UNIVERSITY OF KWAZULU-NATAL

A Critical Analysis of the Retrospective Introduction of Tax Legislation

BY

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MASTERS IN ADVANCED TAXATION

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DECLARATION

I hereby declare and confirm that this research has not been previously accepted for any degree and is not currently being considered for any other degree at any other university.

I further declare that this Dissertation contains my own work except where specifically acknowledged otherwise.

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1. INTRODUCTION

1.1 Background and Problem Statement

> 'Good heavens; give politicians the chance to legislate retrospectively and we will open a Pandora's Box. I find that quite frightening. On this occasion a Pandora's Box is opened in the excuse of catching the filthy people who cheat on tax. It is done for a noble purpose, one might say, and I agree. But I have never been one to subscribe to the view that the end justifies the means. That sort of proposition leads one down a track which is fraught with disaster. That is the track that every tyrant in history has gone down; that is, to make illegal today something which was legal last year.'[1]

It is often argued that the crux of the problem surrounding the practice of retrospectively introducing tax legislation and the reason for it being a topic that will always stimulate heated debate is the apparent conflict of interests between taxpayers and the government.[2] On the one hand, it is argued by government that it has a duty to raise funds and to protect the fiscus from suffering undue harm. Thus, the ability to retrospectively introduce tax legislation is often justified as being a powerful and necessary tool with which to achieve this dual purpose.On the other hand however, all tax legislation must still be subject to both the constitutional rights of taxpayers as well as additional policy considerations.

In light of these competing interests, the aim of this dissertation will be to critically analyse the practice of retrospectively introducing tax legislation from both a legal and a policy perspective. In the course of this analysis, particular attention will be paid to determining whether a specific form of retrospective tax legislation, namely legislation by press release, adequately resolves the legal and policy issues commonly relied upon to argue against the retrospective introduction of tax legislation.

Whilst the practice of legislation by press release is by no means new in the South African tax sphere, there is a concern[3] that this practice is at risk of being abused in light of the judgment in*Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue*

[1] R Loiacono& C Mortimer 'Retrospective tax law: Has Pandora's Box opened never to be shut again?' (2017) 15(1) *eJournal of Tax Research* 105-106.

[2]C L Porter 'Retroactivity of Tax Legislation' (1975) 29 *Tax Law* 21.

[3] I Lamprecht 'Concern about introduction of tax legislation "by press release"' *Moneyweb* 30 August 2017 at 2.

Service and Another.[4] *Pienaar Brothers* represented the first time that legislation by press release was challenged on constitutional grounds. It was ultimately held by the court that there are no constitutional provisions which prohibit the retrospective introduction of tax legislation, nor which require that taxpayers be given advanced notice of such impending legislation.

From a legal perspective it is submitted that the three potential provisions of the 1996 Constitution[5] which taxpayers could rely on to argue against retrospective tax legislation are:

- the Rule of Law;
- the prohibition against the arbitrary deprivation of property as contained in section 25(1) of the 1996 Constitution; and
- the principle of Separation of Powers (with specific reference to the practice of legislation by press release).

In this dissertation I will aim to challenge the above three legal arguments in order to determine whether they have any validity. I will further analyse the manner in which these three arguments were raised (or not raised) in *Pienaar Brothers*.

In evaluating and improving a tax system it is insufficient to simply focus on the legal aspects relating to such system. Rather, an objective approach needs to be adopted that will enable policy-makers to evaluate and improve the tax system and to develop policy that will be broadly perceived to be fair by those being subject to the system in question.[6] The need for such an objective approach has given rise to an entire field of study being dedicated to the development of good tax policy design. Whilst it is unfortunately beyond the scope of this dissertation to focus in-depth on the development of good tax policy design, the practice of retrospectively introducing tax legislation as well that of legislation by press release will be challenged against three of the commonly cited principles of good tax policy:

- the Principle of Certainty;

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[4] *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and Another* 2017 (6) SA 435 GP.

[5] Constitution of the Republic of South Africa Act 108 of 1996.

[6] United Kingdom House of Commons Treasury Committee: *Principles of Tax Policy* (2011) 3.

- the Principle of Tax Neutrality; and
- the Principle of Economic Growth and Efficiency.

The practice of retrospectively introducing tax legislation as well as that of legislation by press release will be critically analysed in light of the above three principles in order to determine whether a system which relies on such taxes can be deemed to be an objectively good tax system.

It will be argued that whilst it is understandable why retrospective tax legislation evokes such strong emotional responses from those who argue against them, there are certain situations wherein they are necessary. From a legal perspective, the court in*Pienaar Brothers* was correct in stating that the question of whether or not retrospective tax legislation falls foul of the 1996 Constitution is a question to be determined on the facts of the particular case in question. Once this approach is adopted, it is unlikely that there will be a rise in the reliance of such legislation, as it must still meet the high standards set by the 1996 Constitution.

It will further be argued that although the court in*Pienaar Brothers* missed a golden opportunity to deal with retrospective tax legislation in the context of the principles of good tax policy design, these principles are still of relevance to any discussion regarding such legislation. It will be argued that when used in the appropriate manner and circumstances, retrospective tax legislation, and more particularly legislation by press release, can meet the standards set by the principles of good tax policy design and can therefore form part of a good tax system.

1.2 Rational for the Study

Due to the wide condemnation of retrospective tax legislation, and in light of the*Pienaar Brothers* judgement, it is crucial that the practice of introducing retrospective tax legislation, and that of legislation by press release, be critically analysed against the relevant constitutional provisions as well as the principles of good tax policy design.

Through such analysis it will be possible to identify the circumstances in which such tax policy can form part of a good tax system. It will also be possible to identify the manner and circumstances in which such taxes should be implemented, so as to ensure that taxpayers being subjected thereto can change their perceptions thereof. This change of perception will, in turn, have a positive influence on tax compliance.

1.3 Research Question and Sub-Questions

The following central research question will guide this study's data collection and analysis:

- What considerations should guide the Legislature when making the decision of whether or not to retrospectively introduce tax legislation in South Africa?

The following subsidiary questions will be used to address various critical issues related to the retrospective introduction of tax legislation:

- In what ways does South African Legislation limit the Legislature's power to retrospectively introduce tax legislation?
- Does the practice of retrospectively introducing tax legislation violate the guiding principles of good tax policy design?
- Does the practice of legislation by press release adequately resolve the issues commonly associated with the retrospective introduction of tax legislation?

1.4 Research Methodology

A desktop research methodology is this study's primary research approach. The reason that this approach is preferred is that through a comprehensive literature review that has been incorporated into each individual chapter, this study will aim to find, interpret, apply and critique the law and policy principles relating to retrospective legislation in South Africa.

It is submitted that there will also be an element of interdisciplinary research undertaken, in terms of which non-legal data will be combined with legal data. This approach is necessary because there are important economic and social-behavioural considerations that must be taken into account when deciding whether or not to introduce retrospective tax legislation.

The data has been collected primarily through studying black letter law, the primary sources of which are the 1996 Constitution and international academic books and articles, online resources as well as foreign commission reports.

The practice of retrospectively introducing tax legislation will be analysed against the standards set by the 1996 Constitution as well as the identified guiding principles of good tax policy in order to determine whether there are any situations in which such legislation is permissible. An in-depth analysis of the judgment in*Pienaar Brothers* will also be undertaken.

1.5 Overview of Chapters

The purpose of the next chapter will be to define what is meant when I refer to retrospective laws and the practice of legislation by press release throughout this dissertation.

Chapter 3 will explore whether there are any provisions in the 1996 Constitution which prohibit the retrospective introduction of legislation. This analysis will focus in particular on:

- the Rule of Law; and
- Section 25(1) of the 1996 Constitution.

In dealing with the practice of legislation by press release as a particular form of retrospective law, the analysis will focus on whether this practice has the potential to violate the principle of Separation of Powers.

An analysis of the legality of retrospective tax legislation is not sufficient to resolve many of the concerns commonly associated therewith. Chapter 4 will analyse the practice of introducing retrospective tax legislation and that of legislation by press release against a selection of the commonly accepted principles of good tax policy design, namely:

- the Principle of Certainty;
- the Principle of Tax Neutrality; and
- the Principle of Economic Growth and Efficiency.

As *Pienaar Brothers*represented the first time that the passing of retrospective tax legislation was challenged on constitutional grounds, Chapter 5 will focus on this case. Firstly, a brief outline of the facts will be provided, and thereafter an examination of the arguments relied on by counsel for the taxpayer and the Commissioner will be undertaken. An analysis of the judgment and the reasons therefore will then be undertaken.

Chapter 6 will focus on a critical analysis of the *Pienaar Brothers* judgment in light of the legal and policy principles dealt with in Chapters 3 and 4.

Chapter 7 will conclude with an overview of the preceding chapters. In addition, recommendations which should guide the practice of introducing retrospective tax legislation and the practice of legislation by press release will be put forth.

2. RETROSPECTIVE LAW-MAKING AND THE PRACTICE OF LEGISLATION BY PRESS RELEASE

2.1 Introduction

One of the primary issues that arises when debating retrospective laws is that the very definition of the term 'retrospective laws' is uncertain. It is therefore essential that at the outset I define what I mean when I refer to retrospective laws. This definition is particularly important as some of the arguments commonly relied upon to argue against such laws only apply to particular formulations of this term. Thus, the broader the definition adopted, the less compelling the arguments against such laws as a whole become as some arguments only apply to limited categories of such laws.

Once an acceptable definition of the term'retrospective laws' has been identified, it will then be necessary to define what the practice of legislation by press release refers to and how it is utilised.

2.2 Defining Retrospective Laws

In the context of tax legislation, Graetz[7] argues that the distinction between retrospective and prospective laws is merely illusory. The reason for this is because all changes in law will have an economic impact on:

- the value of existing assets; or
- existing expectations

When taxpayers are making the decision of whether or not to enter into a particular transaction, and the manner in which such transaction is to be structured, they form suppositions as to what will reasonably be expected to follow from such action. It is highly possible however that an intervening change in the law could derail this and result in the expected consequence not eventuating. It may further be possible that the taxpayer will be faced with a new and unexpected consequence, which is not desirable, and which cannot be avoided due to source of such consequence being in the past. It is submitted that a

[7] M J Graetz 'Retroactivity Revisited' (1985) 98 *Harvard Law Review* 1822.

possible solution to this temporal issue is to rather define retrospective laws in the context of the manner in which such laws are applied.

Driedger[8] defines a retrospective law as being one which ‘attaches new consequences to an event that occurred prior to its enactment’.[9]Driedger further distinguishes between ‘retroactive’ laws and ‘retrospective’ laws as follows:

> ‘A retroactive statute is one that operates backwards, that is to say, it is operative as of a time prior to its enactment. It makes the law different from what it was during the period of its enactment.’[10]

Driedger further defines a retrospective law as being:

> ‘Changes only the law for the future, but it looks to the past and attaches new... consequences to completed transactions... A retrospective statute operates as of a past time in a sense that it opens up a closed transaction and changes its consequences, although the change is effective only for the future.’[11]

Munzer[12] has developed a similar theory to that of Driedger, except that he has termed the two types of retroactive rules ‘strongly retroactive rules’ and ‘weakly retroactive rules.’ According to Munzer, strongly retroactive rules are backward-looking, in that ‘they change the legal consequences of prior events from the date at which the event occurred.’[13] On the other hand, weakly retroactive rules are forward-looking, in that ‘they change the legal consequences of prior events, but only from the date of the creation of the rule.’[14]Driedger would therefore regard a strongly retroactive rule as being retroactive, and a weakly retroactive rule as being retrospective.

In order to illustrate the contrast between strong and weak retroactive laws Munzer uses the example of the passing of a retroactive law validating a previously invalid marriage. According to Munzer, if the law in question is strongly retroactive, the marriage will be

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[8] E A Driedger ‘Statutes: Retroactive Retrospective Reflections’ (1978) 56 *Canadian Bar Review*.

[9]Driedger (note 8 above) 276.

[10] E A Driedger ‘Construction of Statutes’ (1983) 185-186.

[11]Driedger (note 10 above) 185-186.

[12] S R Munzer ‘Retroactive Law’ (1977) 6 *J. Legal Study*.

[13]Munzer (note 12 above) 383.

[14]Munzer (note 12 above) 383.

regarded as having always been valid. If however the law is weakly retroactive, the marriage will be deemed to be valid as from the date of the passing of the law. In the latter case, the law does not serve to erase the period of invalidity.[15] In Munzer's theory, the intervening law that results in a reasonably expected consequence not arising would be deemed to be a weakly retroactive law.

The transitional issues that arise as a result of the operation of weakly retroactive laws have resulted in an entire field of study being dedicated thereto, which is unfortunately beyond the scope of this dissertation. It is submitted however that for the purpose of the current study the term retrospective laws will mean those laws which Munzer classifies as being strongly retroactive. Where weakly retrospective laws are being referred to, this will be stated. Having defined retrospective laws, it is necessary to deal with a particular form of such laws, namely the practice of legislation by press release.

2.3 Legislation by Press Release

Palmer &Sampford[16] regard the practice of legislation by press release as a particular category of retrospective legislation. Nash[17] describes the practice of legislation by press release as follows:

> '... the Treasurer announces that as from today or next week the law will be so and so. At some subsequent stage, legislation embodying the substance of what the minister said is introduced into Parliament and eventually passed either in its original form or in an amended form.'[18]

In the South African context, the practice is implemented by way of the Minister of Finance giving notice of amendments to tax legislation in his budget speech for a particular year in question, which amendments will apply with effect from that date, notwithstanding the fact that they will only be promulgated on some future date. There can be no doubt that this practice constitutes a form of retrospective law-making, in that the announcement itself cannot be said to have changed the law. Once promulgated however, such laws will change

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[15]Munzer (note 12 above) 383.

[16] A Palmer & C Sampford 'Retrospective Legislation in Australia: Looking Back at the 1980s' (1993) 22 *Federal Law Review* 235.

[17] G Nash 'Retrospective Legislation' (1981) *The Australian Accountant*, October.

[18] Nash (note 17 above) 594.

the legal consequences of events that took place prior to their enactment. It is for this reason that despite the derisive term legislation by press release being widely adopted to describe this practice, a more accurate approach is to regard this practice as being a particular category of retrospective legislation, namely 'retrospective to the date of announcement.'[19]

It is submitted that the primary reason why the practice of legislation by press release is utilised is as a result of the lengthy legislative process. It is feared that in the period of time between the announcement of impending legislative amendments, and the eventual passing of such legislation, enterprising taxpayers will accelerate their transactions in order to take advantage of a tax benefit that has been brought to their attention. For this reason the amendment in question is made retrospective to the date of the announcement, thereby preventing a potential lane of tax avoidance from becoming a freeway.[20]

2.4 Conclusion

The terms retrospective legislation and legislation by press release will be used repeatedly throughout this study and it was thus necessary that they were defined at the outset. The Chapter that follows will examine the commonly relied upon constitutional law arguments against the retrospective introduction of tax legislation and attempt to determine whether there are any validity in these. I also analyse whether the practice of legislation by press release adequately addresses these arguments, and further identify whether such practice raises any additional constitutional issues.

[19] Palmer & Sampford (note 16 above) 235.

[20] Palmer & Sampford (note 16 above) 264.

3. THE 1996 CONSTITUTION

3.1 Introduction

In this chapter the retrospective introduction of tax legislation will be weighed against the following constitutional provisions:

- the Rule of Law;
- the right to property as contained in Section 25(1) of the 1996 Constitution; and
- the Principle of Separation of Powers (in the specific context of the practice of legislation by press release).

The starting point to challenge any legislation should be the 1996 Constitution. In his article dealing with constitutional law and taxpayer's rights in South Africa, Croome[21] states that 'whenever facing a legal problem including a tax dispute, the rights contained in the Constitution must not be overlooked.'[22]Croome is critical of the practice of retrospective tax legislation, and went so far as to address the Constitutional Assembly at the time of the drafting of the Constitution in an effort to include a specific provision prohibiting the retrospective introduction of fiscal legislation. Notwithstanding this request, such provision was not included in the Constitution and as a result thereof any taxpayer seeking to challenge the constitutionality of retrospective legislation must do so against the existing provisions of the 1996 Constitution.[23] As the Rule of Law is the most commonly cited constitutional provision relied upon to argue against the retrospective introduction of tax legislation, the validity of such argument will be dealt with first.

3.2 The Rule of Law

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[21]B Croome 'Constitutional Law and taxpayer's rights in South Africa-an overview' (2002) *Act Juridica*.

[22]Croome (note 21 above) 1.

[23] B Croome*Taxpayer's Rights in South Africa; An analysis and evaluation of the extent to which the powers of the South African Revenue Service comply with the Constitutional rights to property, privacy, administrative justice, access to information and access to courts* (unpublished PhD thesis, University of Cape Town, 2008) 58-59.

The Rule of Law is entrenched in Section 1 of the 1996 Constitution, which states *inter alia* that:

> 'The Republic of South Africa is one, sovereign, democratic state founded on the following values:
>
> (c) Supremacy of the constitution and the rule of law...'

In*President of the Republic of South Africa v Hugo*,[24]Mokgoro J, in her concurring judgment held that:

> 'The need for accessibility, precision and general application flow from the concept of the rule of law. A person should be able to know of the law, and be able to conform his or her conduct to the law.'[25]

Based on the very definition of retrospective legislation, it is clear that such legislation undermines the principle of the rule of law as interpreted by Mokgoro J. It is impossible for a taxpayer to 'know the law' and to be able to 'conform his or her conduct to the law' when such law was not in existence at the time that the taxpayer was planning his or her affairs. One of the benefits accorded to taxpayers living in a society in which the Rule of Law is entrenched in the founding values of the Constitution should be that at the time when they are planning to enter into a transaction, they do so with full knowledge of what the tax consequences of such transaction will be. This can only be achieved if such taxpayer has knowledge of the laws applicable at that point in time, and armed with such knowledge he can consequently plan and act with a degree of certainty. It is therefore clear that the principle Rule of Law and the principle of certainty, which is dealt with in more detail in Chapter 5 below, are inextricably intertwined.

As it has been determined that the uncertainty created by the retrospective introduction of tax legislation does indeed undermine the Rule of Law, the question which then arises is whether the Rule of Law can be relied upon to successfully challenge such legislation and to have it set aside.

In dealing with the nature of the Rule of Law, and how it fits into the South African legal framework on a practical level, the Court in*Minister of Home Affairs v National Institute*

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[24]*President of the Republic of South Africa and Another v Hugo 1997 (4) SA 1 (CC).*

[25]*Hugo* (note 24 above) 102.

for Crime Prevention and the Re-Integration of Offenders (NICRO) and Others[26] stated that:

> 'The values enunciated in section 1 of the Constitution are of fundamental importance. They inform and give substance to all the provisions of the Constitution. They do not, however, give rise to discrete and enforceable rights in themselves. This is clear not only from the language of section 1 itself, but also from the way the Constitution is structured and in particular the provisions of chapter 2 which contains the Bill of Rights.'[27]

At base level, the simplest constitutional challenge that can be relied upon to have a law declared invalid would proceed as follows:

- a law is passed that unjustly deprives an individual of property;
- such individual approaches a Court and relies on the provisions of Section 25 of the 1996 Constitution to argue that his right to not be unjustly deprived of his property has been violated; and
- the Court orders that the legislation in question be declared to be invalid to the extent that the constitutional right of the taxpayer has been violated.

Unfortunately, as the Rule of Law does not create an enforceable right, a taxpayer cannot argue that because a retrospective tax law created uncertainty as to what the law was at the time that he entered into a transaction, and thereby undermined the Rule of Law, such law must be set aside due to the fact that one of his constitutional rights was violated. In order to explain this point further, Devenish states:

> 'The rule of law provides for a weak form of constitutionalism, since as Jowell explains, no English court would strike down legislation that introduced punishment without trial, or statute with retrospective effect. Nonetheless, he argues that respect for the rule of law might inhibit the legislature from passing such laws.'[28]

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[26] *Minister of Home Affairs v National Institute for Crime Prevention and the Re-Integration of Offenders (NICRO) and Others* 2005 (3) SA 280 (CC).

[27] *NICRO* Case (note 26 above).

[28] G E Devenish *Commentary on the South African Bill of Rights* (1999) 14.

In*Anglo Platinum Management Services (Pty) Ltd and Others v Minister of Safety and Security and Others*[29]the Applicant attempted to challenge the validity of regulations that had been introduced with retrospective effect. In dealing with such challenge, Van Oosten J stated:

> ‘To revert to the question relating to retrospectivity. The rule against retrospectivity has become firmly entrenched in administrative law. It is founded upon the principle of legal certainty which in turn is derived from the rule of law. Where the exercise of powers affects rights and/or legitimate expectations retrospectivity clearly undermines the constitutional principle of the rule of law. This aspect received the attention of the Constitutional Court in Pharmaceutical Manufacturers Association of SA and Another: In re Ex part President of the Republic of South Africa 2000 (2) SA 674 (CC) paragraph [39] where the following extract from De Smith, Woolf and Jowell Judicial Review of Administrative Action 5 ed at 14-14 was quoted with approval: “... In addition, the rule of law embraces some internal qualities of all public law: that it should be certain, that is ascertainable in advance so as to be predictable and not retrospective in its operation; and that it be applied equally, without unjustifiable differentiation.”’[30]

In *Anglo Platinum* the regulations challenged by the taxpayer were ultimately held to be invalid due to procedural flaws at the time that they were passed. This is unfortunate as it rendered it unnecessary for the Court to determine whether legislation could be set aside due to the fact that it violated the Rule of Law. This is still an issue that has not been decided on by our Courts. It is submitted however that as the Rule of Law does not create any enforceable rights, taxpayers will find it difficult to challenge retrospective legislation on this basis. A stronger argument for taxpayers will be to challenge the uncertainty that arises from the introduction of retrospective tax legislation from a policy perspective, which will be dealt with in more detail in Chapter 4.

3.2.1 The Rule of Law and Legislation by Press Release

As identified in Chapter 2, there is no doubt that the practice of legislation by press release constitutes a form of retrospective law-making. However, the issue that needs to be

[29]*Anglo Platinum Management Services (Pty) Ltd and Others v Minister of Safety and Security and Others* 2000 (1) SA 1127 (SCA).

[30]*Anglo Platinum* (note 29 above) 1145.

determined is whether this practice adequately resolves the argument that retrospective laws undermine the Rule of Law.

The primary argument levelled against retrospective legislation is that it undermines the Rule of Law due to the uncertainty that it creates. To put it simply, the taxpayer's argument would therefore be that his ability to plan his tax affairs in accordance with what the law was at the time that he entered into a transaction was undermined by such legislation, thereby violating the Rule of Law. It is submitted that the strength of this argument is somewhat weakened in instances where the taxpayer was given prior notice of the impending change, as in the case of legislation by press release.

It is submitted that in instances where the Minister of Finance gives notice of impending changes to tax legislation, which amendments will take effect on the date of the announcement, notwithstanding that they will only be promulgated on some future date, do not undermine the Rule of Law provided that:

i. The eventual promulgation of the legislation is not unduly delayed; and

ii. The promulgated legislation closely resembles the amendments that were initially announced by the Minister.

Where the above requirements are met, the issues surrounding the uncertainty of legislation are adequately resolved. This is however not always the case. The procedure to pass Money Bills requires numerous stakeholders to be involved in the decision-making process, and this has the potential to result in the eventual promulgated legislation either differing greatly from what was originally announced, or alternatively not being promulgated at all. Given the high probability of this occurring, taxpayers will always be wary of relying on announcements made by the Minister, thereby adding an additional element of uncertainty to the decision-making process. In the next sub-chapter the retrospective introduction of tax legislation will be challenged against taxpayers' Constitutional right to property.

3.3 The Constitutional Right to Property

Section 25(1) of the 1996 Constitution provides that:

'(1) No one may be deprived of property except in terms of law of general application, and no law may permit the arbitrary deprivation of property.

(2) Property may be expropriated only in terms of law of general application

(a) for public purpose or in the public interest; and

(b) subject to compensation, the amount of which and the time and manner of payment of which have either been agreed to by those affected or decided or approved by a court.'

It is trite law that rights contained in the Bill of Rights, including those contained in section 25(1) of the 1996 Constitution, are not absolute. In*S v Makwanyane and Another*,[31]Chakalson P stated:

> 'The limitation of constitutional rights for a purpose that is reasonable and necessary in a democratic society involves the weighing up of competing values, and ultimately an assessment based on proportionality. This is implicit in the provisions of Section 33(1). The fact that different rights have different implications for democracy and, in the case of our Constitution, for 'an open and democratic society based on freedom and equality', means that there is no absolute standard which can be laid down for determining reasonableness and necessity. Principles can be established, but the application of those principles to particular circumstances can only be done on a case-by-case basis. This is inherent in the requirement of proportionality, which calls for the balancing of different interests.'[32]

The drafters of the 1996 Constitution clearly took cognisance of Chakalson P's statement above when drafting Section 36(1) of the Constitution, which reads:

> 'The rights in the Bill of Rights may be limited only in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors, including-

(a) The nature of the right;

(b) The importance of the purpose of the limitation;

(c) The nature and extent of the limitation;

(d) The relation between the limitation and its purpose; and

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[31]*S v Makwanyane and Another* 1995 (3) SA 391.

[32]*Makwanyane* (note 31 above) 104.

(e) Less restrictive means to achieve the purpose.'

In determining whether a right as contained in the Bill of Rights has been unjustifiably limited, our Courts have adopted a two-stage approach. Firstly, the Court enquires as to whether the provision being challenged has infringed a right as contained in the Bill of Rights. If the answer to this first question is in the affirmative, the Court must then determine whether such infringement is justifiable. In Ex *Parte Minister of Safety and Security and Others: In RE S v Walters and Another,*[33] the court elaborated on the two-stage enquiry, stating:

> 'First, there is the threshold enquiry aimed at determining whether or not the enactment in question constitutes a limitation of one or other guaranteed right. This entails examining (a) the content and scope of the relevant protected right(s) and (b) the meaning and effect of the impugned enactment to see whether there is any limitation of (a) by (b). Subsections (1) and (2) of S39 of the Constitution give guidance as to the interpretation of both the rights and the enactment, essentially requiring them to be interpreted so as to promote the value system of an open and democratic society based on human dignity, equality and freedom. If upon such analysis no limitation is found, that is the end of the matter. The constitutional challenge is dismissed there and then. If there is indeed a limitation, however, the second stage ensues. This is ordinarily called the limitations exercise. In essence this requires the weighing up of the nature and importance of the right(s) that are limited together with the extent of the limitation as against the importance and purpose of the limiting enactment. Section 36(1) of the Constitution spells out these factors that have to be put into the scales in making a proportional evaluation of all the counterpoised rights and interests involved.'[34]

Whilst by their very nature taxes deprive individuals of their property, where such taxes are introduced prospectively they cannot be said to be contrary to the provisions of section 25(1) of the 1996 Constitution. This is because the State requires the funds received from taxpayers in order to fulfil its Constitutional mandate. In such instances, the deprivation of property takes place as a direct consequence of the liability to pay taxes and is therefore neither unreasonable nor arbitrary. The question that needs to be dealt with is whether a taxpayer could successfully challenge an amendment to the Income Tax Act on the basis

[33] *Ex Parte Minister of Safety and Security and Others: In Re S v Walters and Another* 2002 (4) SA 613.
[34] *Walters* (note 33 above) 27.

that it was introduced with retrospective effect, applied to an already completed transaction, and thus violated his constitutional right to property.

Croome argues that a taxpayer will find it difficult to challenge retrospective tax legislation on the basis that it constitutes an unlawful violation of the constitutional right to property as contained in section 25. The reasons identified by Croome include:

i. The Income Tax Act and the TLAA are laws of general application;

ii. As fiscal legislation applies to taxpayers generally, it is difficult to argue that they are arbitrary and thus unlawful;

iii. The collection of taxes arises as a direct result of the government's obligation to fulfil its constitutional mandate; and

iv. This practice is followed by many other open and democratic societies.

As identified in Chapter 2, retrospective tax legislation is generally relied on in instances where it has been identified that there is a loophole in legislation that is granting taxpayers an unintended tax benefit, or where it is necessary to prevent further harm to the fiscus. It is submitted that once a taxpayer has successfully proven that a retrospective tax law has deprived him of his constitutional right to property, he will find it difficult to pass the second stage of the enquiry. This is because the limiting measure does serve a legitimate purpose (being the raising of revenue or alternatively the protection of the fiscus) and secondly that it is rationally connected to its stated purpose (it being generally argued that retrospective tax legislation is passed to close a loophole in an Act or to prevent further harm to the fiscus). In the next sub-chapter it will be analysed whether the practice of legislation by press release violates the principle of Separation of Powers.

3.4 Separation of Powers

In terms of Constitutional Principle VI, the Constitution is required to have:

> 'A separation of power between the legislature, the executive and the judiciary, with appropriate checks and balances to ensure accountability, responsiveness and openness.'

In dealing with this principle, the Court in *South African Association of Personal Injury Lawyers v Heath*[35] stated that:

> 'The separation of the judiciary from the other branches of government was an important aspect of the separation of powers required by the Constitution. It was essential to the role of the courts under the Constitution. Parliament and the provincial legislatures made the laws but did not implement them. Under the Constitution it was the duty of the courts to ensure that the limits to the exercise of public power were not transgressed. Crucial to the discharge of that duty was that the courts be and be seen to be independent.'[36]

Under the 1996 Constitution, and in accordance with the principle of separation of powers, the national government is divided into three categories, namely:

i. The National Parliament – being the branch of government tasked with making the law;

ii. The National Executive – being the branch of government tasked with executing the law; and

iii. The Judiciary – being the branch of government tasked with resolving disputes.

It is submitted that the purpose of dividing the powers of governmentis to increase administrative efficiency as well as to decrease the opportunities for the abuse of the powers conferred upon each branch. In order to determine whether the practice of legislation by press release violates the principle of Separation of Powers, a brief analysis of the legislative process relating to Money Bills must first be undertaken.

Section 77(1) of the 1996 Constitution defines a Bill as being a Money Bill if it 'imposes national taxes, levies duties or surcharges.' In terms of section 77(3) of the 1996 Constitution, Money Bills must be considered in accordance with the procedure as set out in section 77(5) of the 1996 Constitution, and that an Act must be passed to provide for the procedure to amend Money Bills before Parliament.

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[35] *South African Association of Personal Injury Lawyers v Heath and Others 2001* (1) BCLR 77 (CC).

[36] *Heath* (note 35 above) 79.

In accordance with the provisions of section 77(3) of the 1996 Constitution the Money Bills Amendment Procedure and Related Matters Act[37] ('the Money Bill Act') was passed. In terms of Section 11of the Money Bill Act, all Revenue Bills must inter alia:

i. Firstly 'be referred to the Committee on Finance of the National Assembly for consideration and report;'[38] and

ii. Thereafter, once the National Assembly has passed the Revenue Bill, 'it must be referred to the National Council of Provinces.'[39]

Whilst our Courts have recognised that there is no provision in the 1996 Constitution which prohibits the Legislature from delegating its law-making powers to other Constitutional bodies, regard must be had to the wording of the empowering text conferring the legislative power in question. In*Executive Council of the Western Cape Legislature and Others v President of the Republic of South Africa and Others*[40]it was stated:

> 'Sometimes [the Constitution] states that "national legislation must"; at other times it states that something will be dealt with "as determined by national legislation; and at other times it uses the formulation 'national legislation may". Where one of the first two formulations is used, it seems to me to be a strong indication that the legislative power may not be delegated by the Legislature, although this will of course depend upon context.'[41]

Importantly, there is nothing in section 77(3) of the 1996 Constitution, section 77(5) of the 1996 Constitution nor the Money Bill Act which provides for:

i. The delegation of powers from the legislature to the executive in respect of the passing of revenue bills; nor

ii. The implementation of legislation prior to the prescribed procedures being followed.

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[37] Money Bills Amendment Procedure and Related Matters Act No. 9 of 2009.

[38] Section 11(1) of the Money Bill Act (note 37 above).

[39] Section 11(2) of the Money Bill Act (note 37 above).

[40]*Executive Council of the Western Cape Legislature and Others v President of the Republic of South Africa and Others* 1995 (10) BCLR 1289.

[41]*Executive Council of the Western Cape Legislature* (note 40 above) 125.

In order to determine whether legislation by press release amounts to a violation of the principle of Separation of Powers, it is necessary to distinguish two potential forms that this practice may take. Firstly, legislation by press release may operate as a warning to taxpayers that they can no longer rely on a particular provision of the Income Tax Act. In such situation taxpayers are not directed to act upon such announcement in a positive manner, but rather they are merely advised that when structuring a particular transaction, they should anticipate that the retrospective operation of the amendment in question may adversely impact upon such transaction. At best, they are therefore well-advised to refrain from relying on the provision in question. In this situation, it is submitted that the principle of Separation of Powers will not be violated, as no legal change is actually deemed to have taken place by virtue of the announcement.

The second form of legislation by press release is more problematic. In terms of this form of legislation by press release, taxpayers are directed to take positive actions based on the announcement alone, prior to any amendments actually being promulgated. An example of this second form of legislation by press release that illustrates how the practice can potentially amount to an unlawful delegation of legislative power by the Legislature to the Executive can be seen in the context of the introduction of section 23K of the Income Tax Act which was introduced by the Taxation Laws Amendment Act[42] ('the TLAA').

In terms of section 23K of the Income Tax Act, taxpayers were required to make application to SARS in order to obtain prior approval for certain intra-group transactions. A failure by taxpayers to obtain such approval resulted in them being unable to claim the tax benefits applicable to such transactions. In terms of the TLAA section 23K of the Income Tax Act was deemed to come into operation on 2 June 2011, notwithstanding the fact that the TLAA was only promulgated in January 2012. The consequence of this was that taxpayers entering into intra-group transactions between the period of June 2011 and January 2012 were placed in a position where they had to make application for approval to SARS in terms of a section that was not yet law. Whilst the requirements to pass a Money Bill were ultimately followed, that taxpayers were expected to act in accordance with a section that was not yet law amounts to de facto law making by the Executive, and is therefore a violation of the principle of Separation of Powers.

[42] Taxation Laws Amendment Act No. 24 of 2011.

Once it has been established that legislation by press release may in certain situations, such as with the introduction of section 23K of the Income Tax Act, amount to a violation of the principle of Separation of Powers, it falls to be determined what the legal consequences for such legislation are. This question was dealt with by the Court in*Tongoane and Others v Minister for Agriculture and Land Affairs and Others*.[43]

In *Tongoane*, the applicants sought to have the Communal Land Rights Act, No 11 of 2004 set aside on the basis that the incorrect procedure had been followed when it was passed. Once the Court established that the applicants were correct in their allegation that the incorrect procedure had been followed in the passing of the Act, it then had to determine what the consequences of such error were. In this regard the Court referred to the judgment in *Doctors for Life International v Speaker of the National Assembly and Others*,[44] where it was held that:

> 'It is trite that legislation must conform to the Constitution in terms of both its content and the manner in which it was adopted. Failure to comply with manner and form requirements in enacting legislation renders the legislation invalid.'[45]

In *Doctors for Life* it was further held that:

> '.... not only has a right by also a duty to ensure that the law-making process prescribed by the Constitution is observed. And if the conditions for law-making processes have not been complied with, it has the duty to say so and declare the resulting statute invalid.'[46]

Based on the above, the Court in *Tongoane* ruled that the legislative procedure set out in section 76 of the 1996 Constitution was a material part of the process of passing laws of this nature. It was further held that as a result of this, a failure to meet the requirements contained in this section would result in the legislation passed being declared invalid.

It is submitted that once a Bill has been classified as being a Money Bill, the procedures as set out in the Money Bill Act must be followed. As in *Tongoane,* where the Court held that the procedure set out in section 76 of the 1996 Constitution was a material part of the law-

[43]*Tongoane and Others v National Minister for Agriculture and Land Affairs and Others* 2010 (6) SA 214 CC.

[44]*Doctors for Life International v Speaker of the National Assembly and Others* 2006 (12) BCLR 1399 (CC).

[45]*Doctors for Life* (note 44 above) 1463.

[46]*Doctors for Life* (note 44 above) 1466.

making process, the procedure set out in The Money Bills Act is material to the passing of amendments to the Income Tax Act. The reason why such procedure is necessary in relation to the passing of amendments to the Income Tax Act is because this is a highly technical piece of legislation, and a failure to follow the required procedure may lead to financial uncertainty and unintended consequences.[47]

It is submitted that where the practice of legislation by press release results in taxpayers having to take positive actions in accordance with amendments that have not yet been promulgated, such de novo amendments would be unable to withstand Constitutional scrutiny and would most likely have to be declared invalid if challenged before a Court.

3.5 Conclusion

This Chapter has scrutinised three of the commonly relied upon Constitutional challenges against the retrospective introduction of tax legislation. Whilst it is submitted that such legislation creates uncertainty for taxpayers, thereby undermining their ability to plan their affairs in accordance with what the law is at such time, the Rule of Law does not create enforceable rights and there is therefore no basis on which this provision can be relied upon to overturn such legislation. The Rule of Law challenge is further weakened in instances where the practice of legislation by press release has been properly utilised by the Minister of Finance, as it is difficult for taxpayers to rely on the uncertainty argument where they have been given adequate notice of the impending retrospective legislation.

It is further submitted that in instances where the Legislature has relied upon the introduction of retrospective tax legislation to close identified loopholes in the Income Tax Act, taxpayers will find it difficult to argue that the application of such amendments to completed transactions amounts to a violation of the right to property as contemplated in section 25(1) of the 1996 Constitution. This is because there is a rational connection between the amendment in question (the passing of the amendment to close a tax loophole), the manner in which it was implemented (being the fact that it was implemented retrospectively), and its ultimate goal (the protection of the national fiscus against either a real or perceived risk).

[47] P De Vos... et al South African Constitutional Law in Context (2014) 161.

Finally, it is submitted that whilst the practice of legislation by press release, when relied upon properly, deals with the primary Rule of Law argument, it also has the potential to create an additional constitutional challenge. This additional issue arises when an amendment has been announced by the Minister of Finance in the Budget Speech, which amendment is to be deemed to be in force from the date of such announcement, and taxpayers are expected to take positive actions in accordance with such announcement. The problem with this situation is that whilst it is accepted that ultimately the prescribed legislative procedure will be followed, this expectation that taxpayers must arrange their affairs in accordance with the announcement amounts to de novo law-making by the Executive. There is nothing in the Money Bill Act which provides for a delegation of legislative power by the Legislature to the Executive in respect of amendments to the Income Tax Act, nor that authorises the practice of legislation by press release. If challenged by taxpayers, it is therefore unlikely that such legislation would stand up to constitutional scrutiny.

The Chapter that follows will test the retrospective introduction of tax legislation and the practice of legislation by press release against the guiding principles of good tax policy design in order to determine whether there are any policy arguments that can be relied upon to challenge this form of law-making.

4. THE GUIDING PRINCIPLES OF GOOD TAX POLICY DESIGN

4.1 Introduction

Whilst the legal challenges against the retrospective introduction of tax legislation were dealt with in the previous Chapter, the decision of whether or not to implement such taxes forms an important policy consideration in any tax system. In this chapter the policy of retrospectively introducing tax legislation and the practice of legislation by press release will be analysed against a selection of the accepted principles of good tax policy. Unfortunately, the study of tax policy is a complex field and it is beyond the scope of this dissertation to undertake a thorough examination of all areas of it. It is for this reason that the scope of this examination has been limited and only those policies that have been identified as being the most relevant for present purposes will be dealt with (and even then not in enough detail to truly do them justice).[48]

4.2 Relevance of Tax Policy Design

At a base level, the development of good tax policy design can be described as being the endeavour to identify a set of principles that can be utilised to:

- analyse proposals that have been put forth to change tax rules and tax systems; and
- to provide an objective approach in order to evaluate and improve the existing tax rules.[49]

In dealing with the nature of the tax policy principles, Alley & Bentley[50] state that whilst the general principles do not in themselves create legally or morally enforceable rights, 'once the law is developed based on these principles, legislation will transform some of their content into enforceable rights and obligations.'[51] It is therefore submitted that once a

[48] The three principles that will be dealt with in this Chapter are those of certainty, economic growth and efficiency and tax neutrality.

[49] United Kingdom House of Commons Treasury Committee (note 6 above) 3.

[50] C Alley & D Bentley 'A Remodelling of Adam Smith's Tax Design Principles' (2005) 20 *Australian Tax Forum*.

[51] Alley & Bentley (note 50 above) 581.

set of accepted principles has been identified, and then relied upon to evaluate and improve the tax rules, the end product should be an effective tax system.

The development of good tax policy design is a complex process in which a balance must be sought between the objectives of the tax policy in question and the requirements of the individuals being subjected to such taxes. A failure to implement tax policy that is broadly perceived fair by the individuals being subjected thereto can have far reaching consequences at all levels of Government.[52] As a result, numerous academics and commissions[53] have attempted to identify a standardised set of principles of what constitutes a good tax system. A non-exhaustive list of some of the more popular sets of principles can be seen in annexure 'A' to this dissertation.

It is widely accepted that Smith[54] identified the initial principles of taxation which have significantly influenced tax policy design.[55] Whilst other scholars have proposed additional principles, the principles put forward by Smith remain the most commonly referred to.[56] The criteria for an efficient tax system as identified by Smith are: 'Equality, Certainty, Convenience of Payment and Economy of Collection.'[57]

In its guiding principles of good tax policy, the American Institute of Certified Public Accountants ('AICPA') has built on the four principles identified by Smith and created an extended list of principles that are relevant to the creation of good taxes, calling them 'the ten principles of good tax policy.'[58] The six additional principles identified by the AICPA

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[52]Bronkhorst E 'Principles of Tax Policy Design' in Stiglingh M (ed) SILKE: *South African Income Tax* 19 ed Volume 2 (2017) 1187.

[53] See for example, A Smith 'An Enquiry into the Nature and Causes of the Wealth of Nations' (selected edition, 1993) 450; AICPA 'Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals' (2017) available at https://www.aicpa.org/ADVOCACY/TAX/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf (accessed 11 April 2018); Alley & Bentley (note 50 above).

[54]Smith (note 53 above) 450.

[55] Bronkhorst (note 52 above) 1187; AICPA (note 53 above) 6; Alley & Bentley (note 50 above) 586.

[56]Bronkhorst (note 50 above) 1187.

[57] Smith (note 51 above) 307-308.

[58] AICPA (note 53 above). Although the AICPA is a foreign-based institution, it is submitted that these principles are of universal application and are therefore relevant within the South African context.

are; 'simplicity, neutrality, economic growth and efficiency, transparency and visibility, minimum tax gap and appropriate government revenues.'[59]

Whilst it is recognised that the principles of good tax policy exist as a 'tax ecosystem' and should not be dealt with in isolation,[60] it is submitted that for the purposes of the current study the three most important principles to be dealt with in detail are those of:

- Certainty;
- Economic Growth and Efficiency; and
- Neutrality.

4.3 The Principle of Certainty

The AICPA defines the principle of certainty as meaning that 'the tax rules should clearly specify how the amount of payment is determined, when payment of the tax should occur, and how payment is made.'[61] Under this principle it is also stated that 'taxpayers should have the ability to determine their tax liabilities with reasonable certainty based on the nature of their transactions.'[62] The AICPA further states:

> 'Certainty is important to a tax system because it helps to improve compliance with the rules and to increase respect for the system. Certainty generally comes from clear statutes as well as timely and understandable administrative guidance that is readily available to the taxpayer.'[63]

In applying this definition to the retrospective introduction of tax laws, Salve[64] states: 'A retrospective amendment hardly qualifies as a sensible measure by this yardstick.'[65] What Salve is referring to in making this statement is that the retrospective introduction of tax legislation creates significant uncertainty for taxpayers, in that such laws undermine

[59] AICPA (note 53 above) 23.

[60]Bronkhorst (note 52 above) 1187.

[61] AICPA (note 53 above) 11.

[62] AICPA (note 53 above) 11.

[63] AICPA (note 53 above) 11.

[64] H Salve 'Retrospective Taxation – The Indian Experience' available at https://www.biicl.org/files/6722_panel_two_harish_salve.pdf (accessed 12 April 2018) 24-35.

[65] Salve (note 64 above) 24-35.

taxpayers' abilities to plan their affairs in accordance with what the law is at the time when decisions are made.

It is clear from the various formulations of the principle of certainty that it is founded in the belief that taxpayers are entitled to rely on the law as a guide for their conduct. Whilst it is submitted that as a general rule the ability to rely on the law should be valued, it will now be tested against two specific situations, namely:

i. When the practice of legislation by press release has been relied upon to introduce retrospective amendments to the Income Tax Act; and

ii. When taxpayers are employing aggressive tax planning schemes in order to exploit loopholes in the Income Tax Act.

4.3.1 The Practice of Legislation by Press Release

It is again submitted that the reliance by taxpayers' on laws remaining the same is undermined when the practice of legislation by press release has been utilised. The reason for this is that 'no reasonable person would rely on a law remaining the same when the Minister has specifically said that it will be changed.'[66]

In dealing with taxpayers' reliance on the law remaining the same, Fisch[67] distinguishes between what she regards as being a stable and an unstable equilibrium. Fisch describes a stable legal equilibrium as follows:

> 'A particular legal context is in stable equilibrium when the applicable legal rules are clear, have been promulgated by a higher legal authority, have persisted over time and in a variety of specific cases, and have not been widely criticised or questioned by lawmakers with comparable authority.'[68]

Where the above requirements are met, the reliance by taxpayers on the law remaining the same can be seen as legitimate. If however, these requirements are not met, then it will be regarded as being an unstable equilibrium and changes in legal rules are to be expected. It is submitted that in general the legal context of tax laws is to be regarded as being an unstable equilibrium. One only needs to look at the Income Tax Act and how often it is

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[66] Palmer & Sampford (note 16 above) 263.

[67] J E Fisch 'Retroactivity and Legal Change: An Equilibrium Approach' (1997) 110 *Harvard Law Review*.

[68]Fisch (note 67 above) 1102.

amended by the Legislature in order to come to this conclusion. Furthermore, once an announcement of impending amendments has been made by the Minister of Finance, the situation becomes even more unstable and taxpayers should not then complain when the changes are subsequently implemented. The reliance on laws remaining the same in this context is therefore misplaced and illegitimate.

Notwithstanding the foregoing, there is still the potential for the practice of legislation by press release to increase uncertainty for taxpayers when it is not implemented correctly. An examination of the ideal manner in which to use legislation by press release will now be undertaken.

4.3.1.1 Guidelines for Legislation by Press Release

As stated above, whilst legislation by press release has the potential to adequately resolve the uncertainty issues commonly associated with retrospective legislation, it must adhere to certain standards in order to remain effective. In order to establish the standards which legislation by press release must adhere to, it is first necessary to identify the common arguments made against this practice. The primary arguments against the practice of legislation by release can be concisely summarised as follows:

i. That the announcements may be insufficiently clear;[69]

ii. That the promulgated legislation may differ from the amendment that was originally announced;[70]

iii. That there is often a lengthy delay between the date of the announcement of the proposed amendment, and the promulgation of the legislation (in certain instances the legislation has indeed never come into existence at all);[71] and

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[69] See for example H Reicher 'Legislation by Press Release' (1978) 7 *Australian Tax Review* 32; Palmer & Sampford (note 16 above) 267-268.

[70] See for example Palmer & Sampford (note 16 above) 269-270; J C Chen 'The Yet-to-Be Effective but Effective Tax: Hong Kong's Buyer's Stamp Duty as a Critical Case Study of Legislation by Press Release (2014) 10 (E) *University of Pennsylvania East Asia Law Review* 16.

[71] See for example Reicher (note 69 above) 38; Palmer & Sampford (note 16 above) 268-269.

iv. That the announcements are not adequately disseminated to the public.[72]

Whilst it is submitted that it is possible for announcements to be so vague as to render their ability to guide taxpayers' actions null and void, there does not appear to be any examples of this in practice. Those against the practice of legislation by press release may adopt the argument put forth by Reicher,[73] who stated that the Government may intentionally make insufficiently clear announcements so that 'the threat will be more effective than the deed itself.'[74] It is therefore important that one remains cognisant of the fact that vague announcements can be a powerful tool to deter negative taxpayer behaviour, but that in serving this purpose it undermines the positive associations with the practice of legislation by press release. Policy-makers are therefore well-advised to ensure that if they are going to rely on the practice of legislation by press release, the initial announcements should be as clear as possible.

With regards to the second criticism of legislation by press release, it is submitted that one cannot argue against the potential that the promulgated legislation will differ from what was originally announced. The legislative process is (for good reason) a protracted affair and involves numerous stakeholders having input on the laws that are eventually promulgated. However, it is further submitted that this does not necessarily mean that taxpayers' reliance is undermined by this practice. When an announcement is made, it will generally highlight a specific harmful practice that is being targeted by the proposed amendment. Taxpayers should therefore adopt a purposive approach to the interpretation of the announcement. If this purposive approach is adopted then taxpayers 'will probably refrain not only from the practice identified but also from any variants of it which create the same mischief as the practice identified, but which might happen to fall outside the precise terms of the announcement, or the tax adviser's interpretation of it.'[75]

Based on the above, when taxpayers literally interpret an announcement, and act on it as if it is already law, such taxpayers cannot be said to be acting on a rational basis. With this in

[72] A Report by the Committee on Tax Policy, Tax Section, New York State Bar Association 'Retroactivity of Tax Legislation' (1975) 29(1) *Tax Lawyer*. Although this is a Report from a foreign jurisdiction, it is submitted that the concerns raised regarding the dissemination of the notice are applicable within the South African context.

[73] Reicher (note 69 above).

[74] Reicher (note 69 above) 32.

[75] Palmer & Sampford (note 16 above) 268.

mind, it is therefore important that policy-makers explain to taxpayers what the practice of press release entails, as armed with this knowledge taxpayers will then have reasonable expectations regarding the announcements.

An undue delay in the promulgation of the announced legislation may cause a degree of uncertainty amongst taxpayers as it poses the question of whether the announced legislation will ever in fact be introduced. To a certain degree the practice of legislation by press release creates a period where there is in fact no governing law, and in this period taxpayers can only rely on the announcement as a guide for their conduct. One must question how long taxpayers can reasonably be expected to act in accordance with such an announcement, before they return to what the actual law is as contained in the legislation being amended. In order to eliminate this element of uncertainty, it is desirable that a specific cut-off time be specified for the amendment in question to be promulgated, 'failing which the retrospective element should not be proceeded with.'[76] It is submitted that whilst the setting of a deadline is difficult and may result in there being unrealistic expectations, this still constitutes a desirable practice as lengthy delays can only serve to decrease the credibility of future announcements.[77]

In its report dealing with the retroactivity of tax legislation, the Committee on Tax Policy of the New York State Bar Association[78] identified that one of the primary concerns with the practice of legislation by press release (or as it termed in the Report 'Notice Theory') was whether it could be said that an announcement in question had been adequately disseminated to the public. The basis for this concern is that the argument that legislation by press release resolves the uncertainty issues associated with retrospective legislation can only be sustained if taxpayers are actually made aware of the announcement in question. The Committee goes further to state that in order for taxpayer's to be expected to rely on the notice, 'Congress and the executive should, at the least, adopt a policy of immediate and widespread dissemination of actions relating to the proposed changes.'[79] It is submitted therefore that actual notice of the impending legislative amendments is not sufficient to adequately resolve the uncertainty issues relating to retrospective tax laws, but rather

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[76]Reicher (note 69 above) 38.

[77] Palmer & Sampford (note 16 above) 269.

[78] New York State Bar Association (note 72 above).

[79] New York State Bar Association (note 72 above) 21.

taxpayers should see the Government taking constructive steps towards implementing the amendment in question. In order for the practice of legislation by press release to amount to good tax policy there should therefore be an initial notice of the impending amendments that is disseminated to the public, which notice is then immediately followed up with constructive steps towards the implementation of such amendment.

Based on the above, it is clear that it would be highly beneficial for a ‘best policy guide for the practice of legislation by press release’ to be developed. Armed with such a guide, Government can ensure that in instances where it is deemed desirable for the practice of legislation by press release to be utilised, this is done in the most efficient way possible. Whilst it is not an inclusive list, the primary factors that should be met when legislation by press release is utilised should be:

i. That the announcements are sufficiently clear;[80]

ii. That there is a period of time set at the outset in terms of which the announced legislation must be promulgated;[81] and

iii. That not only is there widespread dissemination of the announcements to the general public, but taxpayers should thereafter be able to see the Government taking constructive steps to implement the amendment.[82]

If these guidelines are followed, the practice of legislation by press release will successfully resolve the uncertainty that is commonly associated with retrospective legislation. In such circumstances taxpayers’ reliance on the law remaining the same is undermined and cannot be seen to be a legitimate expectation. It is now necessary to deal with the second scenario in which this reliance can be challenged.

4.3.2 Certainty in the Context of the Exploitation of Loopholes in the Income Tax Act

The reliance by taxpayers’ on laws remaining the same can further be challenged in situations where taxpayers are employing aggressive tax planning schemes to exploit identified loopholes in the Income Tax Act. For the purpose of this dissertation, I will adopt

[80] Reicher (note 69 above) 32; Palmer & Sampford (note 16 above) 267-268.

[81] Reicher (note 69 above) 38; Palmer & Sampford (note 16 above) 269.

[82] New York State Bar Association (note 72 above) 21.

the definition of loopholes put forth by Katz,[83] who regards loopholes as being 'seeming glitches in the formulation of a law (it could be either statutory or case law) that allow clever lawyers to help their clients do things that appear to subvert its purpose.'[84] In such situations it is necessary to ask whether the reliance by taxpayers on the law remaining the same is legitimate, and thereby worthy of protection.

Whilst it is beyond the scope of this dissertation to delve into the distinction between tax avoidance (which is legal) and tax evasion (which is not legal), in the context of reliance it is necessary to understand that unusual and creative schemes which are deployed to gain an unintended tax advantage have the potential to move beyond legitimate tax avoidance.[85] In the event of the banning of retrospective legislation, on the basis that it undermines the principle of certainty, taxpayers who become aware of unintended tax benefits could be encouraged to exploit these. In such situations the only manner in which the fiscus could be protected would be to pass prospective amendments that prevent such harm being suffered in the future. However, nothing can be done to restrict the harm that has already been suffered. Whilst it has been argued that this situation arises as a result of poor law-making, and that therefore Government should bear the losses that consequently arise,[86] it is submitted that in reality the harm in question is actually suffered by the collective public as a whole and as such conduct of this nature should not be countenanced. On this point and in defence of the usage of retrospective tax legislation to close loopholes, Australian Senator Gareth Evans stated:

> 'Of course it will create uncertainty to have the possibility of these schemes being struck down after the event. That, after all, is the very objective – to operate as a deterrent to the future marketing of these schemes and not just a way of collecting lost revenue in the past… The starting point in this kind of argument is the proposition that uncertainty in law is not itself an unmitigated evil. Its role in the front line in the war against tax avoidance schemes is such an eminently noble purpose and one which justifies the operation of fully retrospective tax avoidance laws.'[87]

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[83] L Katz 'A Theory of Loopholes' (2010) 39(1) *The Journal of Legal Studies*.

[84] Katz (note 83 above) 2.

[85]United Kingdom House of Commons Treasury Committee (note 6 above) 20.

[86]Loiacono& Mortimer (note 1 above) 112.

[87] Sen Deb (1979) 619-620.

It is submitted that as a general rule the principle of certainty, and the idea that taxpayers should be able to rely on laws to remain the same, are of fundamental importance to any tax system. One can clearly see the rationale behind the argument that in a system where the introduction of retrospective tax legislation is a fact of life, there is a heightened chance that taxpayers will lose respect for such system and which could lead to decreasing levels of compliance therewith. It is further submitted however that tax systems are a complex ecosystem and that exceptions to this rule do indeed exist. Firstly, where the practice of legislation by press release has been relied upon the arguments that retrospective tax laws undermine the principle of certainty are weakened. Secondly, where a taxpayer's reliance on the law remaining the same is illegitimate, and thereby not worthy of protection, such retrospective laws are acceptable.

4.4 Principle of Economic Growth and Efficiency

Whilst economic growth and efficiency are important for all economies, they are even more so for developing economies such as South Africa – a country that is heavily reliant on foreign investment. In dealing with the principle of economic growth and efficiency the AICPA states:

> 'The tax system should not impede or reduce the productive capacity of the economy. The tax system should neither discourage nor hinder national economic goals, such as economic growth, capital formation, and international competitiveness. The principle of economic growth and efficiency is achieved by a tax system that is aligned with the economic principles and goals of the jurisdiction imposing the tax.'[88]

India provides a real-world example of the manner in which the uncertainty created by the wholesale use of retrospective tax legislation can negatively impact upon a country's international competiveness and thus hinder the national economic goals.

4.4.1 The Indian Example

In a country with a developing economy such as South Africa, it is crucial that the tax policies adopted do not deter any potential foreign investment.A real-world example of the

[88] AICPA (note 53 above) 12.

manner in which the retrospective introduction of tax legislation can potentially be harmful to an economy can be seen in another developing economy, namely India.[89]

During the course of 2016 the Indian government appointed a committee with the mandate to investigate why 'the World Bank published a report downgrading India in the index of investment friendliness.'[90] In its findings, the committee addressed the issue of retrospective taxation and stated:

> 'It has often been said that death and taxes are equally undesirable aspects of human life. Yet, it can be said in favour of death that it is never retrospective. Retrospective taxation has the undesirable effect of creating major uncertainties in the business environment and constituting a significant disincentive for persons wishing to do business in India. While the legal powers of a Government extend to giving retrospective effect to taxation proposals, it might not pass the test of certainty and continuity. This is a major area where improvements should be attempted sooner rather than later...'[91]

Whilst the Indian government had adopted a policy of using retrospective tax legislation to broaden its tax base, the uncertainty created by such legislation ultimately undermined foreign investor confidence in India,[92] thereby violating the principle of economic growth and efficiency.

It is submitted that the Indian example provides a cautionary tale that where the practice of retrospectively introducing tax legislation is widely and indiscriminately used, such practice has the potential to ultimately be harmful to the economy in question. It is further submitted however that where this practice is regulated, and only used in specific circumstances,[93] the practice is less likely to have a negative impact on the economy. It is submitted that the reasons for this are:

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[89] In the United Nations Conference on Trade and Investment Report 2018, Investment and New Industrial Policies 2018, both India and South Africa are ranked as countries with developing economies.

[90] Salve (note 64 above) 23.

[91] Salve (note 64 above) 23-24.

[92] Lamprecht (note 4 above) 3.

[93] For example to remedy defective legislation.

i. That such legislation is relied upon in numerous foreign jurisdictions and is essentially an international norm;[94] and

ii. That in such systems there is a degree of transparency related to this practice, thereby minimising the potential for such laws to undermine foreign investor confidence.

4.5 Principle of Tax Neutrality

The AICPA identifies that taxes should be as neutral as possible, so as to ensure that such taxes achieve their primary purpose of raising revenue for governmental activities, whilst not influencing business and personal decisions.

The Indian example above provides a real-world illustration of the fact that the introduction of retrospective tax has the potential to significantly influence foreign business decisions when businesses are deciding whether or not to invest in a country. This therefore amounts to an undermining of the principle of tax neutrality. The negative impact of the introduction of retrospective tax legislation on business and personal decisions can further be explained from the social cost perspective.

4.5.1 The Social Cost Perspective

Nellor[95] argues that from a social cost perspective, the retrospective introduction of tax legislation should be avoided. The reason for this is that in a system where retrospective tax legislation is the norm, all choices made by taxpayers will require that they form an expectation of future budgetary actions. In such systems, taxpayers cannot confidently arrange their affairs in accordance with what the law is at the time when decisions are being made. Consequently, the uncertainty that this creates results in taxpayers using additional resources in the decision-making process. It is further argued that this additional step in the decision-making process would not be present in a system where legislation can only act prospectively and thus impact upon future tax arrangements.[96] The increased focus on the decision-making process detracts from the actual income-producing activities which

[94] See Annexure 'B' to this dissertation for a table illustrating the countries in which the retrospective introduction of tax legislation is permissible.

[95] D Nellor 'A Note on Retrospectivity and the Tax System' (1982) 58(162) *Economic Record*.

[96] Nellor (note 95 above) 289.

taxpayers should be engaged in, thereby undermining the principle of tax neutrality and harming the economy as a whole.

Based on the above, it can be argued that in a system where taxpayers can predict the legal consequences of a planned transaction with reasonable certainty, the costs of compliance for such taxpayers are small. It is submitted that this will result in taxpayers being more likely to comply with the law. Fisch[97] states that greater compliance with the legal system creates 'uniformity and certainty in transactions, discourages opportunistic behaviour, and enhances the ability of legal rules to influence primary conduct.'[98]

The instability created by retrospective tax legislation undermines the principle of tax neutrality in that it serves as a deterrent to foreign businesses making the decision of whether or not to invest in a country, and further increases the cost of the decision-making process for taxpayers in general. This provides another compelling argument against the retrospective introduction of tax legislation becoming the norm in our legal system.

4.6 Conclusion

From the analysis above it is clear that is almost impossible to deal with the principles of good tax policy in isolation. In almost any debate about a particular tax policy or proposed amendment there will be certain principles which are violated by the said policy or amendment, and certain principles which support it. However, in the context of discussing the retrospective introduction of tax legislation it is clear that when this practice is widely relied upon and unregulated, it cannot be considered as good tax policy. It is submitted that once a policy that blatantly violates the principles of good tax policy in this manner is implemented, there is a real threat that this will result in decreased levels of compliance with the tax system. This, in turn, will harm the fiscus. Whilst it is accepted that once tax legislation has been passed with retrospective effect a taxpayer cannot rely on the guiding principles of good tax policy to challenge such legislation, it is important that policy-makers are aware of these principles as knowledge thereof will inevitably lead to an improved tax system and thereby decrease legal challenges against such system in the future.

[97]Fisch (note 67 above).

[98]Fisch (note 67 above).

In order to align this practice with the principles of good tax policy it is submitted that the approach suggested by Loiacono & Mortimer should be adopted. These authors suggest that when retrospective legislation is to be passed, it should be accompanied by a 'statement of compatibility with the public interest.'[99] In such statement, the Government should explain why, in the circumstances, the passing of retrospective legislation is justified, what the threat to the fiscus that is being prevented is, and why the current legislation is insufficient to adequately deal with the threat. If this approach is adopted, it will firstly prevent an over-reliance on retrospective legislation, and secondly increase the transparency and credibility of such legislation.

It is submitted that the retrospective introduction of tax legislation can therefore meet the requirements of good tax policy, provided that:

i. It is used sparingly and only in situations where the potential harm to the fiscus is grievous;

ii. It is closely regulated;

iii. Wherever possible it should be implemented by way of legislation by press release; and

iv. It should be accompanied by a statement of compatibility with the public interest.

If the above guidelines are followed, the practice of retrospectively introducing tax legislation can pass the scrutiny of the principles of good tax policy.

[99] Loiacono & Mortimer (note 1 above) 117.

5. PIENAAR BROTHERS (PTY) LTD v COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE AND ANOTHER 2017 (6) SA 435 GP

5.1 Introduction

Pienaar Brothers was the first time that the practice of legislation by press release was challenged in South Africa on constitutional grounds. In this Chapter a brief background of the facts will be given, followed by a summary of the arguments relied on by Counsel for the Taxpayer and the Commissioner. An analysis of the reasoning of the Court will then be undertaken. Finally, the judgment and the reasons therefore will be tested against the legal and policy considerations dealt with in the previous chapters.

5.2 Facts

The relevant facts relating to the transaction and subsequent distribution that gave rise to the dispute can be summarized as follows:

On 16 March 2007 Serurubele Trading 15 (Pty) Ltd entered into an amalgamation transaction as defined in section 44 of the Income Tax Act, in terms of which it acquired all of the assets of Pienaar Brothers (Pty) Ltd. In terms of the Sale of Business Agreement the effective date of the transaction was deemed to be 1 March 2007 and the purchase consideration was to be settled as follows:

- Serurubeleundertook to issue shares to Pienaar Brothers which were to have a value that was the equivalent of the purchase price less the liabilities that were assumed (‘equity consideration’);
- From the equity consideration an amount equal to the value of the shares was deducted; and
- This remaining amount was then credited to the share premium account of Serurubele.

On 1 April 2007, after the fulfillment of all of the relevant conditions, the business was transferred to Serurubele against payment of the purchase price in the manner set out above.

On 3 May 2007 the directors of Serurubele made the decision to distribute R29 500 000.00 to their shareholders pro rata to their shareholding, out of its share premium account ('the distribution'). In accordance with the provisions of section 44 of the Income Tax Act[100] as it read at the time of the transaction (more fully dealt with below) this distribution should have been exempt from Secondary Tax on Companies ('STC'). However, this was not to be the case.

SARS, relying on the provisions of the Taxation Laws Amendment Act 8 of 2007 ('TLAA'), issued to the taxpayer an assessment letter in terms of which the taxpayer was advised that SARS was levying STC on the distribution amount. It was against this assessment that the taxpayer objected.

5.3 Applicable Legislation:

Section 44 of the Income Tax Act deals with amalgamation transactions. In terms of section 44(1)(a) of the Income Tax Act, an amalgamation transaction is defined as any transaction-

'(a) (i) in terms of which any company (hereinafter referred to as the 'amalgamated company') which is a resident disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relation to the liquidation or winding-up) to another company (hereinafter referred to as the 'resultant company') which is a resident, by means of an amalgamation, conversion or merger; and

(ii) as a result of which the existence of that amalgamated company will be terminated…'

In terms of section 44(9) of the Income Tax Act, which was in force at the time of the transaction and when the resultant distribution was made, the distribution in question

[100] Income Tax Act 58 of 1962.

should have been exempt from STC. This was due to the fact that section 44(9) 'exempted it from STC by deeming the distribution not to be a dividend for the purposes of STC.'[101]

The timeline of the retrospective amendments to section 44 of the Income Tax Act which gave rise to the dispute was as follows:

- 20 February 2007: In the budget speech, the Minister of Finance made reference, in general terms, to an intention to pass retrospective legislation that would deal with anti-avoidance arrangements relating to STC.

- 21 February 2007: Following the statement made by the Minister of Finance, SARS issued the following press release:

> 'The STC exemption for amalgamation transactions contained in S44(9) of the Income Tax Act, 1962, is withdrawn. This exemption permits a permanent loss of STC, rather than a deferral of tax, which is the intent of the amalgamation provisions.'[102]

- 27 February 2007: SARS and the National Treasury release the Draft Taxation Laws Amendment Bill of 2007 for public comment. At this stage the Bill was aligned with the statement made by the Minister of Finance and the subsequent press release, in that it proposed the deletions of sections 44(9) and (10) of the Income Tax Act, which deletion would be deemed to come into operation on 21 February 2007.

- 7 June 2007: After completion of the public comment process, the Taxation Laws Amendment Bill was published. In the explanatory memorandum that accompanied the Bill, it was stated that:

> 'As a theoretical matter S. 44 amalgamations should as a deferral mechanism. All assets and tax attributes would roll over from the target company to the acquiring company with the acquiring company subsequently bearing these tax benefits and burdens. This same theory holds for the Secondary Tax on companies (STC). The distribution of acquiring company shares in an amalgamation is accordingly free from STC. However,

[101] *Pienaar Brothers* (note 5 above) 25.

[102] SARS Press Statement *Explanatory Notes: STC Reforms* available at https://www.ftomasek.com/archive/p210207a.html, accessed on 13 September 2018.

the profits of the target company do not roll over to the acquiring company. The net result is often a complete STC exemption when the acquiring company makes a distribution of former target company assets.

It has come to Government's attention that certain private stakeholders are attempting avoidance transactions that are specifically aimed at exploiting this gap. In these transactions, a pre-existing target company with substantial assets and profits is amalgamated into a newly formed company without assets or profits. The newly formed company with substantial assets and profits is amalgamated into a newly formed company without assets or profits. The newly formed company then distributes the former target company assets, but this distribution is free from the STC due to the lack of profits within the newly formed acquiring company. From the above anomaly, the proposed amendment inserts Section 44(9A) which deems resultant company equity share capital (and share premiums) arising from the amalgamation to be profits not of a capital nature available for distribution to shareholders to the extent of any profits distributed by the amalgamated company in terms of subsection (9). The result is that the amalgamated company's profits are effectively rolled over to the resultant company, so that STC remains payable when the resultant company makes subsequent distribution.'[103]

- 8 August 2007: The TLAA was promulgated. In accordance with the Bill and the explanatory memorandum, section 34(1)(c) of the TLAA inserted section 44(9A) into the Income Tax Act. In terms of section 34(2) of the TLAA, section 44(9A) was deemed to have come into operation on 21 February 2007, and was applicable:

'to any reduction or redemption of the share capital or share premium of the resultant company, including the acquisition by that company of its shares in terms of Section 85 of the Companies Act, 1973 (Act No 61 of 1973), upon or after that date.'

5.4 Issues

The primary issue which the Court had to decide was whether or not the retrospective operation of section 44(9A) of the Income Tax Act was inconsistent with the provisions of the 1996 Constitution. In the event that this section was held to be unconstitutional, the

[103] SARS *Explanatory Memorandum on the Taxation Laws Amendment Bill* 2007 32 available at http://www.osall.org.za/docs/2011/02/2007-Taxation-Laws-Amendment-Bill.pdf accessed on 13 September 2018.

assessment of the distribution to STC would consequently be invalid and have to be set aside.

5.5 Arguments by the Taxpayer

The two constitutional challenges relied upon by the taxpayer against the retrospective operation of section 44(9A) of the Income Tax Act were as follows:

(i) That the retrospective operation of section 44(9A) of the Income Tax Act amounted to a contravention of the principle of legality and the Rule of Law; and

(ii) That the retroactive removal of the exemption from STC without adequate notice 'amounted to a deprivation of property that was both procedurally and substantively arbitrary, and thus inconsistent with the provisions of section 25(1) of the Constitution.'[104]

5.5.1 The Principle of Legality and the Rule of Law

The taxpayer argued that in terms of section 1(c) of the 1996 Constitution read together with section 2 thereof, the Rule of Law is one of the founding values of the 1996 Constitution and that any law or conduct which is inconsistent with the 1996 Constitution is invalid to the extent of such inconsistency. The taxpayer further argued that the Rule of Law requires that laws should have an essential quality, in this instance being that they should be 'reasonably clear, accessible and prospective in their operation.'[105] The taxpayer therefore proceeded from the premise that if it could be shown that section 44(9A) of the Income Tax Act lacked this essential quality required by law it would be inconsistent with the 1996 Constitution and would have to be set aside and declared invalid.

Whilst the taxpayer did not argue that retrospective laws will always be contrary to the Rule of Law, there was only a small concession made in this regard. The one exception identified by the taxpayer was that retrospective laws will not be contrary to the Rule of Law 'when there was adequate warning of the intention to implement the change retrospectively.'[106] The basis for this was that in the absence of such warning, a taxpayer cannot be said to have knowledge of the law nor the ability to regulate his affairs in accordance therewith. It

[104] *Pienaar Brothers* (note 5 above) 4.

[105] *Pienaar Brothers* (note 5 above) 40.

[106] *Pienaar Brothers* (note 5 above) 68.

was argued however that this exception did not find application in the present case. The primary reason for this was that as set out above, the proposed amendment originally announced by the Minister of Finance differed substantially from the eventually promulgated legislation. There could not therefore be said to have been 'adequate warning of the intention to implement the change retrospectively' and as such section 44(9A) of the Income Tax Act had to be declared to be inconsistent with the Rule of Law and was therefore unconstitutional to the extent of such inconsistency.

5.5.2 Unjustified Deprivation of Property

The second constitutional challenge relied on by the taxpayer was that the retroactive operation of section 34(2) of the TLAA, and the subsequent tax that it was subjected to as a result thereof, amounted to an unjustified deprivation of property under section 25(1) of the 1996 Constitution. The basis of this argument was that the application of section 34(2) of the TLAA to completed transactions, without adequate notice thereof being given, was both procedurally and fundamentally arbitrary and thus unconstitutional. The arbitrariness was founded in the fact that without being given prior notice of the intended legislation, taxpayers were not afforded a fair opportunity to organize their affairs. Any deprivation of property that arose in such circumstances would therefore fall foul of the requirements of section 25(1) of the 1996 Constitution.

5.6 Arguments by the Commissioner

In order to understand the arguments relied on by the Commissioner, it is first necessary to look at the context in which the retrospective legislation in question was passed.

5.6.1 The Introduction of Section 44(9A) of the Income Tax Act

It was contended by the Commissioner that during late 2006 and early 2007 it became aware of a loophole in the Income Tax regime which posed a real risk to the National fiscus suffering extensive and permanent harm. It was in an effort to prevent this harm from being suffered that the Minister of Finance made the statement in terms of which it was announced that the exemption in section 44(9) of the Income Tax Act was to be repealed with retrospective effect from 21 February 2007.

5.6.2 Rule of Law

In dealing with the taxpayer's Rule of Law argument, Counsel for the Commissioner did not attempt to argue that retrospective legislation will never violate the Rule of Law. Rather, it was conceded that whilst retrospective legislation may in certain circumstances fall foul of the provisions of the 1996 Constitution, this is a question which must be dealt with in the context of:

- The nature of the legislation in question;
- The effect of such legislation on the public; and
- The particular reasons for why a retrospective approach was adopted.

In the present case, it was argued that the defective legislation and the existence of the identified loophole in section 44 of the Income Tax Act justified a retrospective approach. Tax legislation acts 'for the benefit of the fiscus and thus the country and the public as a whole,'[107] and therefore the Commissioner was justified in acting as he did. It was further submitted that the taxpayer's contention that retrospective legislation will only be constitutional in instances where adequate prior warning thereof is given was incorrect, on the basis that:

- This is 'inconsistent with the approach in the foreign jurisdictions to which our Courts have frequently look[sic] for guidance in such matters.'[108] From the analysis of the approach adopted by such foreign jurisdictions it was made clear that retrospective laws were both permissible and common place;[109] and
- It is inconsistent with the approach that our own Constitutional Court has laid down in regards to the constitutional scrutiny of legislation.[110]

Counsel for the Commissioner argued that based on the above the question was not whether Parliament could legislate retrospectively, but rather 'the real question is what the standard is by which the constitutional validity of retrospective legislation is judged.'[111] It was

[107] *Pienaar Brothers* (note 5 above) 64.

[108] *Pienaar Brothers* (note 5 above) 68.

[109] See Annexure 'B' for a brief analysis of the legal position relating to retrospective legislation in the foreign jurisdictions relied upon by Fabricius J in his judgment.

[110] *Pienaar Brothers* (note 5 above) 68.

[111] *Pienaar Brothers* (note 5 above) 80.

further submitted that the correct test to determine whether legislation falls foul of the Rule of Law is the rationality test. On the facts, it was contended that based on the rationality test, the taxpayer's argument must fail because:

- SARS had identified an unintended loophole in the Income Tax Act;
- The existence of such loophole created the possibility that a 'flood' of transactions could occur;
- This posed 'a real risk that the national fiscus would suffer extensive and permanent harm;'[112]
- A 'mere prospective amendment would have encouraged tax payers to exploit the loop-hole in the last few months before the loop-hole was closed';[113] and
- It was therefore rational to close the loophole with retrospective effect.[114]

5.6.3 The amendment differed from the original announcement

Once Counsel for the Commissioner had established that the rationality test had been satisfied, it then dealt with the taxpayer's argument regarding the fact that due to the promulgated legislation differing from what had been announced by the Minister of Finance in the Budget speech, no notice thereof had actually been given. In this regard, it was contended by Counsel for the Commissioner that:

- The amendment which was introduced was less drastic than what was originally proposed;
- Notwithstanding the fact that the amendment differed from the announcement, at the very least taxpayers were given notice in the Budget Speech that they could no longer safely rely on section 44(9) of the Income Tax Act; and
- There is nothing in either our law or foreign law that requires that 'the warnings given must relate to the exact same amendment that is ultimately made.'[115]

Accordingly, it was argued that there was no merit in the taxpayer's argument in this regard.

[112]*Pienaar Brothers* (note 5 above) 64.
[113]*Pienaar Brothers* (note 5 above) 84.
[114]*Pienaar Brothers* (note 5 above) 83.
[115]*Pienaar Brothers* (note 5 above) 85.

5.6.4 Unjustified Deprivation of Property

Counsel for the Commissioner contended that the taxpayer's argument that the retrospective operation of the amendment amounted to an unjust deprivation of property must fail because:

i. The amendment did not give rise to a deprivation of property;

ii. Even if the amendment did give rise to a deprivation of property, such deprivation could not be said to be arbitrary; and

iii. Section 36(1) of the 1996 Constitution permits a limitation of rights.[116]

5.7 Judgment and the Reasoning of the Court

After a thorough examination of the arguments relied upon by counsel for the Applicant and the Respondents, the Court ultimately ruled that the application be dismissed, with no order being made as to costs. Below I will undertake an analysis of the reasoning behind this order, especially insofar as the constitutional challenges were concerned.

5.7.1 The Rule of Law

It was held by the Court that there is nothing in our law that prohibits the retrospective operation of legislation. Furthermore, there is nothing in our law that requires that taxpayers be given prior notice thereof. On this point, Fabricius J stated:

> 'There is nothing in our Constitution which prohibits parliament from passing retroactive or retrospective legislation. There is nothing in other jurisdictions of similar constitutional structure that prohibits such passing. Also, and more significantly, there is nothing internal in the Rule of Law which renders retrospective legislation per se unconstitutional.'[117]

It was noted by the Court that the taxpayer failed to provide any authority from either South African or foreign law in support of its contention that 'knowledge of proposed retrospective amendment to the law is fundamental to the rule of law'.[118] Notwithstanding such omission, the Court found it unnecessary to consider this point further as on the facts

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[116] *Pienaar Brothers* (note 5 above) 108.

[117] *Pienaar Brothers* (note 5 above) 102.

[118] *Pienaar Brothers* (note 5 above) 97.

of the case, Fabricius J was satisfied that the taxpayer did indeed have sufficient prior notice of the proposed amendment and therefore its argument on this point was doomed to fail.

The Court agreed with the argument made by Counsel for the Commissioner that once it had been established that there was no absolute constitutional prohibition to retrospective legislation, the remaining question to be dealt with was by what standard the constitutionality of such legislation should be tested. In this regard Fabricius J held that the rationality test is what must be applied to all legislation.[119] In applying the rationality test to the facts, it was held that Counsel for the Commissioner had satisfied the Court that it had acted in a rational manner by implementing retrospective legislation to close a loop hole in the Income Tax Act which posed a real and serious threat to the national fiscus. It was further held that the fact that this threat had not actually materialized was irrelevant and that it was perfectly appropriate for Parliament to act proactively when such threats are identified.[120] The end therefore did justify the means and the taxpayer's argument based on the Rule of Law could not succeed in these circumstances.

The argument by the taxpayer regarding the fact that the promulgated legislation differed from what was announced was also regarded as being without merit. In this regard Fabricius J stated that:

> 'I am not aware of any provision in any of the jurisdictions that I have referred to, or indeed in ours, to the effect that the warnings must relate to the exact same amendment that is ultimately made.'[121]

It was further held that given the legislative process and the public participation that this involves, it would not be possible that the eventual promulgated legislation would mirror that which was originally announced. Notwithstanding this, Fabricius J highlighted the fact that taxpayers were given a general notice of the impending amendment, and should have been aware that they could not rely on the provisions of section 44 of the Income Tax Act.[122] Accordingly the taxpayer's argument on this point was also deemed to have been unsuccessful.

[119] *Pienaar Brothers* (note 5 above) 80.

[120] *Pienaar Brothers* (note 5 above) 83.

[121] *Pienaar Brothers* (note 5 above) 85.

[122] *Pienaar Brothers* (note 5 above) 110.

5.7.2 The Unjustified Deprivation of Property

It was held by Fabricius J that where it is contended that a fundamental right entrenched in the Bill of Rights has been infringed, the statutory standard of reasonableness in terms of section 36(1) of the 1996 Constitution must be applied. In terms of this section a limitation of a fundamental right will only be constitutionally valid if it is shown to be both reasonable and justifiable in an open and democratic society. On this point he further stated that there was a third, intermediate criterion that had to be applied, namely:

> 'If the law permits a "deprivation of property" under Section 25(1) of the Constitution, the intermediate standard of "sufficient reason" applies.'[123]

On the facts it was held that the amendment adopted was not arbitrary and therefore did not breach section 25(1) of the 1996 Constitution. Furthermore, for reasons dealt with above, the amendment met the dual requirements of section 36(1) of the 1996 Constitution in that they were both reasonable and justifiable in the circumstances. Accordingly, the taxpayer's property challenge also failed.

5.8 Conclusion

For the reasons outlined above, it was ultimately held that the taxpayer's constitutional attack on the retrospective operation of section 44(9A) of the Income Tax Act must fail. It is submitted that the significant principles that can be drawn from this case are:

i. That retrospective tax legislation is not unconstitutional;

ii. That provided that there is a legitimate legislative purpose, the retrospective operation of tax legislation is permissible; and

iii. That the retrospective operation of tax legislation to completed transactions does not result in an unjust deprivation of property as contemplated in Section 25(1) of the 1996 Constitution.

In the next Chapter I will analyse the *Pienaar Brothers* judgment against the legal and policy principles identified in Chapters 3 and 4.

[123]*Pienaar Brothers* (note 5 above) 82.

6. CRITICAL ANALYSIS OF THE PIENAAR BROTHERS JUDGMENT

6.1 Introduction

Given the fact that the topic of retrospective legislation has always been contentious, it is of no surprise that a number of authors have expressed views that differ from those of Fabricius J in the *Pienaar Brothers* judgment.[124] In this Chapter I will assess various criticisms of the judgment in light of the legal and policy principles dealt with in Chapters 3 and 4.

6.2 Legal Challenges

In this Chapter I will assess the validity of two legal criticisms of the judgment of Fabricius J. Firstly, I will determine whether there is any merit in the argument that Fabricius J erred in finding as he did that the retrospective application of section 44(9A) of the Income Tax Act to the taxpayer's already completed transaction did not amount to a violation of the Rule of Law. Secondly, the argument that the retrospective application of tax legislation to completed transactions amounts to an unjustified deprivation of property and thereby violates section 25(1) of the 1996 Constitution will be dealt with. Finally, I will determine whether the taxpayer erred in so far as they failed to argue that section 44(9A) of the Income Tax Act should be set aside on the basis that the manner in which it was implemented amounted to a violation of the principle of Separation of Powers.

6.2.1 The Rule of Law

[124] See for example *The Taxpayer* April-May 2017; LG Tredoux and SP Van Zyl 'Some Drastic Measures to Close a Loophole: The Case of Pienaar Brothers (PTY) LTD v Commissioner for the South African Revenue Service (87760/2014) [2017] ZAGPPHC 231 (29 May 2017) and the Targeted Retroactive Amendment of Section 44 of the Income Tax Act 58 of 1962' (2018) 21 *PER/PELJ*.

In the editorial of *The Taxpayer*,[125] Advocate TS Emslie strongly condemned the judgment of Fabricius J. Firstly, Emslie argued that the application of retrospective legislation to already completed transactions amounted to a disregard of taxpayers' rights under the Rule of Law, and that this in itself 'embodies an absence of tax morality.'[126] Whilst it is accepted that in certain circumstances there is the possibility that Emslie's argument could be sustained, on the facts of*Pienaar Brothers* Fabricius J was correct in holding that the retrospective application of section 44(9A) of the Income Tax Act to the taxpayer's already completed transaction did not amount to a violation of the Rule of Law.

Notably, Fabricius J did not approach the Rule of Law challenge from the perspective of whether or not the Rule of Law could be relied upon to strike down legislation with retrospective effect. Rather, Fabricius J took the view that whilst in certain circumstances retrospective legislation may offend against the Rule of Law, the correct approach is to determine the standard against which the constitutional validity of such legislation should be tested. As correctly identified by Fabricius J, the test in our law to determine whether or not the Rule of Law has been violated is that of rationality. In describing the requirement of rationality, the Constitutional Court in*Law Society of South Africa and Another v Minister of Transport and Another*[127] stated as follows:

> 'When making laws, the legislature is constrained to act rationally. It may not act capriciously or arbitrarily. It must only act to achieve a legitimate government purpose. Thus, there must be a rational nexus between the legislative scheme and the pursuit of a legitimate government purpose.'[128]

Based on the above, it is submitted that once the Commissioner had satisfied the Court that there was a legitimate threat to the fiscus, and that a prospective amendment would have been insufficient to adequately deal with such threat, the argument that the retrospective operation of section 44(9A) of the Income Tax Act violated the Rule of Law must fail. In such situation the Commissioner had acted rationally in order to achieve the identified purpose of protecting the fiscus. Once the rationality test had been satisfied, it was unnecessary for Fabricius J to rule on what the consequences of legislation that offends the

[125]*The Taxpayer* (note 124 above).

[126]*The Taxpayer* (note 124 above) 61.

[127]*Law Society of South Africa and Another v Minister of Transport and Another* 2011 (2) BCLR 150 (CC).

[128]*Law Society of South Africa and Another* (note 126 above) 32.

Rule of Law are. It is therefore submitted that Emilie's argument that the retrospective application of section 44(9A) of the Income Tax Act to the taxpayer's already completed transaction violated the Rule of Law cannot be sustained.

6.2.2 The Unjustified Deprivation of Property

Emilie's second criticism of the judgment of Fabricius J is in the approach that was adopted towards the question of whether or not tax laws amount to a deprivation of property belonging to those being subjected to such laws. In this regard Emslie takes issue with the fact that 'Fabricius J seems to suggest, towards the end of his judgment, that tax laws do not give rise to a deprivation of property as contemplated in section 25(1) of the Constitution.'[129] In contrast to this view, Emslie argues that the fact of the matter is that tax does indeed compulsorily deprive taxpayers of their money. Based on this, Emslie therefore argues that the approach that should have been adopted by Fabricius J in this regard is not to ask whether or not taxes amount to a justified deprivation of property, but rather whether tax is a justified deprivation of property 'that warrants the application of retroactive laws to completed transactions.'[130] Emslie argues that if this approach had been adopted, the answer would have been in the negative and the application of section 44(9A) of the Income Tax Act to the taxpayer's already completed transactions would have been found to be unconstitutional.

Whilst there is merit in the criticism by Emslie regarding the manner in which Fabricius J approached the taxpayer's property challenge, it is submitted that even if Fabricius J had adopted the approach put forth by Emslie it is unlikely that the taxpayer would have been successful with this challenge. As previously stated, the Commissioner satisfied the Court that it had identified a threat to the fiscus and that the passing of prospective legislation would have been insufficient to counter such threat. Fabricius J correctly identified that the retrospective operation of section 44(9A) of the Income Tax Act:

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[129]*The Taxpayer* (note 124 above) 61.

[130]*The Taxpayer* (note 124 above) 65.

- Did not solely target the taxpayer, in that it was implemented in terms of a law of general application and could not therefore be said to be arbitrary;
- Served a legitimate purpose, being the closing of an identified loophole in the Income Tax Act in order to protect the fiscus from suffering undue harm; and
- There was a rational connection between the retrospective operation of the amendment and the stated purpose, being the closing of the loophole in order to protect the fiscus.

Fabricius J was therefore correct in finding that the retrospective operation of section 44(9A) of the Income Tax Act to the taxpayer's already completed transaction did not amount to an unjustified deprivation of property as contemplated in section 25(1) of the 1996 Constitution. It is further submitted that even if Fabricius J had come to the conclusion that it did indeed amount to such an unjust deprivation of property, the taxpayer would still have failed in this regard as the limitation provisions contained in section 36 of the 1996 Constitution would have justified such actions.

It is submitted that based on the particular circumstances of the case Fabricius J was correct in his findings on both the Rule of Law and the deprivation of property challenges. It will now be determined whether the taxpayer erred in failing to raise the issue that the practice of legislation by press release amounts to a violation of the principle of Separation of Powers.

6.2.3 The Separation of Powers

The answer to the question of whether or not the practice of legislation by press release violates the principle of Separation of Powers depends on how one interprets the legal impact of the original announcement of the impending amendment. If the law is deemed to be changed as of the date of the announcement, then there is a strong argument to be made that this practice does indeed amount to a violation of the Separation of Powers. This is because notwithstanding the fact that there has been no delegation of legislative power to the Executive in respect of the passing of Revenue Bills, the Executive has exercised such power. There has further been a shortcutting of the legislative process as prescribed by section 77(3) of the 1996 Constitution, section 77(5) of the 1996 Constitution as well as the relevant provisions of the Money Bill Act.

It is noteworthy that although the taxpayer did not raise this challenge, Fabricius J did mention it in passing. In dealing with the taxpayer's argument that the promulgated legislation differed from that which was initially announced, Fabricius J stated:

> 'The fact that this was done in a manner different to that which was initially contemplated does not render the process procedurally unfair. Were I to hold otherwise, the democratic parliamentary and public process would be seriously undermined. The executive does not make laws.'[131]

The above passage of the judgment is noteworthy as it indicates what approach Fabricius J has taken to the legal impact of the original announcement. It would appear that Fabricius J regards the announcement of the impending legislative change as merely serving as notice to taxpayers that retrospective amendments are going to be implemented, and that they can no longer safely rely on the identified legislative provisions when structuring their transactions. The announcement therefore does not in itself alter the status quo, and the actual change in the law will only occur when the amendment is eventually promulgated. It is submitted that on the facts of*Pienaar Brothers* this approach adopted by Fabricius J is correct. The reason for this is that taxpayers were not directed to act positively based on the contents of the announcement. The position would have been more difficult to sustain however had taxpayers been directed to take positive actions, such as in the case of the introduction of section 23K of the Income Tax Act, which was dealt with in Chapter 3. In such instances one would find it difficult to argue that the announcement has not altered the legal position, as the announcement itself placed an obligation on taxpayers to undertake actions which were not prescribed by law prior to it being made. In such circumstances it is difficult to avoid the conclusion that this practice amounts to de facto law-making by the Executive.

It is submitted that whilst the practice of legislation by press release has the potential to violate the principle of Separation of Powers, based on the facts of*Pienaar Brothers* the taxpayer would not have been able to successfully argue this point. The announcement of the impending amendments to section 44 of the Income Tax Act merely placed the taxpayer on notice that it could no longer safely rely on the provisions of this section, and the actual

[131]*Pienaar Brothers* (note 5 above) 85.

legal change (although retrospective) only came into existence when section 44(9A) of the Income Tax Act was promulgated.

It is therefore submitted that, in this regard the judgment of Fabricius J was correct in law. What must now be determined is whether the judgment adequately addressed the policy considerations around the retrospective introduction of tax legislation and the practice of legislation by press release.

6.3 Policy Considerations

In Chapter 4 I dealt with the policy considerations which should be taken into account when the legislature is making the decision of whether or not to introduce retrospective amendments to the Income Tax Act and which should guide the practice of legislation by press release. In this sub-chapter I will analyse whether the manner in which section 44(9A) of the Income Tax Act was implemented met these standards and whether it therefore could be said to have amounted to good tax policy.

6.3.1 Why was Retrospective Legislation Necessary

As identified in Chapter 4, the retrospective introduction of amendments to the Income Tax Act will not undermine the principle of Certainty and thereby amount to bad tax policy in situations where taxpayers are employing aggressive tax planning schemes in order to exploit loopholes in the Income Tax Act. It is therefore first necessary to identify the context in which the retrospective amendment in question was introduced in order to determine whether or not such approach was justified.

In the 2007 Budget Speech the Minister of Finance announced that retrospective legislation was going to be passed that would target 'anti-avoidance arrangements relating to STC.' In the press release that subsequently followed this Budget Speech, the situation was further clarified by SARS, which confirmed that the STC exemption provided for in section 44(9) of the Income Tax Act was to be withdrawn, on the basis that 'the exemption permits a permanent loss of STC, rather than a deferral of tax, which is the intent of the amalgamation provisions.'[132] It was therefore clear that a loophole in the Income Tax Act existed, which if exploited by taxpayers could potentially cause significant harm to the fiscus. Indeed, it was this very loophole that the taxpayer in *Pienaar Brothers* sought to exploit. Had the

[132] SARS Press Statement *Explanatory Notes: STC Reforms* (note 102 above).

taxpayer been successful in this regard, it would have been the beneficiary of an unintended R3 687 500.00 (being the STC rate of 12% applied to the distribution out of the share premium made by the taxpayer on 3 May 2007) tax exemption. It is in these circumstances that it must be determined whether the retrospective introduction of section 44(9A) of the Income Tax Act was justified from a policy perspective.

Emslie further criticized the *Pienaar Brothers* judgment based on what he identifies as being the widely used term loophole by Fabricius J. Emslie argues that the term 'loophole' suggests that 'the legislature, SARS or the fiscus… intended certain tax consequences which have been avoided, undermined or exploited… by unscrupulous taxpayers.'[133] Based on this, taxpayers are therefore cast as the villains who have no right to complain when the Legislature or SARS takes remedial action and applies retrospective legislation to completed transactions. In rejecting this approach, Emslie relies on what Schreiner JA in *Commissioner for Inland Revenue v King*[134] called 'the general scope of the Act'. In this regard Emslie states that:

> 'When the Act is amended, so as to expand this general scope, it does not mean that a so-called "loophole" previously existed, implying that the Act in fact meant something other than what is said and that unconscionable taxpayers have exploited the 'loophole' to subvert what was intended all along.'[135]

Emslie argues that if the above approach is adopted, then every time a taxpayer is entering into a transaction, and trying to determine what the tax consequences thereof will be, such taxpayer must 'divine what was intended rather than read what was said.'[136] Taking this further, if such taxpayer relies on what is actually contained in the Act, and consequently obtains a tax advantage or benefit, such taxpayer has exploited a loophole and therefore acted in an unconscionable manner. In these circumstances, the taxpayer cannot have cause to be upset when a retrospective amendment is subsequently applied to his particular transaction once it has been completed and as a result thereof he is deprived of his tax advantage.

[133]*The Taxpayer* (note 124 above) 62.

[134]*Commissioner for Inland Revenue v King* 1947 (2) SA 196 (A).

[135]*The Taxpayer* (note 124 above) 62.

[136]*The Taxpayer* (note 124 above) 62.

Whilst it is agreed that there is merit in Emslie's argument, it is respectfully submitted that it is somewhat naïve in certain respects. Whilst one can accept that in an ideal world there would be no loopholes in the law, it is clear that in practice this is not the case. This is evident from the vast amounts of research that has been devoted to attempting to explain the existence of such anomalies in the law.[137] According to the Mismatch Theory,[138] the primary reason for the existence of loopholes in the legal system is due to the 'unavoidable imperfection of all human creations.'[139] The core belief of proponents of the Mismatch Theory is that the mismatch between a rule and its underlying purpose arises as a result of the limited foresight and hindsight of the rule maker. The limited foresight of rule makers renders it impossible for such individuals to 'anticipate all situations in which the rule might have to be applied in the future,'[140] whilst the limited hindsight means that'even where on is able to anticipate such situations in theory, it might be hard to determine when one is actually encountering them in practice.'[141]

In*Pienaar Brothers*, Fabricius J made the accurate statement that 'economic circumstances generally will demand a degree of fluidity. Rigidity does not belong to a modern jurisprudence, and even less in tax legislation.'[142] It is against the backdrop of this statement that the Mismatch Theory finds further validity. This is due to the fact that the rapid change in economic circumstances results in rule makers having 'limited foresight,' in the sense that they cannot predict what the future will hold. As a result of this, their ability to implement laws that will achieve their dual purpose of collecting revenue whilst also protecting the fiscus is hampered. This will inevitably lead to situations in which there is a disparity between a law and its purpose, thereby creating a loophole for enterprising taxpayers to exploit. Once it has been established that loopholes in tax legislation are inevitable, the question that then arises is what taxpayers should do when they are encountered.

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[137] See for example Katz (note 83 above); H Field 'A Taxonomy for Tax Loopholes' (2018) 55(3) *The Houston Law Review*.

[138] Katz (note 83 above) 7.

[139] L Katz (note 83 above) 7.

[140] Katz (note 83 above) 7.

[141] Katz (note 83 above) 7.

[142]*Pienaar Brothers* (note 5 above) 50.

Advocate Emslie would appear to argue that as taxpayers can only act in accordance with the provisions of the Income Tax Act as it is at the time of the planning of a transaction, any unintended tax benefit to which they may become entitled is to be welcomed. The fact that such benefit was not foreseen by SARS and may even frustrate the true purpose of the Act is irrelevant. It is once again submitted that there is a certain naivety to this argument.

As loopholes arise as a result of a disparity between the law and its intended purpose, taxpayers' strategic usage of them to obtain an unintended tax benefit is to be frowned upon. On this point, Weisbach[143] states:

> 'There is no social benefit in tax planning… [T]ax planning, all tax planning, not just planning associated with traditional notions of shelter, produces nothing of value… No new medicines are found, computer chips designed, or homeless housed through tax planning.'[144]

Whilst it is accepted that in certain circumstances taxpayers may act in good faith in relying on the contents of the Income Tax Act and thereby obtain a tax advantage, this is not the case where identified loopholes are exploited by aggressive tax planning schemes. In this regard Chen states; 'Seeking out loopholes through a literalist interpretation of the tax law is neither a legitimate expectation to be protected nor a desirable behavior to be encouraged.'[145]

Taxpayers who employ aggressive tax planning schemes which are aimed at exploiting loopholes in the Income Tax Act are acting to the detriment of the fiscus, and the nation as a whole. The loss of revenue that arises as a result of these schemes is significant, and taxpayers who employ such tactics should not be encouraged. In light of this, Emilie's portrayal of taxpayers who are caught out when engaging in these schemes as being deserving of our sympathy cannot be supported.

It is clear from the facts of *Pienaar Brothers* that the conduct of the taxpayer amounted to an attempt to exploit a loophole in an effort to receive an unintended tax benefit. Whilst there was a valid commercial basis for the transaction entered into by the taxpayer, being the introduction of a BEE partner into the business, it was clear that the transaction itself

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[143] D Weisbach 'Ten Truths about tax Shelters' (2002) 55 *Tax Law Review*.

[144]Weisbach (note 143 above) 222.

[145]Chen (note 70 above) 16.

was structured in such a manner so as to avoid the liability to pay the substantial amount of STC that would otherwise have arisen. The prevailing circumstances did therefore justify a retrospective approach to the passing of the amendment. What must now be determined is whether the manner in which such retrospective legislation was passed amounted to good tax policy.

6.3.2 The Announced Change

As discussed in Chapter 4, whilst the practice of legislation by press release adequately resolves the traditional concerns associated with retrospective legislation, it may give rise to additional concerns when it is not implemented in accordance with certain standards. One of these situations is where the initial announcement is so vague as to render it impossible for taxpayers to determine what transactions are being targeted. In such situations the practice will create additional uncertainty for taxpayers and thereby amount to bad tax policy. It is therefore necessary to determine whether the announcement made in*Pienaar Brothers* was sufficiently clear so as to provide guidance to taxpayers as to what transactions were being targeted.

The original announcement by the Minister of Finance on 20 February 2007 was vague, in that it only made reference to an intention that retrospective legislation was to be passed that would target 'anti-avoidance arrangements relating to STC.' If this was the only mention of the proposed amendment prior to its eventual promulgation, it is submitted that it would be difficult to argue that the process amounted to good tax policy. This however was not the case. The position was clarified by SARS in its press release dated 21 February 2007, and further in the draft Taxation Laws Amendment Bill that followed. From these documents it was clear that SARS intended to remove the STC exemption for amalgamation transactions, thereby ensuring that STC became payable at the time that equity shares in the resultant company (in this instance being the taxpayer) were distributed by the amalgamated company to its shareholders. I would therefore argue that the announcements regarding the proposed retrospective legislation were sufficiently clear and did not in themselves give rise to any additional issues relating to the certainty of the law.

Closely related to the issue regarding the clarity of the initial announcement is the fact that in order to amount to good tax policy the promulgated legislation should not differ from what was originally announced. One of the arguments relied on by the taxpayer in *Pienaar Brothers*was that the initial announcement proposed the deletion of subsections 44(9) and

(10) from the Income Tax Act, whilst when the legislation was eventually promulgated it was done so in the form of the insertion of section 44(9A) into the Income Tax Act. Due to this difference, it was contended by the taxpayer that it did not receive warning of the proposed amendment and it therefore violated the Rule of Law (which is closely related to the policy principle of Certainty). It is submitted that in the circumstances of the case the amendment that was eventually promulgated was less drastic than what was originally announced. It is further submitted that the tax liability arising from the taxpayer's transaction would have remained the same had the promulgated legislation conformed exactly with what was originally announced. As stated by Fabricius J on this point, 'all taxpayers were thus given ample notice that, to put it at its lowest, they could not safely rely on section 44(9A) of the Income Tax Act after 21 February 2007.'[146] In these circumstances, the fact that the promulgated legislation differed from what was originally announced does not render the process an example of bad tax policy.

6.3.3 Dissemination of the Announcement

As discussed in Chapter 4, there are two requirements that must be met in order for the announcement of the impending retrospective amendment to be said to have been adequately disseminated, these being:

i. That the actual notice itself must be adequately broadcasted to the general public; and

ii. That following the actual notice there must be an 'immediate and widespread dissemination of actions relating to proposed changes'.

In light of the above it is now necessary to evaluate the manner in which the notice of the proposed retrospective amendment was broadcast in *Pienaar Brothers*.

In South Africa the Budget Speech is firstly disseminated to the general public when the speech itself is televised. After the initial televised announcement, the Budget Speech is then reprinted and discussed widely in the media and by professionals acting in the field of tax. It is therefore submitted that this process is very transparent, and that any interested parties would find it difficult to argue that they were not given adequate notice of the contents thereof. Whilst the actual process by which legislation by press release was not

[146] *Pienaar Brothers* (note 5 above) 85.

dealt with directly by Fabricius J in his judgment, he did agree with the statement made by Counsel for the Commissioner that; ‘The question of whether the Applicant and its advisors actually made themselves aware of the budget speech or Draft Bill is in the present context not relevant.’[147] I would submit that whilst in the present context there was adequate dissemination of the actual notice of the impending retrospective amendment, and that given the nature of the taxpayer and the complex restructuring transaction that it was undertaking it should have been aware of such impending amendment, this statement will not always hold true. Given the fact the fundamental argument in favor of legislation by press release is that it gives taxpayers advance notice of impending retrospective amendments, the fact of whether or not taxpayers were actually made aware of the notice cannot be said to be irrelevant. Where smaller taxpayers that cannot afford the services of a team of tax advisers are concerned, care must be taken to ensure that all possible measures are taken to make them aware of the announcement. As the actual notice itself was adequately disseminated to the taxpayer, or at the very least their tax advisers, it must now be determined whether any constructive steps were taken towards implementing the proposed amendment.

On 27 February 2007, a mere 7 days after the initial announcement of the intention to deal with ‘anti-avoidance arrangements relating to STC,’ SARS and the National Treasury released the Draft Taxation Laws Amendment Bill of 2007 for public comment. There can be no argument that this constitutes a constructive step towards the implementation of the proposed amendment, as it signals the beginning of the legislative process for the passing of a revenue Bill. Whilst the amendment proposed in the Draft TLAA differed from the amendment that was eventually promulgated, it was clear at this stage that positive steps were being taken towards the closing of the identified loophole in section 44 of the Income Tax Act. The next positive step taken by SARS and the National Treasury was to facilitate the public comment process, and to act on the numerous comments receive. It is as a result of this process that the TLAA was then published on 7 June 2007. Based on this process, and the fact that it was clearly always the intention of SARS and National Treasury to close the loophole in section 44 of the Income Tax Act, it is difficult to comprehend the argument made by the taxpayer that it was only when the TLAA was published that it received the

[147]*Pienaar Brothers* (note 5 above) 85.

'first indication of any amendment that would impact upon the STC position of an entity in the position of the Applicant.'[148]

6.4 Statement of Compatibility With The Public Interest

As identified by Loiacono& Mortimer, it would be beneficial that when the decision is made to implement retrospective tax legislation, this should be accompanied by what they term a 'statement of compatibility with the public interest.'[149] In *Pienaar Brothers*, it is clear from the original announcement, as well as the various press releases and explanatory memoranda that SARS and National Treasury did indeed explain what the threat to the fiscus was, and why merely prospective legislation was unable to adequately deal with such threat. What was not addressed however was whether there were alternative measures that could have been relied on to deal with the taxpayer's transaction in question.

One of the criticisms of the judgment handed down by Fabricius J is that the Court failed to acknowledge that based on the facts, the Commissioner was not entirely without remedy if he wanted to prevent the negative impact of taxpayers 'engaging in tax avoidance transactions by using section 44(9) of the Income Tax Act.'[150] Once the Commissioner had identified that taxpayers were abusing a loophole in the Income Tax Act in order to enter into tax avoidance schemes, the Commissioner could have challenged such transactions by relying on the general anti avoidance provisions (GAAR) contained in sections 80A-L of the Income Tax Act. Whilst a debate on whether the transaction in question could have been successfully challenged by relying on GAAR is beyond the scope of this dissertation, it is still of significance to note that there was this potential alternative option available to the Commissioner.

It is submitted that the fact that the Commissioner had more than one option with which to challenge the transaction in question does not impact upon the validity of the judgment from a legal perspective. Fabricius J was correct in holding that the correct standard against which to test the legislation in question was that of rationality. It is further submitted that the standard of rationality sets a low bar, because as soon as it can be shown that the law

[148]*Pienaar Brothers* (note 5 above) 11.

[149]Loiacono & Mortimer (note 1 above) 112.

[150] Tredoux &Van Zyl (note 124 above).

served the purpose for which it was implemented, the fact that a better manner to achieve the desired result existed is irrelevant.[151] In such situations the law in question is rationally related to the purpose for which it was implemented (in this instance being 'revenue collection') and it is difficult to imagine a Court questioning the decision made by the Legislature or interfering in the legislative process by striking down such law.

From a policy perspective however, the fact that the judgment was silent on the alternative measures with which to challenge the transaction is of significance. As dealt with in Chapter 4, whenever Government wants to rely on retrospective legislation there should be an onus on it to prove why the current legislation is inadequate to deal with the identified threat. A failure to adequately deal with potential alternative measures is a sign that the use of retrospective legislation is open to abuse by Government, due to it not being implemented in a transparent manner. It is therefore unfortunate that Fabricius J did not deal with this point, as from a policy perspective it is clear that the manner in which legislation by press release is utilized in South Africa can be improved.

6.5 Conclusion

Based on the above analysis it is submitted that the judgment of Fabricius J in *Pienaar Brothers* was a well-balanced one in the circumstances. Importantly, what one can take away from the judgment is that whilst there is nothing in law that will automatically render retrospective legislation unconstitutional, this must be a decision that is made on the facts of the particular case in question.

Although it is accepted that Fabricius J was correct in his conclusion that there is 'no authority for the proposition that retrospective tax legislation would survive constitutional scrutiny only if there were "good reasons" for it,'[152] and further that 'It is not for a court to say what a good "reason" is,'[153] the only criticism which I have of the judgment is that Fabricius J was silent on the policy considerations that are relevant when discussing tax policy design and the decision of whether or not to introduce retrospective amendments to the Income Tax Act. There is a fear that the judgment in *Pienaar Brothers* will lead to an increase in the usage of retrospective tax, and it would have been beneficial if Fabricius J

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[151] L Kruger 'Retrospective Legislation: Do Taxpayers Have Any Recourse?'*Business Tax & Company Law Quarterly.*

[152] *Pienaar Brothers* (note 5 above) 99.

[153] *Pienaar Brothers* (note 5 above) 99.

had discussed the circumstances of when such legislation will be justified from a policy perspective, and how such legislation should best be implemented.

In the next Chapter a brief overview of the findings of the preceding chapters will be provided. In addition, recommendations which should guide the practice of introducing retrospective tax legislation and the practice of legislation by press release will be put forth.

7. CONCLUSION

This study set out to challenge and to answer the question of what considerations should guide the Legislature when making the decision of whether or not to retrospectively introduce tax legislation in South Africa? In this chapter I will summarise my conclusions as to my findings in this regard.

Firstly, although there is no express prohibition against retrospective tax legislation in the 1996 Constitution, the question of whether or not such legislation is inconsistent with the provisions thereof is one which falls to be determined on the facts of the particular case in question. It is submitted that there are two situations in which there is a strong possibility that retrospective tax legislation will fall short of the high standards set by the 1996 Constitution, namely:

i. Where such legislation is not rationally connected to a legitimate Government purpose;[154] and
ii. Where the practice of legislation by press release has been relied upon to circumvent the legislative process and where taxpayers are expected to take positive actions based on the contents of the announcement.

It is therefore recommended that if Government is intending on introducing retrospective tax legislation, it must be ensured that such legislation is rationally connected to the purpose that it is aiming to achieve. Furthermore, where there is reliance on legislation by press release, it should merely serve to warn taxpayers that they can no longer safely rely on a particular provision of the Income Tax Act, as opposed to directing taxpayers to take positive actions based on an announcement that is not yet law.

[154] *Pienaar Brothers* (note 5 above) 80.

Secondly, it is possible for the retrospective introduction of tax legislation to meet the requirements of good tax policy design. In order to ensure that this is achieved, the starting point should be for Government to communicate with the general public so as to ensure awareness of:

i. The fact that the use of aggressive tax planning schemes aimed at exploiting loopholes in the Income Tax Act in order to obtain unintended tax benefits amounts to theft; and
ii. Furthermore, that in such instances they are the ultimate victims of such theft.[155]

Once the general public is made aware of these facts, and further awareness that retrospective tax legislation is a powerful tool in the hands of Government to combat such thefthas been created, what should follow is a more positive attitude towards this practice. To further strengthen this practice, Government should further ensure that:

i. Retrospective tax legislation is sparsely used; and
ii. That when it is used, it is accompanied by a 'statement of compatibility with the public interest'[156] which advises the general public as to why retrospective legislation is necessary, what the threat which it is aiming to counter is and finally why the existing legislation is insufficient to deal with this threat.

Thirdly, where the practice of legislation by press release is utilised and meets the requirements of the 'best policy guide for the practice of legislation by press release' such practice does resolve both the legal and policy concerns commonly associated with the retrospective introduction of tax legislation. In order to meet this policy guide, Government must ensure that:

i. The original notice of the impending retrospective legislation is sufficiently clear;
ii. That there is a period of time established at the outset in terms of which the proposed legislation is to be promulgated;[157] and

[155]Loiacono & Mortimer (note 1 above) 116.
[156]Loiacono& Mortimer (note 1 above) 117.
[157] Palmer & Sampford (note 16 above) 269.

iii. Not only must there be widespread dissemination of the announcement to the general public, but the Government must also be seen to be taking constructive steps towards the implementation of the legislation in question.[158]

Fourthly, whilst the judgment handed down by Fabricius J in *Pienaar Brothers* was correct in law, it can be criticised on the basis that the learned judge did not discuss the policy considerations underpinning the retrospective introduction of tax legislation and the practice of legislation by press release. Had these considerations been discussed, it is possible that the fear of the judgment resulting in a flood of retrospective legislation may not have arisen.

Finally, it is submitted that Palmer &Sampford were correct in stating that 'the fact that the proposed statute is 'retrospective' should merely be the starting-point of that debate, not its conclusion.'[159]Once this approach is adopted, and all of the surrounding circumstances are taken into account by the Legislature when making the decision of whether or not to introduce retrospective tax legislation, it may well be that the outcome of the debate is that the legislation in question is not tyrannical, and that the end does indeed justify the means.

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46. Tredoux, LG & van Zyl, SP 'Some Drastic Measures to Close a Loophole: The Case of Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service (87760/2014) [2017] ZAGPPHC (29 May 2017) and the Targeted Retroactive Amendment of Section 44 of the Income Tax Act 58 of 1962' (2018) 21 *PER/PELJ* 1-27 available at http://dx.doi.org/10.17159/1727-3781/2018/v21i0a3371, accessed on 15 September 2018.
47. The United Nations Conference on Trade and Investment: World Investment Report 2018 'Investment and New Industrial Policies 2018' available at https://unctad.org/en/PublicationsLibrary/wir2018_en.pdf, accessed on 17 November 2018.

Annexure 'A'

Criteria for an Efficient Tax System[160]

Author	Criteria	Title
Adam Smith 1776[161]	- Equality - Certainty - Convenience of Payment - Economy in Collection	Canons of Taxation
Meade Report – United Kingdom 1978[162]	- Incentives and Economic Efficiency - Distributional Effects - International Aspects - Simplicity - Costs of Administration and Compliance - Flexibility and Stability - Transitional Problems	Characteristics of a Good Tax Policy
OECD (Ottawa) 1998[163]	- Neutrality - Efficiency - Certainty and Simplicity - Effectiveness and Fairness - Flexibility	Taxation Framework Conditions (for electronic commerce)
American Institute of Certified Public Accountants	- Equity and Fairness - Certainty - Convenience of Payment - Economy in Collection	Guiding Principles of Good Tax Policy

[160] Adapted from C Alley & D Bentley 'A Remodelling of Adam Smith's Tax Design Principles' (2005) 20 *Australian Tax Forum* 586.

[161]Smith (note 53 above).

[162] Meade Report 'The Structure and Reform of Direct Taxation' (1978) available at https://www.tandfonline.com/doi/abs/10.1080/00014788.1978.9729134?journalCode=rabr20 (accessed 13 September 2018).

[163] Committee on Fiscal Affairs 'Electronic Commerce: Taxation Framework Conditions' (1998) available at http://www.oecd.org/dataoecd/46/3/1923256.pdf (accessed 12 September 2018).

2001[164]	- Simplicity - Neutrality - Economic Growth and Efficiency - Transparency and Visibility - Minimum Tax Gap - Appropriate Government Revenues	
The Mirrlees Review 2011[165]	- Minimise the Negative Effects of the Tax System on Welfare and Economic Efficiency - Minimal Administrative and Compliance Costs - Fairness (other than in the distributional sense) - Transparency	Tax by Design
The Davis Committee 2015[166]	- Efficiency (Economic and Administrative) - Equity - Fairness - Transparency and Certainty - Flexibility and Buoyancy	An Analytical Framework for the Davis Tax Committee

[164] AICPA (note 53 above).

[165] The Mirrlees Review 'Tax by Design' (2011) available at https://www.ifs.org.uk/mirrleesreview/design/taxbydesign.pdf (accessed 15 May 2018).

[166] The Davis Tax Committee 'The Tax System and Inclusive Growth in South Africa: Towards an Analytical Framework for the Davis Tax Committee (2015 available at http://www.taxcom.org.za/docs/20150605%20DTC%20First%20Macro%20Analysis%20Report%20-%20Full%20Report.pdf (accessed 15 May 2018).

Annexure 'B'

Legal Position in Respect of Retrospective Taxation in Foreign Jurisdictions

Below is a brief outline of the foreign jurisdictions which the Court in the *Pienaar Brothers* case looked to for guidance on the issue of retrospective tax legislation.

1. Canada:

The only prohibition against retroactive law-making is contained in Section 11(g) of the Canadian Constitution, which deals with criminal law.[167] Professor Hogg identifies that retroactive statutes are commonly used in two situations, namely:

i. Tax legislation is often made retrospective to budget night, when the law was publicly announced; and

ii. Retroactive legislation is used to change laws that have been interpreted in an unexpected manner.[168]

2. United States:

At a federal level, the only prohibition to retrospective taxation legislation is where such legislation cannot meet the threshold requirement of rationality.[169] In dealing with the rationality test, the court in United States v Carlton[170] stated that:

> '... provided that the retroactive application of a statute is supported by a legitimate purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches...
>
> To be sure, ... retroactive legislation does have to meet a burden not faced by legislation that only has future effects... the retroactive aspects of legislation, as well as the prospective aspects, must meet the test of due process, and the justifications for the latter may not suffer for the former... that the burden is met simply by showing that the

[167] *Pienaar Brothers* (note 5 above) 72.

[168] P W Hogg Constitutional Law of Canada 5 ed supplemented Vol. 2 (2010) 51.

[169] *Pienaar Brothers* (note 5 above) 75.

[170] *United States v Carlton* [1994] USSC 23; 512 US.

retroactive application of the legislation is itself justified by a rational legislative purpose'.[171]

3. The European Union:

In the European Union there is no bar to retrospective taxation legislation.[172] In the case of *Hail v Rutgen*[173] the court stated:

> '... there is no general principle under the (European Convention on Human Rights) that changes in Civil Law should not operate retrospectively'.[174]

4. England:

In English law there is no bar to retrospective taxation legislation.[175] In the case of *James v IRC* the court stated as follows with regards to retrospective legislation:

> 'As the Constitutional Law of England stands today Parliament has the power to enact by statute any fiscal law, whether of a prospective or retrospective nature and whether or not it may be thought by some persons to cause injustice to individual citizens'.

5. Germany:

In Germany the general position is that there is a ban on retrospective legislation, although this ban is subject to certain exceptions. Two of the identified exceptions in which retrospective legislation will be permissible are:

i. When a reasonable taxpayer cannot claim trust or confidence in the prevailing legal situation; and

ii. When the confidence of a taxpayer in the prevailing legal system has to be subordinated to the interest of the legislator.[176]

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[171] *Carlton* (note 167 above) 26.

[172] *Pienaar Brothers* (note 5 above) 76.

[173] *Hail v Rutgen* [2001] QB 27 C (CA).

[174] *Hail* (note 170 above) 49.

[175] *Pienaar Brothers* (note 5 above) 77.

[176] *Pienaar Brothers* (note 5 above) 46.