



UNICUS TAX UPDATE

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Company AF and others v CSARS

GAAR, paragraph 43A, choice principle and penalties



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HELLO & WELCOME!

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THE TRANSACTION: THE SIMPLE VERSION

- The appellants held shares in RASS
- ANCIENT wanted to acquire RASS through SRIA
- Instead of a direct sale of shares for full value, the parties used a four-step structure
- RASS declared a large pre-closing dividend to the existing shareholders
- SRIA subscribed for new shares in RASS and funded the dividend payment
- The existing shareholders then sold their diluted residual shares for R1 000

THE FOUR STEPS

- Step 1: RASS declared a pre-closing distribution of approximately R274.666 million
- Step 2: SRIA subscribed for new RASS shares for approximately R280.325 million
- Step 3: RASS used the subscription proceeds to pay the dividend to the existing shareholders
- Step 4: The existing shareholders sold their original shares, now diluted to 0.01%, to SRIA for R1 000
- Economic result: the shareholders exited and ANCIENT obtained 100% of RASS

THE TAX EFFECT ABSENT GAAR

- The main amount was received by the appellants as an exempt inter-company dividend
- The subscription itself was not a disposal by the appellants
- The final sale was only for R1 000, producing no material capital gain
- The structure avoided the CGT that would have arisen on a direct sale of shares for full value
- That is why the structure mattered

SARS'S BASIS FOR THE ASSESSMENT

- SARS applied the GAAR to the composite transaction
- It disregarded or recharacterised the dividend and subscription steps
- It treated the transaction as an ordinary sale of the appellants' shares for full value
- It assessed CGT on that basis
- It also imposed understatement penalties, provisional tax underestimation penalties and interest

THE TAXPAYERS' BROAD DEFENCE

- The transaction had a genuine commercial purpose: ANCIENT acquired RASS and the shareholders exited
- The taxpayers argued that they were entitled to choose a tax-efficient route to that commercial result
- They relied on professional tax advice
- They disclosed the transaction as a reportable arrangement
- They challenged SARS's alternative pleading of a different arrangement
- They resisted the penalties on the basis of reasonable and bona fide conduct

THE COURT'S JUDGMENT IN BRIEF

- The alternative arrangement pleaded by SARS was struck out
- But the principal GAAR assessment was upheld
- The Court held that the composite transaction was an impermissible avoidance arrangement
- The dividend and subscription steps were disregarded or recharacterised
- CGT had to be calculated under the normal rules: proceeds less base cost
- The understatement penalty was remitted
- The provisional tax underestimation penalty was set aside and remitted to SARS for reconsideration
- Interest was confirmed

TAKEAWAY 1: THE ALTERNATIVE ARRANGEMENT

- SARS's original assessment identified the entire four-step composite transaction as the GAAR arrangement
- In rule 31, SARS pleaded an alternative: the dividend and subscription steps themselves were a separate impermissible arrangement
- The Court held that this was a different arrangement
- That matters because the GAAR operates on the arrangement identified by SARS in the section 80J process and assessment
- After Erasmus, SARS cannot use rule 31 to introduce what is in substance a new GAAR determination

WHY SARS PROBABLY PLEADED THE ALTERNATIVE

- The overall transaction had an obvious commercial purpose: sale, exit and change of control
- The dividend and subscription steps looked much more tax-driven when isolated
- SARS likely wanted to avoid the argument that the main purpose of the whole transaction was commercial
- The alternative allowed SARS to say: even if the sale was commercial, the inserted mechanism was not
- But the Court held that SARS did not need to plead a new arrangement to make that argument

WHY THE ALTERNATIVE WAS UNNECESSARY

- The Court could examine the steps within the composite transaction
- The composite arrangement did not have to be treated as indivisible or viewed only from the outside
- The commercial rationale of the dividend and subscription could be tested within the assessed arrangement
- That is different from treating those steps as a separate assessed arrangement
- SARS won on the principal case even after the alternative was struck out

POINT ON ERASMUS AND RULE 31

- This is not merely a rule 31 pleading technicality
- The real issue is the limit of SARS's GAAR power after assessment
- Section 80J reasons may be refined before the GAAR assessment crystallises
- After assessment, SARS cannot substitute a new arrangement through litigation
- Same quantum does not cure a change in the factual or statutory basis

TAKEAWAY 2: THE CHOICE PRINCIPLE

- The Court confirms that the Conhage choice principle still exists
- Absa also confirmed that taxpayers may structure affairs tax efficiently within the limits of the GAAR
- The difficulty is how narrowly the Court applies that principle
- The Court distinguishes between the purpose of doing the deal and the purpose of giving it this form
- The sale had a commercial purpose, but the dividend-and-subscription mechanism was found to have only a fiscal purpose

THE BROADER CONHAGE ARGUMENT

- Commercial result: shareholders exit and ANCIENT acquires RASS
- Route 1: direct sale of shares for full value
- Route 2: pre-closing dividend, purchaser subscription, dilution and nominal sale
- If both routes achieve the same commercial result, the taxpayers say they may choose the more tax-efficient route
- On that broad view, the transaction looks like it should be protected by the choice principle

THE COURT'S NARROWER APPROACH

- The Court asked what the dividend and subscription added to the sale
- It held that the sale and change of control could have been achieved directly
- The dividend and subscription did not change commercial risk or cash flow beyond the sale itself
- Their distinguishing function was to convert sale proceeds into an exempt dividend
- The Court therefore held that Conhage did not protect the structure

IS THIS NEW?

- It is not new that an overall commercial purpose does not immunise tax-driven steps
- It is not new that courts may examine inserted steps and entities
- But this judgment sharpens the enquiry
- The taxpayer must show that the tax-efficient features are part of a genuine commercial route
- It is not enough that the end result has a commercial purpose
- This substantially narrows the practical protection of the choice principle

CHOICE PRINCIPLE: DISCUSSION POINT

- If the commercial result is defined broadly, the structure may look like a permissible choice
- If the commercial result is defined narrowly, the tax-efficient steps may look like fiscal additions
- The judgment gives the Court significant room to decide the level of analysis
- Key question: was this a genuine alternative means of disposing of the investment, or merely a tax device attached to a sale?
- That is likely to be the most important conceptual debate in the case

TAKEAWAY 3: GAAR AND PARAGRAPH 43A

- Paragraph 43A is the specific dividend-stripping rule for capital assets
- The transaction happened in February 2017
- The major substituted paragraph 43A rules applied from 19 July 2017
- SARS therefore could not simply apply the later strengthened paragraph 43A
- SARS used the GAAR instead

WHY THIS MATTERS

- The transaction resembles the type of dividend stripping later targeted by paragraph 43A
- The Court held that the GAAR already applied on the February 2017 facts
- The later paragraph 43A amendments did not prove that the transaction was previously safe
- The Court treated the later legislation as not excluding the GAAR
- This creates a focused paragraph 43A question: what work did the later amendments do if the GAAR already reached the mischief?

PARAGRAPH 43A HISTORY TO COVER

- Pre-2017: narrower dividend-stripping rules existed
- 2017: major substitution of paragraph 43A, generally effective for disposals on or after 19 July 2017
- 2018: deferral transaction / rollover-related amendments, generally effective for disposals on or after 1 January 2019
- 2019: dilution rule introduced, effective where effective interest was reduced on or after 20 February 2019
- These dates matter because each amendment addressed perceived gaps or workarounds

TAKEAWAY 4: EXPOSURE BEFORE LATER PARAGRAPH 43A AMENDMENTS

- The judgment may expose transactions before the relevant paragraph 43A amendment took effect
- Example 1: pre-19 July 2017 extraordinary dividend followed by disposal
- Example 2: pre-1 January 2019 structures using rollover or replacement shares
- Example 3: pre-20 February 2019 dilution structures where the shareholder did not formally sell
- The exposure is subject to prescription and the facts of each case
- But SARS may now argue that the GAAR already attacked the same dividend-stripping mischief

IMPORTANT LIMIT: GAAR AND PARAGRAPH 43A MAY NOT PRODUCE THE SAME COMPUTATION

- Under the GAAR in this case, the Court recharacterised the transaction as a sale
- It held that CGT must be calculated under the normal rules
- That means proceeds less base cost
- Paragraph 43A may operate differently, especially in a deemed-disposal dilution case
- In some paragraph 43A scenarios, the extraordinary dividend may effectively be taxed without an immediate base-cost deduction

TAKEAWAY 5: UNDERSTATEMENT PENALTIES

- SARS imposed a 75% USP on the basis that the arrangement was an impermissible avoidance arrangement
- The Court remitted the USP
- A successful GAAR assessment does not automatically mean a GAAR USP follows
- The assessment enquiry and the penalty enquiry are distinct
- The GAAR enquiry focuses on the objective character of the arrangement
- The USP enquiry focuses on the taxpayer's conduct

USP: CONDUCT, NOT OUTCOME

- The question is how the understatement arose
- Do not reason backwards from the success of SARS's assessment
- The taxpayer may have been wrong on the law without acting dishonestly or carelessly
- The Court treated this as an error of legal judgment
- The taxpayers disclosed the transaction and did not misdescribe the facts
- They relied on specific professional advice in an unsettled area

USP AND BONA FIDE RELIANCE ON ADVICE

- The Court accepted that bona fide reliance on advice could excuse the taxpayers
- The advice was specific to the structure
- The transaction was disclosed as a reportable arrangement
- The GAAR position was unsettled when the taxpayers acted
- Later appellate authority did not retrospectively make the earlier reliance unreasonable
- Reliance on advice is not automatic protection, but it was enough on these facts

USP AFTER THE 2026 AMENDMENT

- Bona fide inadvertent error is no longer a general gatekeeper in section 222
- It now operates as a remission ground for substantial understatement
- That makes the penalty category more important
- If SARS proves the 75% impermissible avoidance arrangement category, the amended law may be harsher
- But this judgment supports the argument that SARS cannot simply equate a GAAR assessment with a GAAR penalty
- The result may still be no USP if the proper category is substantial understatement and bona fide inadvertent error is established

TAKEAWAY 6: PROVISIONAL TAX UNDERESTIMATION PENALTY

- SARS also imposed a paragraph 20 underestimation penalty
- The Court set it aside and remitted it to SARS for reconsideration
- The estimate must be judged when it was made, not with hindsight
- A later adverse GAAR judgment does not automatically make the original estimate negligent
- Specific advice, disclosure, unsettled law and absence of concealment all matter

TAKEAWAY 6: PROVISIONAL TAX UNDERESTIMATION PENALTY

- The Court treated paragraph 20(2) as giving SARS a discretion in the first instance
- The Court considered substituting its own decision
- It decided that the width of the discretion made remittal the proper course
- This is different from the USP issue, where the Court decided the penalty itself
- The remittal is debatable because the Court had already made most of the factual findings needed for remission

UNDERESTIMATION PENALTY: DISCUSSION POINT

- Was there any real discretion left for SARS after the Court's findings?
- The Court identified the factors SARS must weigh on remittal
- Those factors strongly favour remission
- But the Court stopped short of substituting its own decision
- Training point: penalty disputes may turn on whether the court views the issue as a legal entitlement or a SARS discretion

FINAL SUMMARY

- The taxpayer lost the GAAR case but won important procedural and penalty points
- Erasmus limits SARS's ability to plead a different GAAR arrangement after assessment
- The choice principle survives but may now operate more narrowly in practice
- The judgment raises important questions about GAAR exposure before paragraph 43A amendments
- GAAR and paragraph 43A may both attack the mischief but may compute the result differently
- Penalty exposure must be assessed separately from the success of the assessment

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