, and selling the spares for R15 million stated:

"If I say I did not think about it, it was also on my mind yes, but it actually has nothing to do with me"

but later said he was only advised by the accountant regarding notional input tax "when the claim was put in or the deal was on". However, he then agreed with the suggestion that there was a discussion about VAT, when the deal was being structured and "done".

[26] When the vacillation in the evidence of Roux and McGovern in this regard is considered, in the context of the finding I have made as to their dishonesty in respect of their professed motivation for concluding the sale, as well as the details of the sale, I am again driven to the conclusion that they have not been honest in this regard.

[27] I am therefore satisfied that the Court *a quo* was correct in concluding that the appellant had failed to discharge the onus of showing that the respondent wrongly concluded that this was a scheme to obtain a tax benefit, within the meaning of Section 73 of the VAT Act. It therefore becomes unnecessary to consider the remaining criticisms advanced by Mr. Louw, S.C., against the Judgment of the Court *a quo*, which were largely based upon the

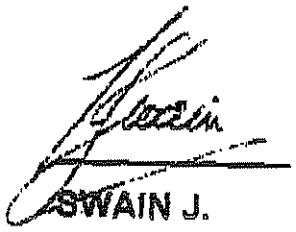
argument that the Court *a quo* wrongly decided that the spares were not worth the value placed upon them. In this regard, Mr. Louw, S.C., pointed to the valuation I have previously referred to. He submitted that this view permeated the Judgment of the Court *a quo* and led it to incorrectly reach the conclusion it did. In the view I take of the matter, and for the reasons I have set out above, I do not regard the issue of the valuation of the spares as being of overriding significance.

[28] As regards the penalty imposed by the respondent, in terms of Section 60 of the Act, the only submission by Mr. Louw, S.C. in this regard, was that it had to be found that the conduct of the appellant was intentional, i.e. that the scheme was entered into with the purpose of obtaining the tax benefit. I have found this to be the case.

[29] As regards the costs of the appeal, this matter was adjourned on two previous occasions. On the first occasion the costs were reserved, and on the second the costs were directed to be costs of the appeal. On the first occasion, the appeal was adjourned to enable the appellant to obtain legal representation. On this basis, Mr. van der Merwe, who appeared for the respondent, submitted that the appellant should be ordered to pay the costs of the first adjournment. Mr. Louw, S.C. submitted that each party should pay their own costs. Mr. van der Merwe's submission is clearly preferable.

[30] I would therefore propose the following order:

> The appeal is dismissed. The appellant is ordered to pay the costs of the appeal, such costs to include the costs occasioned by the two previous adjournments of the appeal.

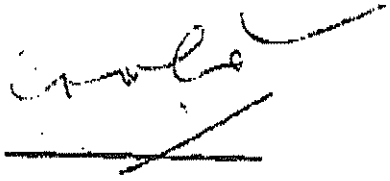


SWAIN J.

I agree

THERON J

I agree and it is so ordered



NICHOLSON J

Appearances: /

Appearances:

For the Appellant	:	Adv. A. Louw, S.C. with Adv. A. Ellis
Instructed by	:	Roelof van der Merwe Attorneys Pretoria
For the Respondents	:	Adv. M.P. van der Merwe.
Instructed by	:	The Commissioner for the S.A. Revenue Service/State Attorney
Date of Hearing	:	21 August 2009
Date of Filing of Judgment	:	27 August 2009