Onlangse regspraak/Recent case law

A (Pty) Ltd v The Commissioner for the South African Revenue Service

ITC 12644 (2012)

Capital loss incurred on the redemption of redeemable shares: a clogged loss or not?

1 Introduction

It is said that the reasons for the taxation of capital gains are enthused by the fundamental notions of fairness, a need for economic efficiency and the improvement of tax administration (Brooks *Taxing Capital Gains is Good for the Tax System, the Economy and Tax Administration* (2001) 2). This report was drafted for the Portfolio Committee on Finance and presented before Parliament. It is used to substantiate the introduction of CGT in the *Comprehensive Guide to Capital Gains Tax*). The Income Tax Act 58 of 1962 (ITA) provides for the inclusion of capital gains or the limited deduction of assessed capital losses made by a taxpayer in determining its tax liability. The determination of such capital gains or assessed capital losses is governed by the Eighth Schedule to the ITA (the Eighth Schedule). The Eighth Schedule sets out provisions that determine a taxpayer's capital gains or capital losses (De Koker *Silke on South Africa Income Tax* (2011) par 24.1).

Brooks stated in his report that the then draft South African Capital Gains Tax Legislation was impressively clear, precise and comprehensive. However, tax legislation is inherently abounded with complexities and controversy as to its application, interpretation and purpose. The interpretation of the Eighth Schedule has led to a degree of uncertainty where the tax treatment of the redemption of redeemable preference shares is concerned. This matter was dealt with in the recent case of *A (Pty) Ltd v Commissioner for the South African Revenue Services* ITC 12644 (2012). In this matter, the court addressed the nature of a disposal and the essential nature of the redemption of redeemable preference shares. Due to the nascence of the taxation of capital gains in South Africa, it was the first time that the courts dealt with this aspect of the taxing statute. In this case the application of Paragraph 39(1) of the Eighth Schedule to the redemption of redeemable preference shares was placed under scrutiny. It is worth noting that this case is of importance not only for taxation purposes, but also for the purpose of the statutory interpretation.

2 The Law

Paragraph 39(1) was introduced at the inception of the capital gains tax as an anti-avoidance provision to prevent a taxpayer from avoiding tax liability, by creating a capital loss through the disposal of an asset to a connected person (a connected person is defined in s 1 ITA as a company that holds more than 50 per cent of the equity shares or voting rights in another company, and forms part of the same group of companies). Were it not for Paragraph 39(1), a taxpayer would be able to avoid CGT by disposing of an asset to a connected person at a loss (whilst effectively still retaining control of the asset and its benefit through the relationship with the said connected person). Paragraph 39(1) provides for the "clogged-loss" rule in respect of capital losses incurred as a result of disposals made to certain connected persons. This clogged loss rule disallows a set off or deduction of losses on disposals to connected persons or group companies. The salient provisions of Paragraph 39(1) state as follows:

> A person must, when determining the aggregate capital gain or aggregate capital loss of that person, disregard any capital loss determined in respect of the disposal of an asset to any person –
>
> (a) who was a connected person in relation to that person immediately before that disposal; or
>
> (b) which is immediately after the disposal –
>
> (i) a member of the same group of companies as that person ...

The capital loss disregarded in terms of this paragraph can only be set off against capital gains made on the disposal which was made to the same person in that year or a subsequent year if the person to whom the asset is disposed is still a connected person to the taxpayer (par 39(2)).

3 Facts

The appellant was a company, part of a group of companies (a group of companies is defined in s 1 ITA as companies where at least one of the companies holds 70 per cent of the equity shares or more in another company), which held shares in a second company (the issuer company) that was part of the same group of companies. The shares held by the appellant were redeemed by the issuer company and as a result thereof, the appellant suffered a capital loss. In its 2003 year of assessment, the appellant claimed the capital loss incurred as a deduction from its tax liability and the Commissioner for the South African Revenue Services (the Commissioner) disallowed the deduction on the grounds that the capital loss suffered was a clogged loss as envisaged in Paragraph 39(1). Consequent to the disallowance, the appellant raised an objection against the Commissioner's assessment which the Commissioner dismissed. The appellant then lodged an appeal against the Commissioner's assessment to the Tax Court. The Commissioner sought to have the assessment confirmed and contended that Paragraph 39(1) was applicable to the transaction and the redemption of the preference shares was a disposal as contemplated by the said Paragraph. The appellant, however, expressed the view that because the redemption of the shares was not a disposal "to any other person", as contemplated by

Paragraph 39(1), it did not amount to a clogged loss and thus the deduction should have been allowed. The Commissioner also sought to have the preference dividend and the redemption premium received by the appellant deducted from the base cost of the preference shares on the grounds that these amounts constituted a recovery in terms of Paragraph 20(3) of the Eighth Schedule.

There were therefore two primary issues brought before the court. The first being the interpretation of Paragraph 39(1) and whether that Paragraph applied to the redemption of preference shares and accordingly, rendered the appellant's capital loss a clogged loss due to the fact that the appellant and the said company were connected persons. The second issue before the court was whether the preference dividend and premium received in the redemption of the redeemable shares amounted to a recovery of the base cost (the cost at which the appellant acquired the preference shares).

4 Judgment

In relation to the first issue, the court held that the word "disposal" had to be given a narrow meaning in light of its context, particularly because it was used in conjunction with the preposition "to" (11). The court made reference to *Van Heerden v Joubert* (1994 4 SA 793 (A) 795) where it was held that the golden rule of statutory interpretation was that words had to be given their ordinary literal meaning and if it is clear and unambiguous, it is this grammatical meaning that must be adhered to. Departure from such a grammatical interpretation is only permissible if not doing so would lead to an absurdity that could never have been envisioned by the legislature.

The court also referred to *Cape Brandy Syndicate v England Revenue Commissioners* (1 KB 64 71), where the court stated that: "… one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied" (par 12). Further, reference was made to the *Concise Oxford Dictionary* which stated that the word "to" means "in the direction of" and "so as to reach" (par 19). In light of its reasoning, the court held that in order for a transaction to amount to a disposal as envisaged in Paragraph 39(1), the asset represented therein had to be transferred to the connected person. Since, in the transaction in question, no shares were transferred to the connected person but were extinguished instead, the redemption did not amount to a disposal and thus Paragraph 39(1) did not apply.

With regard the second issue the court held that the same principles of interpretation which applied to the first issue also applied in the interpretation of Paragraph 20(3) of the ITA. The court further held that when the company paid the appellant the dividend and the redemption premium, it did not intend for the amounts to constitute a reimbursement for the expenditure incurred for the acquisition of the preference shares. In calculating the appellant's capital loss, the respondent had erred in treating the dividend portion and the redemption premium portion as recoveries of the acquisition cost as envisaged in Paragraph 20(3) of the ITA. As a result, the appeal was upheld.

5 Analysis of the Court's Judgment

The effect of the court's decision is that Paragraph 39(1) does not apply to the redemption of shares. As a result any loss incurred due to the redemption transaction upon a disposal to a connected person is not ring-fenced. Therefore, a taxpayer is allowed to take into account any capital loss determined in respect of the redemption of preference shares held in a connected company when calculating its aggregate capital gain or loss for the year of assessment. It should be noted that a redemption does constitute a disposal as a general matter; however, it is not a disposal "to any person" for the purposes of Paragraph 39(1).

5 1 Application of Paragraph 39(1) to a Redemption of Shares

5 1 1 Statutory Interpretation

As stated above, Paragraph 39 was introduced as an anti-avoidance measure to combat the avoidance of tax by loss making transfers of capital assets between connected parties. In applying the anti-avoidance provisions, the courts should look at the objectives of the provision and give effect to what the provision seeks to achieve.

The courts have predominantly accepted the practise of applying a grammatical interpretation to legislation in order to determine its meaning. However, regard must be had to the fact that the purpose of interpreting statutes is to ascertain the intention of the legislature. This principle was affirmed in *Glen Anil Development Corporation Ltd v Secretary for Inland Revenue* (1975 4 SA 715 (A) 727), where the court confirmed the view in the *Commissioner for Inland Revenue v Delfos* (1933 AD 242), and stated "… even in the case of fiscal legislation the true intention of the Legislature is of paramount importance, and, I should say, decisive". In *R v Hildrick Smith* (1924 TPP 68 81) the court stated "[t]here is only one kind of interpretation with one definite object, and that is, to ascertain the true intention of the legislature as expressed in the Act".

It is notable that in *Natal Joint Municipal Pension Fund v Endumeni Municipality* (2012 (4) SA 593 (SCA) 605) the court stated that in interpretation, the expression "intention of the legislature" should be avoided because this creates the misnomer that interpretation entails an enquiry into the mind of the legislature. However, what remains significant is that the judge recognised the necessity of taking the purpose for which the legislation was created into account in interpretation, despite his caution against the use of the phrase "intention of the legislature". (As for instances where the intention of the legislature is in inconsistent with constitutional provisions see *Matiso v The Commanding Officer, Port Elizabeth Prison* 1994 4 SA 592 (SE) 596 in which the court states that in a constitutional state and in constitutional matters, it is not the intention of the legislature that should prevail but the constitutionality of the particular provision in question).

Notwithstanding the fact that the "golden rule" of adopting the grammatical interpretation of statutes is a widely accepted practice in our courts, the development of law has seen a progression in methods of interpretation which are far more effective in the pursuit of ascertaining the intention of the legislature. This progression from the use of a narrow grammatical method of interpretation of statutes to a more holistic approach that encompasses the use of a wider range of interpretative methods can be depicted in the South African Law Reform Commission's Discussion Paper 112 *Statutory Revision: Review of the Interpretation Act 33 of 1957* (Discussion Paper 112 (Project 25)) (the Discussion Paper). This paper was drafted during the Law Reform Commission's task of revising the Interpretation Act 33 of 1957 in order to align it with the Constitution and contains the Commission's research results. The Discussion Paper encompasses a draft Interpretation of Legislation Bill (the Bill). Chapter Two of the Bill attempts to codify a comprehensive method of interpretation that should be adopted in the interpretation of legislation. Clause 5 of Chapter Two currently reads as follows:

(1) When interpreting legislation –

(a) the meaning of a provision in that legislation must be determined by –

(i) its language; and

(ii) its context in the legislation read as a whole and

(b) any reasonable interpretation of a provision in accordance with paragraph (a) that is consistent with the purpose and scope of that legislation must be preferred over any alternative interpretation of that provision that is inconsistent with the purpose and scope of legislation.

The clause read with the rest of Chapter Two recognises all the interpretative methods of the classical Von Savigny quartet (Du Plessis "Learner Staatsrecht from the Heartland of the Rechtstaat" 2005 *PELJ* 3 paragraph III), which are; grammatical interpretation, systematic interpretation, purposive interpretation and historical interpretation (Le Roux "The Law Reform Commission's Proposed Interpretation of Legislation Bill: Critical Comments" 2007 *SAPL* 528). It is evident in clause 5(1)(a) of the Bill that even where a grammatical interpretation is adopted, the court is required to interpret the provision in light of the legislation read as a whole.

In Du Plessis & Corder *Understanding South Africa's Transitional Bill of Rights* (1994), the authors recognise that there are several principles of interpretation which must be used collectively in order to truly interpret statutes in accordance with the legislature's intention. These principles of interpretation, similar to the Von Savigny quartet, are (in no particular hierarchical order); a grammatical interpretation which encompasses giving words their ordinary meaning, a systematic interpretation which entails the interpreting of statutes as a whole and not interpreting a provision in isolation, a teleological interpretation which entails the consideration of the purpose and values that underpin the legislation, a historical interpretation which encompasses the interpretation of statutes in light of the historical background they were created in, and also a comparative interpretation in instances where such an interpretation would be appropriate (73-74).

These principles of interpretation identified by Du Plessis were also given recognition in our courts in *Minister of Land Affairs v Slamdien* (1999 4 BCLR 413 (LCC) 422) where the court stated that in interpreting legislation it is imperative that its purpose be analysed, regard must be had to the historical origin of the statute, the statute's broad objects and values which underlie it must be considered and regard must also be given to the part of the statute to which the provision appears or those provisions with which it is interrelated. The principles were further entrenched by the Constitutional Court in *S v Makwanyane* 1995 3 SA (CC) 154 where Mahomed J stated:

> What the Constitutional Court is required to do in order to resolve an issue, is to examine the relevant provisions of the Constitution, their text and their context; the interplay between the different provisions; legal precedent relevant to the resolution of the problem both in South Africa and abroad; the domestic common law and public international law impacting on its possible solution; factual and historical considerations bearing on the problem; the significance and meaning of the language used in the relevant provisions; the content and the sweep of the ethos expressed in the structure of the Constitution; the balance to be struck between different and sometimes potentially conflicting considerations reflected in its text; and by a judicious interpretation and assessment of all these factors to determine what the Constitution permits and what it prohibits.

The interpretation principles entrenched in *Makwanyane* apply, not only where the interpretation of the Constitution is at issue but, also to instances where other forms of statute are interpreted. This *dictum* in *Makwanyane* re-enforces the subsequent contention that a grammatical approach on its own, as adopted by the Tax Court in *A (Pty) Ltd*, is insufficient to truly ascertain the true meaning of Paragraph 39(1).

It is submitted that the Tax Court erred in its finding that Paragraph 39(1) did not apply to the redemption of shares. Albeit the relevance of a grammatical interpretation is recognised, such an interpretation should not result in the fragmentation of the legislative instrument as a whole (Du Plessis *Re-interpretation of statutes* (2002) 224). In the *Executive Council of the Western Cape v Minister for Provincial Affairs and Constitutional Development of the RSA; Executive Council of KwaZulu Natal v President of the RSA* (1999 12 BCLR 1360 (CC) 33), the court stated that it is an accepted principle of interpretation that where two subsections of an Act deal with the same subject matter, these subsections should be read together.

In *A (Pty) Ltd* the court failed to interpret Paragraph 39(1) in light of Paragraph 11(1). Paragraph 11(1)(b) of the Eighth Schedule expressly includes a redemption in its definition of a disposal. It clearly states that a disposal includes the redemption of an asset. When the legislature included “a redemption” in its definition of a disposal, it was fully aware of the nature of a redemption and that it could not result in the shares, or the rights attached thereto, transferred to the redeeming company because a company cannot hold shares in itself. The court failed to take into account that in interpreting statutes, the statute must be read in its entirety and thus the construction of the word “to” should have been interpreted in light of the entire Eighth Schedule, and particularly, the expressed inclusion of redemptions in Paragraph 11(1).

5 1 2 Reasons Behind Introduction of CGT

It cannot be said that the court’s interpretation of the word “to” and thus the entire Paragraph 39(1) provision was consistent with the legislature’s intention. In the Briefing by the National Treasury’s Tax Policy Chief Directorate to the Portfolio and Select Committees on Finance on Wednesday, 24 January 2001, reasons for the introduction of the CGT system are provided. Amongst others, the reasons stated for the introduction of the CGT system are in order to attain “horisontal” and “vertical” equity. The system sets out to achieve “horisontal equity” by ensuring that individuals in similar economic circumstances bear a similar tax burden irrespective of the form of accretion the economic power takes. *Id est*, irrespective of the fact that the economic accretion takes the form of wages or capital gain. Thus the exclusion of the CGT system would essentially undermine the “horisontal equity” of the tax system (10).

The CGT system aspires to achieve “vertical equity” by imposing a greater tax burden on individuals with a greater capacity to bear such a burden of tax. The introduction of CGT is also aimed at creating a disincentive for taxpayers who would opt to characterise their income as capital in order to avoid a tax burden. Lastly, CGT was introduced to enable the tax base to be broadened in an attempt to eventually lower the overall tax rates. It was introduced in order to bring more taxpayers within the “taxation net” (Briefing by the National Treasury’s Tax Policy Chief Directorate to the Portfolio and Select Committees on Finance on 20010124 2).

As discussed above, it is imperative that in interpretation of legislation, the legislature’s intention should be ascertained. In light of the reasoning for the introduction of the CGT system, it is clear that the court’s construction of Paragraph 39(1) is inconsistent with the legislature’s intention. The interpretation of the word “to” as stated by the court, has the effect of excluding a capital loss incurred as a result of the redemption of redeemable shares from the ambit of Paragraph 39(1). This in turn limits the "taxation net" by allowing taxpayers to deduct from their taxable income every capital loss made from the redemption of shares. This is in direct contradiction to the intention of the legislature as indicated in the *Comprehensive Guide to Capital Gains Tax*.

If merit is given to the court's argument that the word "to" means "in the direction of" and that this implies that the shares must have been transferred to the connected person for the redemption to constitute a disposal, as envisaged by Paragraph 39(1), then it is submitted that in order for the asset to be able to move "in the direction of" a connected person, it must surely first "move away from" the other party. It is common knowledge that the taxpayer, after the redemption of the shares, no longer held shares in the company and in return, acquired a capital loss. It is the taxpayer's state of affairs that must be considered in determining its tax liability and not the effect a particular transaction has on the reciprocating party.

5 1 3 Contra Fiscum-rule

It is worth mentioning that in the case of ambiguity arising during the interpretation of fiscal legislation, the *contra fiscum* rule will be applicable. The *contra fiscum* rule is a common law principle stipulating that should a taxing statutory provision reveal an ambiguity, the ambiguous provision must be interpreted in a manner that favours a taxpayer (*Badenhorst v CIR* 1955 (2) SA 207 (N) 215). In other words, when a provision of ITA is reasonably capable of two constructions, the court will adopt the construction that imposes the smaller burden on the taxpayer. In *Glen Anil Development Corp* (1975 4 SA 715 (A) 727), the court held that an anti-avoidance provision must be interpreted in a robust manner in order to "… suppress the mischief against which the section is directed." In *Commissioner for Taxes v Ferreira* (1976 2 SA 653 (RAD) 657), the court held that a wide interpretation that gives effect to the legislature's intention should be employed when interpreting anti-avoidance legislation "… in order to suppress subtle inventions and evasions for the continuance of mischief and add force and life to the … remedy". Therefore, as to whether the *contra fiscum* rule could be applied in this case in favour of the taxpayer, the answer has to be in the negative. This is because Paragraph 39(1) is essentially an anti-avoidance provision; the *contra fiscum* rule will not be of assistance to the taxpayer. Furthermore, the rule would not find application if, as it appears, the court finds that there is no ambiguity as to the interpretation of Paragraph 39(1).

5 1 4 Steps in a Redemption

The court avoided analysing the distinction between a redemption and a share buy-back. The distinction could have changed the decision that the court arrived at. A buy-back of shares entails a two-step event. The first step is a reacquisition of the shares followed by a cancellation of those shares. In a redemption, the company reacquires the shares, however, the shares revert back to authorised but unissued shares. The first step, the reacquisition, is a common characteristic between a redemption and a buy-back. In a buy-back, the reacquisition of the share is followed by a cancellation thereof. On the other hand, in a redemption, the company may retain the shares in the authorised unissued share capital account. The distinction is thus, in what follows after the reacquisition (s 48 Companies Act 71 of 2008, which sets out requirements for the reacquisition by a company of its own shares, specifically excludes a redemption from its operation. This is an indication that the Companies Act recognises a distinction between a redemption and a share buy-back). What the company does with the shares does not determine whether the shares have been transferred to the issuer company or from the shareholder company. It is therefore submitted that the reacquisition of the shares by the company is a transfer by A to B, and therefore Paragraph 39(1) would apply regardless of what the second leg of the transaction requires, that is what company B does with the shares post acquisition of the shares in question.

5 1 5 Result of the Redemption

As stated in the decision a "redemption of shares *results in the extinction* and not in the transfer of rights embodied in the states to the company redeeming them, or to any other person" (emphasis added). The court refers to the *result* of the redemption. This does not necessarily mean that a redemption is a cancellation. An action happens, which is a disposal of the shares by the shareholder to the company and a result of that disposal is that the company extinguishes the rights by cancelling the shares. These are two actions by two different entities. The determining factor should be whether the shareholder disposed of the share.

If the decision in *A (Pty) Ltd* is to be followed, unintended tax consequences would result. Connected persons would be able to redirect transfers using various contracts. In this regard an illustration can be made with regards to a cession. Suppose the transaction required that B would transfer the shares to C, an unrelated third party in terms of a cession agreement between A and C. The first part of the transaction would be that B transfers the shares to A, but due to the cession agreement the transfer then passes on to C (*Grobler v Oosthuizen* [2009] ZASCA 51 12). If C compensates A at market value, then A and B would be able to manipulate the process to generate a loss by A compensating B at an amount that would generate a loss in the hands of B.

5 1 6 No Purpose Requirement

In the language of Paragraph 39(1) a person must "disregard any capital loss determined in respect of the disposal of an asset to any person" who is a connected person. A disposal is an action that results in the creation, variation, transfer or extinction of an asset by the person disposing of the asset. Paragraph 39(1) makes no reference to what the person receiving the asset should do with the asset upon receipt thereof. Should the person to whom the asset is disposed order the asset to be destroyed at or prior to delivery, the person disposing of the asset would still have disposed of the asset. Once again, the determination of whether the asset has been disposed of or not should be based on the action of the person disposing of the asset and not what the recipient of the asset does with it.

By its very nature, and as used in the salient parts of Paragraph 39(1), the word "to", is a preposition. A preposition is "a word or group of words used before a noun or pronoun to relate it grammatically or semantically to some other constituent of a sentence" (*Collins Concise Dictionary*). The purpose of the word "to" in "disposal of an asset to any person" is to introduce the counterparty to the transaction. There is no reference to what the counterparty should do with the asset in order for Paragraph 39(1) to apply. Therefore, the fact that the asset, being the share, is cancelled and ceases to exist is of no impact on the transaction transferring the share to a connected person.

5 2 Redemption Premium

Regarding the second issue before the court, it is submitted that the court correctly held that the redemption premium and dividend declared did not amount to the recovery of the base costs. It is notable that the *Comprehensive Guide to Capital Gains Tax* clearly states that the post-acquisition of a dividend does not constitute a recovery as contemplated by Paragraph 20(3) of the Eighth Schedule (148). The Commissioner's contention that the dividend and premium received constituted a recovery of the base cost was contradictory to the *Guide* issued by SARS. Section 1 of the ITA defines a dividend as including a redemption premium. Therefore, it is submitted that the court correctly decided that the redemption premium and dividend acquired by the taxpayer did not amount to a recovery of the base cost. Therefore, the second issue before the court will not be discussed any further.

5 2 1 Substance Over Form?

The facts of the case provide several factors to indicate that the transaction was entered into with the purpose of resulting in a return of the acquisition price of the preference shares to company A. The Commissioner submitted that it was important to take into account the following five aspects of the transaction:

(a) the purchase agreement for the shares was entered into on the 5th of November 2003;

(b) B Ltd's preference dividend was payable, in arrears, on or about the 30th of June and 31st of December every year; at the time of the conclusion of the purchase agreement the preference dividend for 31 December 2003 was not due and payable, but the parties agreed that this would be deducted from the purchase price;

(c) the purchase price (in terms of the agreement) was only paid on the 25th of February 2004, but the parties had already agreed that that amount (i.e. the December dividend) which was not due and payable at the time of the conclusion of the agreement, would be deducted from the purchase price;

(d) the evidence (i.e. given by Mr X) established that the benefits referred to in clause 7.1.2 of the purchase agreement were limited to dividends which would accumulate from 1 January 2004 onwards as well as the premium which accumulated on the nominal redemption value of the preference shares and it was those benefits which the appellant wished to acquire in terms of the purchase agreement;

(e) it was no co-incidence that the preference shares were redeemed within a short period after the implementation date; the directors (i.e. of B Ltd) only passed a resolution on the 12th of March 2004, but there is a very close connection between that date and the implementation date (i.e. even if one accepts for the purpose of argument that the implementation date was the 5th of February 2004) and that this is confirmed by the language used in the letter of the 8th of November 2004.

Based on the above, a question arises as to whether the intention of the parties was to ensure that company A effectively receives the purchase price of the preference shares. In this regard, if the intention of the parties as reflected in the substance of the transaction is different from the form of the transaction, the substance over form principle would apply. The Commissioner did not attempt to apply the substance over form principle in this case. The substance over form doctrine entails two elements: The label principle and the simulation principle (Surtees & Millard "Tax Avoidance" November/December 2004 *Accountancy SA* 14). In terms of the label principle parties attach a wrong label to a transaction but act in good faith and intend to give effect to the transaction. On the other hand, in terms of the simulation principle parties enter into a sham transaction or a transaction that is *in fraudem legis* (Surtees & Millard 15). In terms of the simulation principle the transaction is designedly disguised to escape the tax, whilst in truth it falls within the provisions (*Dadoo Limted v Krugersdorp Municipal Council* 1920 AD 530 547).

The Appellate Division elaborated in *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd* (1941 AD 369 395-396) that (emphasis added):

> [a] transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, *if the parties honestly intend it to have effect according to its tenor, is interpreted by the Court according to its tenor*, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax.

The court has recently extended the application of the substance over form doctrine in *Commissioner, South African Revenue Service v NWK Limited* 2011 (2) SA 67 (SCA), 73 SATC 55 2010. The effect of this decision is that a transaction will be regarded as a sham if the transaction lacks commercial sense. The mere fact that a transaction was implemented in accordance with its terms would not preclude a finding that it was a sham. If there is no real commercial reason for a particular arrangement other than the additional tax benefit obtained, the transaction would be regarded as a sham. It could be argued that the five aspects of the transaction in *A (Pty) Ltd* referred to above are irregular in their nature as well as the manner in which they are executed. Therefore, the Commissioner should have at least pondered the application of the doctrine.

6 Conclusion

In interpreting fiscal legislation it is imperative that the correct methods of interpretation be applied in order to truly ascertain the intention of the legislature. A restrictive interpretation method could lead to a resolution that the legislature could not have intended in light of the circumstances prevailing when the legislation was created. Taxation should not be viewed as a peril towards a taxpayer's financial comfort. Instead, tax legislation should be construed in a manner that realises the objects for which it was created, which are often beneficial to the tax system as a whole.

In *Venter v R* (1907 TS 910 915), the court held that words must be given their ordinary meaning unless such an interpretation would lead to a result contrary to the legislature's intention or a glaring absurdity that could never have been contemplated by the legislature. It is clear that the introduction of the CGT regime was introduced in order to broaden the "taxation net". The court's interpretation of the provision in the Eighth Schedule in this instance is contradictory to the legislature's intention and thus amounts to a glaring misconstruction as a result of the narrow approach of interpretation it imposed on itself. Such a misconstruction of Paragraph 39(1) results in the absurd consequence that a taxpayer may elect to have its shares redeemed at a loss in order to reduce its taxable capital gains without actually incurring an economic loss due to the fact the taxpayer and the redeeming company are connected persons or part of the same group of companies. It may elect to reduce its taxable liability by creating what is essentially a fictitious loss.

The tax treatment of the redemption of redeemable shares should thus be in accordance with the provisions set out in the Act and in accordance with the proper interpretation of those provisions. It is therefore a capital loss incurred in the redemption of redeemable shares and thus amounts to a clogged loss as envisaged by the legislature in Paragraph 39(1) of the Eighth Schedule to the ITA and should therefore not be deductible in determining a taxpayer's taxable capital gains.

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