



# Synopsis

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Tax today\*

The PricewaterhouseCoopers Total Tax Contribution Survey provides valuable insight into the South African tax system and confirms the significant contribution that large companies make to the South African economy.

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# Release of Total Tax Contribution Survey

The results of the PricewaterhouseCoopers 2007 survey of the Total Tax Contribution of large South African companies were published in September 2008.

## Key findings

This survey, which is the latest of many similar studies conducted by PwC around the world, contains the following key findings in relation to the participating South African companies in respect of the two financial years under scrutiny:

The total number of business taxes in South Africa was 23. This includes 21 national taxes and 2 local taxes.

The 50 participants bore R49 622 million in taxes, representing 9.9 per cent of total estimated South African government taxation receipts from these sources.

For every R1 of corporate income tax paid, a further R0.51 was paid in the form of other business taxes. Corporate income tax therefore comprises only 66 per cent of all taxes borne by companies.

In addition to taxes borne, taxes collected from customers and/or employees totalled R52 890 million, representing 16.4 percent of total estimated South African government taxation receipts from these sources.

For every R1 of taxes borne, a further R1.07 was collected on behalf of the South African government.

Participating companies bore as many as 15 different taxes and on average they were responsible for 8.7 taxes.

The average number of taxes collected by the companies surveyed was 3.2 different taxes.

The average Total Tax Rate (total taxes borne as a percentage of total South African profits before all business taxes) for participants was 34.3 per cent.

The total cost of SA tax compliance for participants, including their external spend to external tax service providers, was R144,8 million.

On average the cost of compliance represents 0.81 per cent of their tax payments (taxes borne and collected).

The companies surveyed paid an amount equal to 16.8 per cent of their turnover in taxes in the form of taxes borne and taxes collected. This was split as 8.1 per cent of taxes borne and 8.7 per cent of taxes collected.

Charles de Wet, the PwC director responsible for the South African Total

Tax Contribution project, says that the data received from the largest companies in South Africa in the course of this study provides the opportunity to gain an understanding of the aggregate impact of business taxes on the large corporate sector, including the burden of tax compliance activities.

He says that by placing this information in the public domain, PwC intends to facilitate an informed debate with all stakeholders regarding the contribution that large companies make to the South African economy.

### The large corporate sector is coming under increasing scrutiny

Paul de Chalain, managing partner of PwC tax services, has observed that the amount of corporate tax paid by large companies is the subject of increasing scrutiny and public debate. He says that there has hitherto been a perception that large companies are not paying their fair share of tax, thereby shifting the tax burden onto other taxpayers, including individuals.

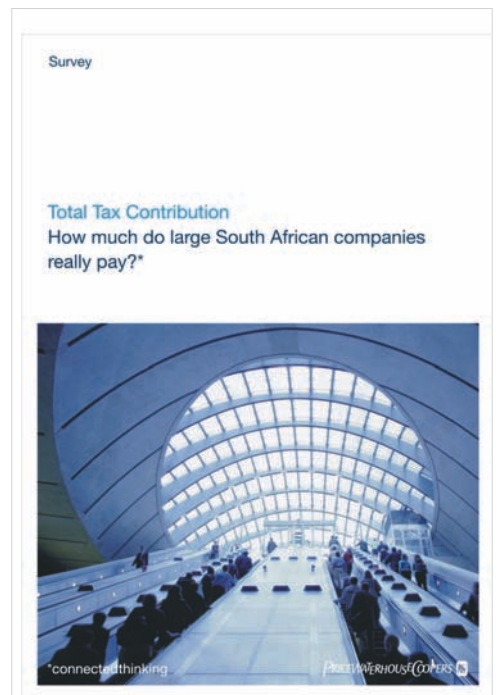
Yet, says de Chalain, the PwC study reveals that, in reality, companies pay many business taxes in addition to corporate tax, and their overall tax contribution significantly enhances

public finances. In addition to the taxes actually borne by the large corporate sector, further large amounts of tax are collected by these companies from their customers and employees in the form of VAT and PAYE, and remitted to SARS.

However, because of the lack of transparency and dearth of factual data in regard to the extent and impact of business taxes borne and collected by large companies, there has hitherto been inadequate understanding of the nature and extent of their overall tax contribution to the national economy.

De Chalain says that, in an effort to enhance transparency regarding the overall amount of taxes borne and taxes collected by large companies, PricewaterhouseCoopers designed the Total Tax Contribution Framework to enable companies and groups of companies to collect and report total tax information in a consistent manner.

The results of the survey, he says, facilitate an informed debate amongst stakeholders and enhance corporate social responsibility reporting. The Total Tax Contribution Report provides valuable insight into the South African tax system, its impact on the corporate business community, and confirms the significant contribution that large



companies make to the South African economy.

### The study will be repeated

The study is to be repeated for 2008. The data gathered in the new study will make it possible to monitor tax trends and will further stimulate debate on the total tax contribution made by large companies to the South African economy.

A judicial decision holding a trust to be a sham and its assets to be the property of its trustees moves a step closer

## Test case now in the pipeline

Ever since the decision in *Land and Agricultural Bank v Parker* 2005 (2) SA 77 it has been clear that the Supreme Court of Appeal is awaiting an opportune case to declare that a particular trust's assets are, in reality, the personal property of one or more of its trustees.

In that case, Cameron JA warned that –

“The courts will themselves in appropriate cases ensure that the trust form is not abused. ...It may be necessary to go further and extend well-established principles to trusts by holding in a suitable case that the trustees' conduct invites the inference that the trust form was a mere cover for the conduct of business ‘as before’, and that the assets allegedly vesting in trustees in fact belong to one or more of the trustees [and] that the trust form is a veneer that in justice should be pierced in the interests of creditors.”

### A test case now in the pipeline

Just such an “appropriate case” may now be in the pipeline, set in train by the decision of the Durban High Court in *Nedbank Ltd v Thorpe* (case 7392/2007; judgment delivered on 26 September 2008; not yet reported).

In this case, the bank had applied for the provisional sequestration of the estate of one Thorpe, arising out of a failure to recover a loan of some R6 million from a trust of which Thorpe was a trustee and



a beneficiary, for which Thorpe had bound himself as surety.

Over an extended period preceding the litigation, Thorpe had done what attorneys, estate planners and investment advisers have for many years counselled their moneyed clients to do, namely to move all or the bulk of their growth assets out of their personal estate and into a trust, substantially controlled by themselves as trustees.

Conventional wisdom is that this ensures, not only that the growth in value of such assets is not subject to estate duty and capital gains tax on the individual's death, but also that funds and assets held in the trust are not

available to their personal creditors in the event of their insolvency.

In this case the respondent, Thorpe, admitted that he had no assets and was insolvent. He said that he was one of the trustees and one of the beneficiaries of a discretionary family trust that he had formed many years ago. He said that the Trust had been set up to care for his family –

“so as to ensure an independent source of income outside my estate to guard against the possibility that a financial disaster may befall me, as is common cause happened. That was a perfectly lawful and prudent thing to do ...”

That may have been true as far as it goes, but it was the manner in which he

thereafter used the trust that provoked his creditors' wrath.

## The use of a trust to quarantine assets from the claims of creditors

Nedbank contended that Thorpe had over the years been conducting his business via corporate entities or trusts; that he had established various family trusts which he used to insulate his wealth from creditors and thereby frustrate the efforts of his creditors to recover the debts owed to them; that, despite a prohibitory interdict, he had continued to carry on business as a short-term insurance broker; that Thorpe was a trustee and beneficiary of a discretionary family trust established by himself, namely the Banavie Trust (previously called the Robin Thorpe Family Trust); that this trust had made an expensive car available for his personal use; and that whenever he received funds or assets, he would transfer them to the trust.

## Proving that sequestration would be to the advantage of creditors

The first hurdle that Nedbank, as the applicant creditor, had to overcome was to show that, as required by section 10 of the Insolvency Act –

“there is reason to believe that it will be to the advantage of creditors of the debtor if his estate is sequestrated”

In this regard, the Durban High Court, per Levinsohn DJP ruled that this requirement would be fulfilled if, on the facts placed before the court, it was satisfied that –

“there is a reasonable prospect – not necessarily a likelihood, but a prospect that is

not too remote – that some pecuniary benefit will result to creditors. It is not necessary to prove that the insolvent has any assets. Even if there are none, but there are reasons for thinking that as a result of the inquiry under the [Insolvency] Act, some may be revealed or recovered, that is sufficient.”

Nedbank's argument in this regard was that –

“there is reason to believe that the respondent [Thorpe] is possessed of considerable financial assets which a trustee [of his insolvent estate] will uncover and this will be to the advantage of creditors”

and, in particular, that –

“the use of the Banavie Trust as a vehicle for [Thorpe's] business activities constitutes an abuse of the institution of a trust and is simply a mechanism to shield his personal assets from creditors”.

On the evidence of the affidavits placed before it, the Court accepted Nedbank's argument in this regard, holding that –

“In my opinion, there is a prima facie case that there is a reasonable prospect that investigation and interrogation under the Insolvency Act will yield a not negligible pecuniary benefit to creditors.”

This inference flowed from the conclusion that, on the evidence placed before the Court, there was –

“the strong suspicion that [Thorpe] is simply conducting his personal business through the trust and that the trust is simply the vehicle to do so. The impression is created that the remaining trustees, while notionally independent persons, may simply be doing [Thorpe's] bidding. ... In my view, there is a real prospect of [a forensic examination] showing that the trust is a mirage used by [Thorpe] for his own commercial ends.”

In this dictum, the Court accepts the premise, articulated by the Supreme Court of Appeal in *Land and Agricultural*

*Bank v Parker* that, as a matter of law, it is conceivable that, in appropriate circumstances –

“the assets allegedly vesting in trustees in fact belong to one or more of the trustees [and] that the trust form is a veneer that in justice should be pierced in the interests of creditors.”

This proposition encompasses two distinct possibilities, one narrow and containable, the other broad and radical.

## The narrow possibility – no divestment of particular funds or assets to the trust

The first possibility is that a court may find that, when the founder or a trustee remitted particular funds or transferred particular tangible assets to the trust, neither he nor the trust had the intention that they should, in reality, pass out of his de facto ownership or control.

In this regard, our courts have recognised the concept of a “disguised transaction”, entered into in fraudem legis, as contemplated in *Erf 3183/1 Ladysmith (Pty) Ltd v Commissioner for Inland Revenue 1996 (3) SA 942 (SCA)*, where the court quoted with approval from *Zandberg v Van Zyl 1910 AD 302 at 309*, where Innes J said that –

“Not frequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be

Thus, if a court were to find in particular case that the founder of a trust or a

*The more radical possibility, arguably implicit in Cameron JA's dictum, is that, in certain circumstances, a trust may be a sham (what he called a "veneer") in other words that, at its inception, there was no intention to create a genuine trust.*

trustee, when donating money to the trust, did not genuinely intend to divest himself of those funds, ownership in the money would have passed to the trust by virtue of the legal rule that property in money passes by commixtio (in other words, ownership passes as soon as the recipient mingles the received money with his own funds) but that donor or his trustee in insolvency would have a right, in personam, to reclaim such moneys from the trust.

### **The broad and radical possibility – the trust itself was a sham that never came into existence**

The more radical possibility, arguably implicit in Cameron JA's dictum, is that, in certain circumstances, a trust may be a sham (what he called a "veneer" and what Levinsohn DJP in the Thorpe case called a "mirage") in other words that, at its inception, there was no intention to create a genuine trust.

This would arise where the founder and the first trustees, in giving their assent to the terms of the deed of trust, had no genuine intention to create the legal relationships inherent in a trust, but intended instead to create a mere facade – a pretence to conceal the reality that the founder or a trustee would remain, in every substantial respect, the owner or controller of the trust assets.

In such a situation, it is arguable that the trust – even though ostensibly duly formed, and registered in an office of the

Master of the High Court – never came into existence at all.

In this regard, it should be borne in mind that a trust is not, save where a statute provides otherwise, a legal person in its own right. An inter vivos trust comes into existence as a contract entered into between the founder and the first trustees, in which the latter agree to administer the trust assets in accordance with the terms of the trust deed.

What is at stake is therefore not the creation of a legal persona, but merely a pretence at the creation of a contractual arrangement.

Thus, the Companies Act provides that –

"A certificate of incorporation given by the Registrar in respect of any company shall, upon its mere production, in the absence of fraud, be conclusive evidence that .... the company is a company duly incorporated under the Act"<sup>1</sup>

but no similar statutory rule applies to a trust that is registered in the office of the Master of the High Court.

Nevertheless, for a court to declare a trust, duly registered in the office of the Master of the High Court, to have no existence in the eyes of the law, would give rise to a juridical nightmare, with potentially catastrophic consequences for innocent third parties.

Such parties may have done all that they could by way of a due diligence investigation into the authenticity of the trust deed, the trustees' letters of authority, and the registration of the trust

at the Master's office, only to find later that they have contracted with a phantom that has no legal substance.

It would, in short, be ruinous for legal certainty if a court were to hold that a duly registered trust was a sham with no legal existence.

There is, however, some precedent for an ostensibly duly-formed legal entity to be non-existent in the eyes of the law.

Thus, in terms of section 65 of the Close Corporations Act, where there has been a "gross abuse of the juristic personality of the corporation", a court may declare that the close corporation "is deemed not to be a juristic person".

In *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 (2) SA 303 (C) the Cape High Court applied this provision, and held that the sole member and the manager of the close corporation were jointly and severally liable for the debt owing to the plaintiff. (On appeal, the Supreme Court of Appeal held that these individuals were personally liable in terms of the reckless trading provisions of the Close Corporations Act, but found it unnecessary to determine whether they were liable in terms of section 65 of the Act.)

1 Companies Act 61 of 1973 section 64(2)

## SARS's power to issue a garnishee-type order

# Effective short-cut to obtain speedy payment of a tax debt

Where a tax debt is owing, SARS is entitled to use all legal means to collect it. One of the organisation's most effective powers in this regard is that laid down in section 99 of the Income Tax Act 58 of 1962 which provides that –

“The Commissioner may, if he thinks necessary, declare any person to be the agent of any other person, and the person so declared an agent shall be the agent for the purposes of this Act and may be required to make payment of any tax, interest or penalty due from any moneys, including pensions, salary, wages or any other remuneration, which may be held by him or due by him to the person whose agent he has been declared to be.”

The effect of section 99 was explained in *Hindry v Nedcor Bank Ltd* 1999 (2) SA 757 (W), where Wunsh J said that the section provides for –

“a form of garnishment, such as is available in regard to ordinary civil judgment debts”

By ‘garnishment’ in this regard is meant a garnishee order, in which a creditor obtains a court order in terms of which a third party, who owes the debtor money, is ordered to pay those moneys directly to the judgment creditor.

Thus, for example, the creditor might obtain a garnishee order against the debtor's employer to require the latter to withhold a proportion of the debtor's monthly wages and remit the payment to the creditor.

In the absence of a garnishee order it would, of course, be improper for the



employer to remit any part of the employee's wages to the judgment creditor, because the employer is contractually obliged to pay those wages to the employee; payment thereof to a third party would not discharge the employer's obligation toward the employee.

This was pointed out in *Paramount Furnishers v Lezar's Shoe Store and Outfitters* 1970 (3) SA 361 (T) where Trengove J said that –

“The effect of [a garnishee] order is that the employer as garnishee is obliged to deduct the amount stipulated from the emoluments accruing to the judgment debtor and to pay them to the garnishor... [B]ut for the garnishee order, the garnishee would ordinarily be obliged to pay the amounts deducted to the judgment debtor as his employee. Ordinarily the garnishee, as employer, cannot discharge his obligation towards his employee by paying emoluments due to him to any third party unless he has some express or implied authority to do so. The garnishee order, however,

compels him to pay to the judgment creditor and consequently any such payment operates as a discharge pro tanto of the garnishee's obligation as employer to the judgment debtor as his employee. By operation of law the judgment creditor thus becomes entitled to receive money which would otherwise be payable to the judgment debtor and to that extent he steps into his shoes.’

Where a taxpayer owes a tax debt and has money in the bank, or money that is about to be paid into a bank account, SARS can use its powers in terms of section 99 of the Income Tax Act, quoted above, to require the bank to pay over those funds to SARS.

This can be a highly effective short-cut for SARS to obtain speedy payment of a tax debt.

Sometimes the procedure goes awry, as in *Pestana v Nedbank Ltd* 2008 (3) SA 466 (W) where the section 99 notice was given to the bank's head office, and the taxpayer managed to withdraw the money in his account from his local branch before that branch was told of the section 99 notice.

The success of such a stratagem by a taxpayer can bring only temporary relief. The tax debt remains intact, and SARS will simply continue its pursuit by other means at its disposal.

# Australian Law Reform Commission recommends extending client legal privilege to tax law advice provided by accountants

In February 2008, the Australian Law Reform Commission published the results of its year-long inquiry into the application of client legal privilege to the activities of the forty-plus federal government bodies that have coercive information-gathering powers.

“Client legal privilege” (which in South Africa is called “attorney-client privilege” or “legal professional privilege”) is a rule of law protecting communications between legal practitioners and their clients from having to be disclosed under compulsion by order of court or under a statute.

## A right of paramount importance

The report notes that client legal privilege is viewed as a right of paramount importance, which provides an essential protection to clients by enabling them to communicate fully and frankly with their lawyers, and that the protection of the confidentiality of such communications facilitates compliance with the law.

However, the report notes that a plethora of unclear legislation in Australia has led to confusion over the application of such privilege, and in some instances its abuse.

The report, entitled *Privilege in Perspective: Client Legal Privilege in Federal Investigations*, calls for forty-five changes to the current law in this regard.

The president of the Commission is reported as saying that, while there are competing interests that need to be balanced, there is nevertheless a general consensus that privilege is a right of central importance that should prevail, other than in extenuating circumstances.

The inquiry found, however, that the lack of clear, consistent legislation has sometimes resulted in the right’s being abused.

“Unfortunately there are cases in which it appears that claims of privilege have been used primarily to delay or frustrate investigations – with some disputes taking years to resolve. Many of our recommendations focus on streamlining the process for handling claims of privilege, and deterring or punishing abuses,” the president of the Commission said.

The report’s primary recommendation is the development of a single legislative enactment covering all aspects of client legal privilege in federal investigations.

“A single federal statute would make it clear that privilege applies unless expressly modified or abrogated by another statute, as well as establishing a system in which regulators and clients would have to operate in a much more open and transparent manner, according to published policies,” said Professor Rosalind Croucher, the commissioner in charge of the inquiry.

## The extension of privilege to tax law advice by accountants

The report recommends extending privilege to tax law advice provided by accountants where a copy of that advice is sought by the Australian Taxation

Office, and introducing a streamlined procedure for resolving privilege disputes.

The report takes the view that persons required to disclose information under a coercive information-gathering power of the Commissioner of Taxation should not be required to disclose “tax advice documents”, which the report defines as confidential documents created by an independent professional accounting adviser for the dominant purpose of providing that person with advice about the operation and effect of tax laws. In this context, an “independent professional accounting adviser” means a registered tax agent in terms of Australia’s Income Tax Assessment Act.

The report draws a distinction between source and advice documents, and notes that source documents are not to be protected in any circumstances. Furthermore, the benefit of the privilege should extend only to the advice itself and not to any other information that may form part of an accountant’s file or briefing documents.

The report proposes a targeted education program to improve an understanding of the legal and ethical obligations surrounding privilege, and clarifying and strengthening the disciplinary procedures which would apply in cases where asserting privilege might amount to unethical conduct.

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