IN THE COURT OF APPEAL OF LESOTHO

C OF A (CIV) 25/ 2011

In the matter between:

PATRICK TSENOLI N.O. Appellant

AND

THE LESOTHO REVENUE AUTHORITY First Respondent
THE ATTORNEY-GENERAL Second Respondent
THE MASTER OF THE HIGH COURT Third Respondent

CORAM: RAMODIBEDI P
SMALBERGER J A
SCOTT J A
HOWIE J A
FARLAM J A

HEARD: 18 APRIL 2012
DELIVERED: 27 APRIL 2012

SUMMARY

Sales Tax and Value Added Tax Acts – Seizure of third party's goods in terms of the Acts by the Lesotho Revenue Authority with a view to acquiring security to cover the tax debtor's liability - construction of the seizure provisions in the light of s 17 (4) (a) (i) of the Constitution – whether all seized goods subject to seizure.

JUDGMENT

HOWIE JA

[1] Lekim Textiles (Pty) Ltd (in liquidation) ("Lekim"), a Lesotho company, imported rolls of knitted and woven fabric into Lesotho as well as quantities of sewing thread and clothing accessories (collectively, "the goods"). The importation occurred between April 2002 and November 2003, and would ordinarily have attracted payment of customs duty, sales tax (up to 1 July 2003) and value-added tax (VAT) (after 1 July 2003). Sales tax was payable in terms of the Sales Tax Act, 1995 (the GST Act) and VAT was payable in terms of the Value-Added Tax Act, 2001, (the VAT Act). 1 July 2003 was the last date on which the GST Act applied and after which the VAT Act came into force.

[2] Lekim was granted a rebate absolving it from the payment of duty and import tax on the strength of its declared intention that the goods were to be made into garments for export outside the area of operation of the Southern African Customs Union.

[3] Contrary to that declaration of intent, and before the goods had all been made up into garments, Lekim sold and transferred a quantity of completed garments and the remaining rolls of material to Silverside Textiles (Pty) Ltd (in liquidation) ("Silverside"), also a Lesotho company. Silverside thereby became owner of the goods sold and Lekim became liable for customs duty, sales tax and VAT in respect of their importation.

[4] To obtain security for payment of Lekim's sales tax and VAT debt ("the tax debt") the Lesotho Revenue

Authority ("LRA") seized the goods in Silverside's possession in November 2003. The LRA sought to justify the seizure by reliance on the identical seizure provisions in the GST and VAT Acts and on the relevant terms of the Customs and Excise Act, 1982 ("the Customs Act").

[5] The liquidator of Silverside ("the liquidator") thereafter paid the customs duty but the tax debt remains unpaid.

[6] In June 2005 the LRA sued the liquidator in the High Court (CIV/T/254/05) for payment of the tax debt. Having been presented with an agreed stated case for his decision, the trial Judge (Peete J) held, in effect, that there had been lawful seizure in terms of the Customs Act but that Silverside, having been an innocent purchaser, was not liable for "import tax" and the claim therefore failed.

[7] On appeal to this Court by the LRA the primary issue was not whether Silverside was liable for the tax debt but whether it was liable to the seizure, the constitutionality of the seizure coming into contention by reason of Silverside's having been at all times unaware of Lekim's non-payment of the tax debt. The existence of this constitutional question led to the remittal of the matter to be dealt with by the High Court exercising its constitutional jurisdiction. An appropriate application was duly brought in that jurisdiction (CC 5/2009) for a declarator that the seizure provisions in the GST and VAT Acts were unconstitutional or liable to a construction that avoided unconstitutionality.

[8] In a judgment concurred in by the other members of a three-Judge panel, Majara J held that the seizure provisions, properly construed, were not unconstitutional. Hence the present appeal by the liquidator.

[9] There are thus, in effect, two appeals in this matter and they raise essentially two questions for decision. The first is the constitutional one and the second is whether the goods seized were the goods to which the tax debt related. Put another way: were the goods seized the goods imported?

[10] In what follows only the VAT Act provisions need be referred to. They are contained in s 41 (1):

> "The Commissioner may seize any goods in respect of which the Commissioner has reasonable grounds to believe that value added tax that is, or will become, due and payable in respect of the supply or import of those goods has not been, or will not be, paid."

[11] It is not in dispute that Lekim and no other entity or person was liable to pay the tax debt. It is also clear that the tax debt related to the goods which Lekim imported. It

should be observed that the appeal concerns only import VAT, not supply VAT.

[12] The case for the liquidator is, first, that the seizure provisions offend against s 17 (1) and (2) of the Constitution and that even if they qualify to be saved from unconstitutionality by the terms of s 17 (4) (a) (i) they are not so rescued because they are not, in the words of the latter sub-paragraph, "necessary in a practical sense in a democratic society". In the latter regard the onus, so it was said, was on the LRA to show such necessity and it had not been discharged. Second, the liquidator contends that even if the provisions were necessary in some situations they were not necessary in the case of a so-called innocent purchaser. Third, it was submitted that as only about a quarter of the imported goods formed the subject of the

sale to Silverside the remaining goods sold, being manufactured garments, were not liable to seizure.

[13] The Constitution says that no property shall be taken possession of compulsorily except where certain conditions (not applicable in this case) are satisfied (s 17 (1)) and that such taking is subject to payment of compensation (s 17 (2)). Section 17 (4) then provides (where relevant):

> "Nothing contained in or done under the authority of any law shall be held to be inconsistent with or in contravention of subsection (1) or (2) –
>
> (a) to the extent that the law in question makes provision that is necessary in a practical sense in a democratic society for the taking of possession or acquisition of any property ..... -
>
> (i) in satisfaction of any tax ....."

[14] As mentioned, the goods seized were the property of Silverside whereas the tax debt was the liability of Lekim.

The additional vital fact, however, is that the goods seized were, at least in part (the remainder being subject to what follows) goods to which the tax debt related. They were goods in respect of which tax was payable. There was therefore a significant nexus between the tax debt and some of the seized goods.

[15] The existence of that connection distinguishes the seizure provisions here from those held in the South African case of First National Bank of SA Ltd t/a Wesbank v Commissioner, South African Revenue Service and Another 2002 (4) SA 768 (CC) at 814-815 to be overbroad in permitting a result grossly disproportional to the infringement of the property rights subject to the seizure concerned.

[16] There was thus in this matter a rational connection between the goods and the seizure. Moreover, the object of the seizure was to exact payment of a tax debt. As said in the case just referred to, exacting payment of a debt due to the revenue is a "legitimate and important legislative purpose, essential for the financial well-being of the country and in the interest of all its inhabitants" (see 814 H).

[17] The question then is whether seizure of property belonging to a third party, as opposed to the tax debtor, can be said to be "necessary in a practical sense in a democratic society". Such a society guarantees property rights and regulates their deprivation by fair measures. The Constitution and subsections (1) and (2) of s 17 in particular evince the intention to establish and maintain just such a society in Lesotho. And, as pointed out,

recovery of tax debts is a legitimate and important purpose aimed at the maintenance of that society.

[18] It was submitted for the liquidator that the onus was on the LRA to establish that such necessity existed. As I understood him, counsel for the LRA did not contend to the contrary but urged that the case for practical necessity had been made out.

[19] In this regard counsel for the liquidator argued that the statements made in the affidavit deposed to by the Commissioner General of the LRA were ex cathedra, unhelpful and lacked specificity.

[20] Summarised, the Commissioner General's deposition was to this effect. VAT evasion is common and extremely difficult to control and VAT is one of the country's main

sources of revenue. Because tax debtors frequently evade payment it becomes necessary to target the goods to which the tax debts relate. The goods are by then in the possession of third parties who commonly do not have proof of payment of tax by the tax debtors. When confronted by the LRA they shift attention to the tax debtors, from whom the goods were acquired. The tax debtors being by then untraceable more often than not, recovery of VAT becomes impossible in the vast majority of cases. Even if traced they are often unable to pay – as in the case of Lekim. The constant pursuit of tax debtors occasions a major and unaffordable expense. Faced with seizure, however, third parties, having become owners of the goods, are in most cases willing to pay the tax debt rather than part with the goods. Without the seizure provisions the LRA would lose very substantial sums and the absence of the provisions would aid not only

purchasers such as Silverside that were ignorant of non-payment of the tax debts but also those who bought in the knowledge of non-payment.

[21] That account by the Commissioner General was criticized by counsel for the liquidator as fatally deficient in statistical details. Apart from the undisputed assertion that the LRA was not in possession of such details, it seems to me that the unchallenged evidence for the LRA – and accepting that it bore the onus – cannot fairly be disparaged as ex cathedra and unhelpful. On the contrary, it established to my mind that the seizure provisions are a practical necessity.

[22] In addition there is the consideration that it is a readily practical expedient available to the third party who buys in bulk from an importer-tax debtor to demand from

the latter production of an official LRA receipt. It was argued for the liquidator that this is not how businessmen operate. That is not an acceptable answer. If the importer insists on acceptance by the buyer within a time-frame which does not permit production of a valid receipt the buyer will knowingly accept the risk of seizure if it then buys. One might add that this consideration serves to demonstrate that if Silverside failed to raise the matter of a tax receipt its ignorance of the tax debt could hardly be said to have rendered it an "innocent purchaser" in the sense of one entirely blameless. Be that as it may, the blameworthiness or not of the third party's state of mind has no bearing on the issues in this case for in my view the seizure provisions in the VAT Act are not unconstitutional either in themselves or when applied to the case of a third party buyer ignorant of the tax debt.

[23] Turning to the second question, there was indeed a change in the appearance and nature of the greater portion of the imported goods. By a process of manufacture they had been substantially transformed into garments such as T-shirts, trousers, children's clothing, pyjamas, ladies' vests and dresses. At the same time no evidence on record shows or even tends to show that the made up goods consisted of anything but the imported materials. In other words the manufactured goods were, by necessary inference, identifiable as consisting of nothing but the imported materials. The imported materials were, of course, the goods in respect of which Lekim's tax debt was due.

[24] Prior to the hearing before Peete J the parties formulated an agreed special case. In terms of their agreement if VAT was payable on the value of the fabric

and garments it had to be calculated on the value of the fabric and garments as imported. (They also referred to customs duty, a subject which is presently irrelevant.) The liquidator undertook to provide security to the satisfaction of the Commissioner in a stated amount of VAT pending determination of his liability to pay "such tax". To enable the High Court to determine if such liability existed, the special case embodied the parties' rival contentions. That of the liquidator was that the imported goods on which VAT was payable by Lekim were rolls of material whereas the vast majority of the seized goods were garments made from such material and were not the goods imported. The LRA's contention, on the other hand, was that Silverside was liable for the VAT that Lekim should have paid and that such VAT was calculable on a reconstruction of the amount of imported fabric in the garments. Peete J did not resolve that dispute and, as mentioned above, held that Silverside

was not liable for "import tax" because it had "innocently purchased" the goods later seized.

[25] The question in issue is therefore this. Do the seized goods fall within the ambit of the words "any goods" in s 41 (1) of the VAT Act if it is clear that the later words in the subsection – "those goods" – plainly refer to the imported unmade up goods on which the tax debt was due?

[26] Counsel for the LRA submitted in this regard that the tax sought from Silverside was not calculable on the value of the goods seized but the value of the materials imported and that Silverside was not liable for its own debt but that of Lekim. The fallacy there is that Silverside (and the liquidator) had no liability in law to pay Lekim's debt. All that Silverside was liable to was seizure of the imported goods.

[27] In answering the question posed in the preceding paragraph one cannot, in my view, ignore two considerations. First, the imported materials were intended to be used in the manufacture of clothing. They were intended to become specific articles, not random aggregates of imported materials. Second, neither in ordinary parlance or the commercial world is a manufactured garment regarded or defined as the sum of its component parts. It is called, and traded as, a shirt or a dress, as the case may be. In my opinion, therefore, the completed garments seized were no longer the goods imported albeit that they were made of the imported materials. They had become something else. The tax debt was due on the materials as imported, not on the manufactured garments which were the result of the expenditure of time, labour and skill on the imported materials. These conclusions are supported by the case of

Minister of Finance v Bacher Aron & Co (Rhod) Ltd 1956 (1) SA 63 (S.R.) where the question was whether alteration of imported clothing with a view to its resale involved manufacture. Statements were made (at 64H) and approved (at 65A-B) to the effect that manufacture involves transforming an article into something substantially different by effecting "a very great change" in the character of the component materials.

[28] I accordingly hold that the made up garments were not liable to seizure and that only the remaining goods seized were so liable. The evidence is not clear as to the exact percentage proportion of unmade up materials to made up garments but it would be fair to say the unmade up materials constituted a quarter of the total import.

[29] The two questions in issue in this appeal having been thus answered, the appeal against the order of the High Court in case CC 5/2009 must fail. The declarator sought there was confined to the constitutional issue on which the LRA has succeeded in both courts. As regards costs, the case started as a commercial claim and was opposed on commercial grounds. When Peete J's order was taken on appeal it was as a result of this Court's pointing out that a constitutional issue was involved that resulted in the liquidator applying, on remittal, for a constitutional declarator. This was not a case of a substantial constitutional challenge of a public nature. The liquidator did not set out to challenge the relevant statutes in the public interest. The case remained an essentially commercial one. Costs should follow the result. (Road Transport Board & Others v Northern Venture Association, LAC (2005-2006) 64 at 71 E-G; Khathang-Tema-Baitsokoli

& Another v Maseru City Council & Others LAC (2005-2006) 85 at 98 C-E; Tsepe v Independent Electoral Commission & Others LAC (2005-2006) 169 at 188 D-H; Minister of Labour and Employment & Others v Tseuoa LAC (2007-2008) 289 at 302 G-J.

[30] In case CIV/T/254/05 Peete J dismissed the claim by the LRA on the basis, as I have said, that Silverside was not liable for import tax because it had innocently bought the goods sold.

[31] Although not liable to pay Lekim's debt, the liquidator, in response to Silverside's liability for seizure, put up security precisely to avoid seizure. The stated case and the agreement to put up security were before the learned Judge. The liquidator's contention that the seized goods were in the main not the imported goods was included in

the stated case. Accordingly the LRA was entitled at least to declaratory relief that seizure was competent in respect of a quarter of the imported goods and that the LRA therefore had the right to execute on the security to the extent of a quarter of the sum put up. That would have constituted substantial success in the action and have justified costs being awarded to the LRA. The appeal must therefore succeed to that extent.

[32] The order of this Court is accordingly as follows:

1. The appeal against the order in High Court constitutional case CC 5/2009 is dismissed with costs.

2. The appeal against the order in High Court case CIV/T/254/05 is allowed with costs. The order of the court below is set aside and in its stead there is substituted the following:

"It is declared that the seizure effected by the plaintiff was legally competent in respect of one quarter of the quantity of the goods imported by Lekim Textiles Pty Ltd (in liquidation) and that the plaintiff is entitled to execute on one quarter of the amount of security put up by the first defendant. The first defendant is ordered to pay the costs of the action."

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C.T. HOWIE
JUSTICE OF APPEAL

I agree:

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M.M. RAMODIBEDI
PRESIDENT OF THE COURT OF APPEAL

I agree:

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J.W. SMALBERGER
JUSTICE OF APPEAL

I agree:

_____

D.G. SCOTT
JUSTICE OF APPEAL

I agree:

_____

I.G. FARLAM
JUSTICE OF APPEAL

For the Lesotho Revenue Authority in both appeals : Adv H.P. Viljoen SC

For the Liquidator in both appeals: Adv R.A. Suhr