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Tax update

New case law: STC on debit loans

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The matter of STC being imposed on deemed dividends under section 64C(2)*(g)* is still very relevant, despite dividends tax having come into effect since April 2012, with many taxpayers being assessed for STC on debit loans following tax audits. Case 13512 that was heard in the Gauteng Tax Court deals with a counter argument to the imposition of STC on debit loans that existed prior to 1 April 2012. This newsletter provides a brief overview of the judgment.

Tax Court case number 13512 (Gauteng Tax Court)

In brief, the facts of the case, which are likely to be very familiar to many taxpayer and practitioners, is that the company in question had made interest-free loans to its shareholders and their connected persons during the 2010 and 2011 years of assessment. SARS viewed the loans as deemed dividends under section 64C(2)*(g)* and imposed STC as well as interest on the late payment of this STC.

What perhaps made the facts in this case rather different from the many other debit loans used to extract or move funds from the company, is that the taxpayer company (hereafter referred to as the company) formed part of a group of companies. The group developed and invested in commercial and industrial property. In addition to owning properties, the company fulfilled the function as group treasurer. This function entailed that the company borrowed funds from lenders on an interest-free basis (one would assume these lenders were related to the group) and on-lent the funds to its shareholder or connected persons to the shareholder, again without charging interest. It was possible to show from the financial statements that all outgoing loans were funded from incoming loans, as opposed to profits of the company.

The company objected to the imposition of STC on the basis of section 64C(4)*(bA)*. In short, this subsection has the effect to state that a benefit granted to a shareholder or connected person (as contemplated in section 64C(2)) does not constitute a deemed dividend if consideration was received by the company granting the benefit in exchange for making such benefit available to the counterparty. A simple example where this paragraph would apply would be where a company transfers an asset to its shareholder and receives cash consideration from the shareholder. This transaction is a sale, as opposed to a dividend.

The Commissioner contended that the only exemption that is applicable in respect of loans that are deemed to be dividends is section 64C(4)*(d)* on the basis of the maxim *expressio unius est exclusion alteriusi,* which simply put, states that the fact that a specific section deals with the exemption of loans (s 64C(4)*(d)*) excludes loans from the other exemptions in section 64C(4). Van Oosten J was however of the view that this maxim did not apply in the context of the exemptions from deemed dividends. It is perhaps important to note that it was said that this maxim would not apply to the interpretation of exemption provisions. It is submitted that this view may be useful when considering other exemptions where there may be some overlap – for example, in the context of employer owned insurance policies, where sections 10(1)(gG) as well as the newly enacted section 10(1)(gI) may potentially apply to the same policy.

SARS' contention against the taxpayer's argument in terms of section 64C(4)*(bA)* was that it did not receive any consideration in the sense intended by that section in exchange for advancing the loans on an interest-free basis. In arriving at the judgment, the judge was of the view that the company did in fact receive consideration, or a *quid pro quo*, as the loans advanced to it on an interest-free basis were advanced on the understanding that it would be passed on to the borrowers on the same basis. The consideration was therefore the benefit of an interest-free incoming loan. On the basis of the purpose of the deeming provisions (to avoid mischief by taxpayers to extract profits in forms other than dividends), the conduit nature of the company's activities as well as the quid pro quo nature of the back to back loans, the taxpayer's appeal was allowed.

Concluding thoughts

It is submitted that there may be a few aspects of this judgment that would justify further consideration. Firstly, the persuasive effect of considering the purpose of legislation, in particular anti-avoidance legislation, should not be underestimated. The views set out in paragraphs 16 to 18 of the judgment illustrate this. Secondly, it would be important to consider other implications of an argument as well. A scenario where the taxpayer received the benefits of an interest-free loan came before the court in *C:SARS v Brummeria Renaissance (Pty) Ltd and Others.* In that case, together with Interpretation Note 58 that was subsequently issued, the precedent was set that the benefit of an interest-free loan, earned in exchange for a *quid pro quo* may constitute an amount to be included in gross income. Despite the favourable outcome in the STC case, the *quid pro quo* argument could count against the taxpayer in income tax case, it should be applied with caution.

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