



THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 20192/14

In the matter between

Reportable

**THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE**

FIRST APPELLANT

and

STEPNEY INVESTMENTS (PTY) LIMITED

RESPONDENT

Neutral citation: *Commissioner for the South African Revenue Service v Stepney Investments (20192/14) [2015] ZASCA 138 (30 September 2015)*

Coram: Navsa, Shongwe, Majiedt and Mbha JJA and Van der Merwe AJA

Heard: 8 SEPTEMBER 2015

Delivered: 30 SEPTEMBER 2015

Summary: Tax – determination of base cost of shares in terms of Eighth Schedule to the Income Tax Act 58 of 1962 for capital gains tax purposes – 4.37% of shares in company disposed of – market value of shares on valuation date to be determined – whether discount cash flow valuation method appropriately applied by taxpayer.

ORDER

On appeal from: Tax Court of South Africa, Cape Town (Yekiso J sitting as President of the Tax Court):

1. The appeal is upheld with costs, including those of two counsel.
2. The order of the Tax Court is substituted with the following:
 - ‘(a) The appeal is upheld.
 - (b) The additional assessments in respect of the 2002 and 2003 tax years of assessments are hereby set aside.
 - (c) The matter is remitted to the Commissioner for the South African Revenue Service for further investigation and assessment.
 - (d) The Commissioner is ordered to pay the costs, including those of two counsel where so employed’.

JUDGMENT

MAJIEDT JA (Navsa, Shongwe and Mbha JJA and Van der Merwe AJA concurring):

[1] Capital gains tax was introduced on 1 October 2001 through the insertion of s 26A and the addition of the Eighth Schedule (the Schedule) to the Income Tax Act 58 of 1962 (the Act). Where a capital gain accrues on the disposal of assets in the seller’s possession on, or acquired after, 1 October 2001, capital gains tax is payable. The tax payable is determined by a calculation of the difference between the proceeds of the sale and the base cost of the asset disposed of. At issue in this appeal is whether the Tax Court of South Africa, Cape Town, (Yekiso J sitting as President of the Tax Court),

was correct in setting aside the additional assessments raised by the appellant, the Commissioner for the South African Revenue Service (the Commissioner) against the respondent, Stepney Investments (Pty) Ltd (Stepney), in respect of the 2002 and 2003 years of assessment for capital gains tax. This requires a determination whether Stepney had proved the base cost of the asset disposed of during those years of assessment, namely 4.37% of the shares it had held in Emanzini Leisure Resorts (Pty) Ltd (ELR). This appeal is with the leave of the Tax Court in terms of s 86A(2) of the Act.

The legislative context

[2] The shares disposed of were a pre-valuation date asset as defined in paragraph 1 of the Schedule, ie an asset acquired prior to 1 October 2001 and not sold prior to that date. Paragraph 25 of the Schedule provides that '[t]he base cost of a pre-valuation date asset . . . is the sum of the valuation date value of that asset, as determined in terms of paragraph 26, 27 or 28 and [certain other expenditure]' Stepney elected in terms of paragraph 26(1)(a) to utilise 'the market value of the asset on the valuation date, as contemplated in paragraph 29, of the Schedule' as the method of determining the value of the shares as at 1 October 2001¹. Paragraph 29(1)(c) provides that the market value on the valuation date of the shares would be 'the market value determined in terms of paragraph 31 on valuation date' (the paragraph 29 market value). Such market value would, in terms of paragraph 31(1)(g), be 'the price which could have been obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market'.

[3] The contention advanced by Stepney was that it had sustained a loss in respect of the disposal of the shares because the aggregate base cost of the shares had exceeded the amount of the disposal proceeds. It placed a value of R8 686 162 on the aggregate base cost, calculated as 4.37% of the

¹ Paragraph 26(1) of the Schedule provides that a taxpayer may elect one of three methods to determine the valuation date value of the asset, the first of which is the market value (para 26(1)(a)).

paragraph 29 market value of the total ELR shares, namely R198 768 000. This valuation of the total ELR shares emanated from a valuation conducted by Bridge Capital Services (Pty) Ltd in respect of all the ELR shares (the Bridge valuation), undertaken for all companies in the Tusk group (which included ELR) in order to determine the base cost of the various assets of the group as at 1 October 2001 for capital gains tax purposes. Purportedly acting in terms of paragraph 29(7)(b) of the Schedule², the Commissioner adjusted this valuation to nil. In additional assessments raised on 10 April 2007 as a consequence of this adjustment, Stepney was assessed for a capital gain of R2 million in its 2002 year of assessment and for a capital gain of R2.2 million in its 2003 year of assessment in respect of its disposal of the shares during those years. The Commissioner disallowed Stepney's objection to these additional assessments, but the Tax Court set aside this disallowance³.

The factual context

[4] Stepney originally held 23.73% of the shares in ELR. The latter was mainly engaged in developing, owning and operating casinos, hotels and related leisure activities. The Kwazulu Natal Gambling Board (the Gambling Board) awarded a casino licence to ELR on 21 August 2000 for a period of 15 years in respect of a defined area, namely Richards Bay. Complications arose subsequently when members of a religious grouping, known as the Richards Bay Ministers' Fraternal, litigated against ELR in respect of the site where the casino was to be erected. The awarding of the casino licence itself was, however, not in issue. The litigation, which ultimately reached this court and in which the Richards Bay Ministers' Fraternal was unsuccessful, caused considerable delays in the establishment of the casino at Richards Bay. Consequently, ELR acquired an alternative site at Empangeni under a temporary licence issued by the Gambling Board on 4 October 2001. At the

² Paragraph 29(7)(b) reads:

'(7) The Commissioner may, notwithstanding any proof of valuation submitted by a person to the Commissioner . . .

(a) . . .

(b) where the Commissioner is not satisfied with any value at which an asset has been valued, the Commissioner may adjust the value accordingly'.

³ In terms of s 3(4)(g) of the Act.

time of the valuation for capital gains tax purposes, ELR was in possession of a permanent casino licence which it was unable to utilise and was in the process of acquiring a temporary licence.

[5] The Bridge valuation lies at the heart of the dispute whether the value placed on ELR (and *a fortiori* the determination of the aggregate base cost of the shares disposed of) was reasonable. In this regard Stepney bore the onus of proving that its valuation of the shares disposed of is correct⁴. In the Tax Court it called a number of witnesses to discharge this onus, the main one being an expert, Mr Pieter Veldtman of Bridge Capital Services, a chartered accountant and an accredited sponsor and designated advisor in respect of JSE matters and listed companies. One of his specialities is the valuation of unlisted shares. The Commissioner, in turn, adduced the evidence of several witnesses to meet this case, the most important of whom were Professor Harvey Wainer and Mr David Costa who, like Mr Veldtman, are chartered accountants. Prof Wainer is also an expert valuer of companies and businesses, having lectured on the subject for more than 20 years and having done several hundred such valuations. Mr Costa is a SARS employee based in Port Elizabeth, responsible for large and complex audits.

The evidence

[6] Before setting out the evidence adduced by the various witnesses, it is necessary to mention certain significant features of the case as it unfolded in the Tax Court. These were emphasized by Stepney's counsel during argument. Firstly, the Bridge valuation was done by utilising the discount cash flow (DCF) valuation method. This was contended to be the most appropriate method in respect of the valuation of an asset such as shares. It entails valuing the business of an entity on its future forecast free cash flows, discounted back to present value through the application of a discount factor. The Commissioner, on the other hand, in adjusting the base cost valuation to nil, utilised the net asset value (NAV) valuation method. It was implicitly

⁴ Section 102(1)(e) of the Tax Administration Act 28 of 2011.

conceded in the court below that this valuation method was inappropriate and that the DCF method should have been used. The concession was properly made. It has the consequence that Mr Costa's evidence on behalf of the Commissioner became largely irrelevant, as is the case with that of Mr Christiaan Vorster for Stepney, which evidence was led solely for the purpose of justifying the adoption of the DCF, as opposed to the NAV, methodology. And it has a direct bearing on the second striking feature of the case, namely the nature of the evidence of Prof Wainer.

[7] Not only did the Commissioner concede that the wrong methodology was utilised by his official, Mr Costa, but Prof Wainer's mandate was also narrowly circumscribed, namely to analyse the Bridge valuation and to subject it to criticism. No separate independent valuation was done by Prof Wainer or anyone else on behalf of the Commissioner. Prof Wainer compiled his report in 2013, some nine years after the Bridge valuation. He listed numerous shortcomings in the Bridge valuation, an aspect to which I shall revert presently. But ultimately the Tax Court had before it only the Bridge valuation, which was subjected to extensive criticism by Prof Wainer.

[8] The evidence of the lay witnesses on behalf of Stepney was largely common cause. The narrative advanced by Mr Thabo Mokoena, a former executive director in the Tusk group of companies, Mr David Hirschowitz, Stepney's general manager and Mr Jeremy Franklin, the former chief executive of the Tusk group, which was later taken over by Peermont Global, can be summarized as follows. With the advent of democracy and following the abolition of the former homelands, Sun International, a major international leisure group, had to dispose of some of its casino businesses, in line with the new casino licences regime. Mr Franklin and some of his fellow Sun international employees at that time established the Tusk group to explore new casino opportunities flowing from Sun International's disposal of some of its casinos. The Tusk group became one of the major shareholders in ELR, together with Stepney and an empowerment consortium. One of the entities in the Tusk group, Tusk Casino Hotel Management, was contracted by ELR to manage the Richards Bay casino. As stated, ELR had acquired a casino

licence for Richards Bay for a period of 15 years, which it was unable to utilise until the litigation with the Ministers' Fraternal was concluded. In the interim it acquired a temporary licence on 4 October 2001 and operated a temporary casino at Empangeni. A valuation of the assets of all the corporate entities in the Tusk group (including ELR) was undertaken by Bridge Capital on 25 August 2004 for capital gains tax purposes. This valuation was done utilising the DCF method and having regard to financial projections prepared by Deloitte Consulting Group (Deloitte) and information provided by Tusk management for ELR's submission to the Kwazulu Natal Gambling Board for a temporary casino licence at Empangeni. That application was dated 10 July 2001. Ancillary information was given to Bridge Capital by Messrs Mokoena and Franklin and the rest of the Tusk group's management to compile the valuation report.

The Bridge valuation

[9] Mr Veldtman, who was responsible for the Bridge valuation, testified about it. He confirmed having used the DCF methodology and that he had relied on information from Tusk management, including the financial projections prepared by Deloitte. The market value of the assets of all the entities in the Tusk group, including ELR, was determined in accordance with the relevant provisions of the Schedule for capital gains tax purposes. These assets were unlisted shares. He explained and motivated his determination of the future forecast cash flows and the discount factor that he had applied. On behalf of the Commissioner Mr Costa issued a letter of audit findings to explain why the Bridge valuation was not accepted. He advanced two main reasons for the rejection of the Bridge valuation and for the raising of additional assessments. The first was that the DCF valuation method was wrongly utilised for the determination of the market value of the shares and, second, that the forecasts used by Mr Veldtman for purposes of the valuation were not reliable. The Tax Court found that the Commissioner did not advance the unreliability of the financial projections and assumptions made in the Bridge valuation as one of the factors that had been taken into account in raising the additional assessments. The Commissioner's primary contention

before us was that Stepney had failed to discharge its onus to establish the validity or reliability of the projected revenue utilised by Mr Veldtman in compiling his valuation. Stepney also contended that the Commissioner impermissibly sought to change the grounds of assessment which it sought to have upheld in this court.

[10] Mr Costa's criticism of the Bridge valuation was along the following broad grounds:

- (a) the financial projections were made in perpetuity, and not for the limited 15 year period of the casino licence;
- (b) the estimates were not based on a trading history as ELR was a 'greenfields operation' at the valuation date, 1 October 2001;
- (c) the estimates utilised by Bridge Capital was made in 2000 before the temporary casino was erected; and
- (d) it failed to factor in the effects of the September 11 terrorist attacks in the USA.

[11] Prof Wainer's main criticisms of the Bridge valuation were as follows:

- (a) in valuing the shares Mr Veldtman failed to apply a discount based on the fact that they were 'minority' shares;
- (b) the validity or reliability of the information collated in the valuation spreadsheet containing the financial projections was fundamentally flawed in several respects, namely the projected tax, projected revenue, projected working capital and the terminal value; and
- (c) an incorrect date was used.

Before I discuss these criticisms, a brief consideration of the applicable legal principles is apposite. First, I consider two legal principles which Stepney vigorously advanced as preliminary aspects and, second, consideration will be given to the nature of expert evidence.

The law

[12] Stepney submitted that on appeal against a decision of the Tax Court this court has limited, narrowly circumscribed powers. It placed reliance on the following dictum in *Commissioner of Inland Revenue v Da Costa*⁵:

'[I]f a decision of a Special Court is based on the exercise of a discretion, this Court will interfere only if the Special Court did not bring an unbiased judgment to bear on the question, or did not act for substantial reasons, or exercised its discretion capriciously or upon a wrong principle: *Ex parte Neethling and others* 1951 (4) SA 331 (A) at 335'.

The submission is misconceived and the passage from *Da Costa* is quoted out of context.

[13] In *Da Costa*, Van Heerden JA in fact held that there is 'a full right of appeal against any decision of a Special Court on issues of fact or law'.⁶ In this regard the learned Judge referred to s 86A of the Act, as inserted by Act 103 of 1976, where this full right of appeal had been enacted. Reference was also made to *Hicklin v Secretary for Inland Revenue*⁷ where Trollip JA held that under s 86A:

'The appeal is . . . a re-hearing of the case in the ordinary, well-known way in which this Court, while paying due regard to the findings of the Special Court on the facts and credibility of witnesses, is not necessarily bound by them.'

The excerpt from *Da Costa* and the reference to *Ex parte Neethling*⁸ must be understood in the proper factual context. *Neethling* concerned the sale of immovable property which was subject to a fideicommissum in favour of certain minor children. As upper guardian the Provincial Division was called upon to consider, in the exercise of its discretion, whether the proposed deed of sale was in the interests of the minor children. It is in this context that this court considered whether the Provincial Division had exercised its discretion

⁵ Per Van Heerden JA in *Commissioner of Inland Revenue v Da Costa* 1985 (3) SA 768 (A) at 775 F-G; (14/1984) [1985] ZASCA 32; [1985] 2 All SA 335 (A).

⁶ At 775C.

⁷ *Hicklin v Secretary for Inland Revenue* 1980 (1) SA 481 (A) at 485F; [1980] 1 All SA 301 (A).

⁸ *Ex parte Neethling & others* 1951 (4) SA 331 (A); [1951] 4 All SA 231 (A).

capriciously or upon a wrong principle, or whether it has not brought its unbiased judgment to bear on the question or had not acted for substantial reasons. And it is in this context that the passage from *Da Costa* above, relied upon by Stepney, must be understood. Stepney incorrectly categorized the matter before us as a 'review'. It is not, as outlined above it is a full appeal.

[14] The second preliminary aspect concerns Stepney's contention that the Commissioner impermissibly sought to change the grounds of assessment. In this regard reliance was placed on *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd & others*.⁹ Stepney's argument proceeded along these lines that the original grounds of assessment was limited to those enumerated in SARS' statement of the grounds of assessment in terms of Tax Court Rule 10(3). SARS could not subsequently alter those grounds by, for instance, conceding that the DCF method was the correct valuation method and in then seeking to assail this method on various grounds. The contention cannot be upheld. Rule 12 of the Tax Court Rules provides that the issues before the Tax Court are those adumbrated in SARS' statement of grounds of assessment under Rule 10, together with those outlined in the taxpayer's statement of grounds of appeal in terms of Rule 11. In paragraphs 4, 9, 20 and 23, in particular, of the statement of grounds of assessment SARS pertinently raised the issue that Stepney's market value of the relevant ELR shares had been 'overstated/inflated' for purposes of determining the base cost of the shares. SARS set out a summary of the reasons why it took this view. It had therefore not merely confined itself to the methodology utilised, DCF versus NAV, but it had pertinently challenged the premise underlying Stepney's valuation in several respects. *Brummeria* is entirely distinguishable on the facts. There the Commissioner had issued original assessments in March 2000 and revised assessments in March 2002. Consequent to an objection in April 2002 by the taxpayer (*Brummeria*) to the revised assessments, the Commissioner issued further revised assessments in July 2004. Like the first revised assessment, the further revised assessment had an entirely different basis than the original assessment.

⁹ *Commissioner, South African Revenue Service v Brummeria Renaissance (Pty) Ltd & others* 2007 (6) SA 601 (SCA); (391/06) [2007] ZASCA 99; [2007] 4All SA 1338 (SCA).

Brummeria's contentions that the further revised assessments were out of time (s 79(1)(c)(i) of the Income Tax Act 58 of 1962, as it read at that time, precluded the Commissioner from raising a further assessment after the expiration of three years from the date of the first assessment (unless he was satisfied that there was fraud, misrepresentation or non-disclosure of material facts) were upheld on appeal. Cloete JA said that:

' . . . once the Commissioner changed the entire basis of the assessment in the further revised assessments, he allowed Brummeria's objection to the revised assessments in full as contemplated in s 81(5) and, as no fraud, misrepresentation or non-disclosure is relied upon, that is the end of the matter. I therefore consider that the Commissioner was precluded by the provisions of s 79(1) read with s 81(5) of the Act from raising the assessments against Brummeria'

The reliance on *Brummeria* is therefore misplaced.

[15] In April 2006 the Commissioner challenged the Bridge valuation. By letter dated 5 July 2007 Stepney lodged detailed objections to the letter of assessment of 10 April 2007. It pointedly addressed various aspects raised in the letter of assessment, namely the unresolved litigation against the Ministers' Fraternal and the delay in trading operations as at 1 October 2001. Stepney also motivated fully why the Bridge valuation is correct. The dispute was thus clearly understood by all concerned to go beyond the mere valuation methodology. And on 30 April 2013 the Commissioner amended the statement of grounds of appeal as follows:

'Even if the Net Asset Value method were to be considered less appropriate or not appropriate at all, and the Discounted Cash Flow Model considered more appropriate, the valuation of the shares remains overstated / inflated for the reasons mentioned in paragraphs 20 and 23 [of the statement of grounds of assessment].'

All the issues were in any event fully ventilated in the Tax Court. There was no objection from Stepney in the Tax Court that the Commissioner had changed the grounds of assessment. Stepney cannot now, on appeal, complain about the widening of the issues, assuming in its favour that there had been any.¹⁰ In the premises Stepney's contention that the Commissioner

¹⁰ *Shill v Milner* 1973 AD 101 at 105.

impermissibly sought to change the grounds of assessment cannot be sustained. The next aspect for consideration is the nature of expert evidence.

[16] The nature of expert evidence and a court's approach to it is well established. In *Coopers (SA) (Pty) Ltd v Deutsche Gesellschaft Für Schädlingsbekämpfung MBH*¹¹, Wessels JA described it thus:

'As I see it, an expert's opinion represents his reasoned conclusion based on certain facts [or] on *data*, which are either common cause, or established by his own evidence or that of some other competent witness. Except possibly where it is not controverted, an expert's bald statement of his opinion is not of any real assistance. Proper evaluation of the opinion can only be undertaken if the process of reasoning which led to the conclusion, including the premises from which the reasoning proceeds, are disclosed by the expert'¹².

More importantly, as Addleson J said in *Menday v Protea Assurance Co Ltd*:¹³

'It is not the mere opinion of the witness which is decisive but his ability to satisfy the Court that, because of his special skill, training or experience, *the reasons for the opinion which he expresses are acceptable* . . . the Court, while exercising due caution, must be guided by the views of an expert when it is satisfied of his qualification to speak with authority and *with the reasons given for his opinion*' (My emphasis).

It was contended on behalf of the Commissioner that Mr Veldtman's evidence did not meet the criteria laid down in *Coopers* and in *Menday*. It was submitted that he failed to give reasons for some of his conclusions and that much of the data upon which he based his conclusions was shown to be fatally flawed. Further that he gave a bald statement of his opinions without providing the underlying reasoning. It was contended that the information on which Mr Veldtman based the valuation was not sound. I discuss those aspects next.

The future forecast free cash flows

¹¹ *Coopers (SA) (Pty) Ltd v Deutsche Gesellschaft Für Schädlingsbekämpfung MBH* 1976 (3) SA 352 (A).

¹² At 371 F-H.

¹³ *Menday v Protea Assurance Co Ltd* 1976 (1) SA 565 (E) at 569B-E; [1976] 1 All SA 535 (E).

[17] As stated, Mr Veldtman testified that he received information from Tusk management, upon which he relied to compile his valuation report. But at the time of the valuation there was other information available which would have had a material effect on the figures. The DCF calculation in the Bridge valuation was not based on the management accounts of 2004, but on the forecast amounts calculated by Deloitte in 2001 as part of the figures submitted to the Gambling Board in respect of the application for a temporary licence. Stepney sought to justify the use of the 2001 Deloitte figures on the basis of them being closer to the time of the valuation date, 1 October 2001. But this approach is fatally flawed inasmuch as the actual figures which were available in 2004 (when the Bridge valuation was done) showed that the figures forecasted by Deloitte in 2001 were unreasonable. As Prof Wainer illustrated in his expert report and in oral evidence, the forecast for 2003 was R49 million, whereas the actual figure was a R61 million negative, ie a variance of R110 million. The actual figures for 2004 constituted only 10% of the 2005 projected figures and only 20% of the projections for 2006 and 2007.

[18] Mr Veldtman also consciously disregarded ELR's letter to the Gambling Board dated 20 March 2003. In the letter, signed by Mr Mokoena on behalf of ELR, the challenges and travails facing the temporary casino at Empangeni was tabulated. Revenue during the nine months of trade was a mere 43% to 46% of budget and this, together with the ongoing litigation by the Ministers' Fraternal, was said to have 'precipitated a major crisis for Emanzini' (ELR). As a result ELR submitted a revised project proposal to the Gambling Board in respect of the permanent casino at Richards Bay in order to 'obviate disastrous consequences'. The letter undoubtedly casts a long shadow over ELR's optimistic forecasts of 2001, and yet no regard was given to it.

[19] Counsel for Stepney argued strenuously that the factors outlined above could not have been taken into account, since to do so would amount to applying hindsight. Taking into account the actual figures which were available in 2004 and having regard to the letter above, would have been eminently reasonable in the circumstances. In doing so Mr Veldtman would have tested the reasonableness and correctness of the projections provided

by management. A valuer cannot just blindly accept at face value figures presented to him or her – there is a duty to assess their reasonableness and correctness. The necessity of assessing the reasonableness of the forecasts was acknowledged in the Bridge valuation. The information available at the time of the Bridge valuation pointed clearly to a significant overstatement of revenue projected in 2001. But, as stated, no regard was given to it. The information was available at the time that the valuation was conducted and the proper perspective is that the valuer was duty bound to have regard to it to interrogate the soundness of management's projections. It was wrong not to take the later information into account. And it resulted in a gross overstatement of the projected revenue forecast which in turn led to a material inflation of value in the Bridge valuation.

[20] The next aspect to be considered is the fact that the wrong date was utilised in the valuation. As this had become common cause in the Tax Court, it can be disposed of briefly. Instead of utilising the valuation date set out in the Schedule (1 October 2001), the relevant figures were calculated in the Bridge valuation with reference to 31 March 2002. The experts (Mr Veldtman and Prof Wainer) had agreed in their joint minute that this mistake had a 10% adverse impact on the valuation, ie approximately R19.8 million on ELR's total valuation and about R860 000 on the valuation of the relevant ELR shares. Whilst relatively small, the adverse impact on the aggregate base cost is self-evident.

[21] In respect of the tax calculations, it is uncontroverted that an understatement of the tax amount would have led to an overstatement of value in the Bridge valuation. The tax calculations emanated from ELR management and was, on his own version, not verified for reasonableness by Mr Veldtman, because he 'felt comfortable' that a 'detailed and rigorous calculation' had been done by management. There was no evidence of this, save for vague assertions by Mr Mokoena that the calculation had been done as 'part of the budgetary process' and 'by applying the norms in terms of tax factors'. The problem is that the tax calculation does not accord with an application of the relevant statutory rates. The matter is exacerbated further

by the fact that the tax calculations in the Bridge valuation, which according to Mr Franklin were made by Deloitte as part of the submission to the Gambling Board, differ from the tax amounts submitted to the Gambling Board as a schedule to ELR's letter of 10 July 2001. Thus, while the Bridge valuation utilised the revenue figures contained in this letter, it strangely and inexplicably did not use the tax amounts it contained. The Bridge valuation thus falls short in respect of the tax calculations as well insofar as there has been an understatement of the tax.

[22] There are material shortcomings in the reliability of the projected capital expenditure as well. The amounts of projected capital expenditure underlying the Bridge valuation were strikingly low – R5 0000 for 2003 and 2006 and nil for 2002 and 2004. The only substantial amount is the approximately R181 million forecast for 2005. This amount was, according to Mr Veldtman, provided for in respect of the permanent casino. No additional capital expenditure for the construction of the temporary casino was taken into account in the Bridge valuation. That amount would have been R71 million according to ELR's letter of 10 July 2001 to the Gambling Board. Mr Veldtman testified that the expectation was for little or no capital expenditure to have been invested in the temporary site. Not only was this in direct conflict with the aforementioned letter, but it was also out of kilter with the facts available at the time of the Bridge valuation. The temporary casino was to be housed in a building previously owned and operated by Clover Dairies as a distributing warehouse. It is self-evident, and in any event plain from Mr Mokoena's testimony, that substantial construction had to be undertaken to convert this site into a temporary casino which was planned to operate for a period of three years. Apart from the failure to include the sum of R71 million for the temporary casino in the capital expenditure forecasts, the Bridge valuation also did not include any substantial amounts for ongoing capital expenditure for the maintenance of buildings, furniture and fittings.

[23] Stepney's counsel conceded during argument that there were flaws in the capital expenditure forecasts in the Bridge valuation, but contended that these aspects had not been put to Mr Veldtman during cross-examination.

This contention loses sight of the fact that the ELR letter of 10 July 2001 to the Gambling Board and the accompanying schedules reflecting the figures came to the fore only when Mr Franklin testified, ie after Mr Veldtman's testimony. It appeared from Mr Franklin's evidence that he had found these documents in a storeroom at his house long after discovery of documents had been made by Stepney. The criticism is therefore unfounded. In conclusion on this aspect, the understatement of the amounts for capital expenditure impacted materially on the Bridge valuation.

[24] A further aspect for consideration in respect of the future forecast free cash flows is the reliability of the terminal value of R527 218 000 which was used in the Bridge valuation. That figure is based on revenue flows into perpetuity. It fails to take cognisance of the term of the casino licence, 15 years. The terminal value was in effect calculated on the basis that there was no risk of the licence not being renewed upon expiry of the 15 year period. This calculation was sought to be justified by Messrs Mokoena and Franklin on the basis that renewal of the licence after 15 years was a mere formality and that only the exclusivity period would expire. The only circumstances imaginable under which the licence would not be extended, Mr Franklin said, would be non-compliance with the licence conditions. This approach is far-fetched and out of touch with reality. There was undeniably some measure of risk attached, for example, changes in attitudes to gambling and in policy and legislation. Prof Wainer is correct, in my view, that allowance should have been made for the risk of non-renewal or, at the very least, the costs associated with a renewal application. In essence, the loss of exclusivity after 15 years should have been taken into account. This fact would of necessity also have an impact on the Bridge valuation.

The discount factor

[25] As stated, an appropriate discount rate must be applied to the projected cash flows for a proper application of the DCF method. The discount factor represents the required return on investment but also the risk inherent in the business. A discount rate of 20.86% had been applied in the Bridge

valuation. This discount factor, also known as the weighted average cost of capital, comprises the cost of equity and the cost of debt. The cost of equity made up 19.92% and the cost of debt 0.95% of the discount factor of 20.86%, ie a cost of equity: cost of debt proportionality of 90:10. Mr Veldtman failed to furnish adequate reasons for applying a risk premium of 15%; he merely gave vague assertions in this regard.

[26] A serious shortcoming is the fact that the same discount rate was applied to all the entities in the Tusk group. The group owned and operated casinos in Mmabatho, Venda, Klerksdorp, Taung and the one in Richards Bay/Empangeni. Self-evidently, the risks in respect of these entities must vary, particularly having regard to the fact that the others were established casinos, whereas the one in the present instance was a start-up or greenfields operation. There were many uncertainties in respect of this new casino – whether it would attract sufficient clientele, the actual cost, when it would start trading and so forth. Mr Veldtman conceded the point that there were varying risks for the various entities and sought justification in the ‘swings and roundabouts’ principle. He however failed to demonstrate how this principle operated in practice in respect of the different casinos. The ELR correspondence addressed to the Gambling Board, referred to above, clearly showed that the temporary casino at Empangeni faced significant challenges, amongst others the low revenues and ongoing litigation. On behalf of Stepney much was made of the fact that Richards Bay was at the time of the valuation one of the fastest growing metropolitan areas in the country. That may be so, but the fact remains that the casino had been established at Empangeni and, in terms of the concentric model of calculating population density and potential clientele, the location of the casino would in the present instance have resulted in the dilution of this consideration. The ‘one size fits all’ approach of Mr Veldtman was clearly inappropriate. The failure to assess the ELR casino separately and with due regard to its own particular risk factors had an adverse impact on the discount factor that was applied.

[27] A further problem is that certain obvious risk factors had been disregarded. These were the unresolved litigation (which by its very nature is

steeped in uncertainty) and the risk of increased construction costs to erect a temporary casino. Whatever legal advice might have been received concerning the strength of Stepney's case in respect of the litigation, a purchaser of the shares would have considered it as an additional risk factor and a valuer would be required to take that into account in applying a discount factor.

Conclusion

[28] It is clear that the Bridge valuation is fatally flawed in the various respects outlined above. A court is entitled to reject a valuation if it is not satisfied with the investigations underpinning it:

'For instance, if the expert added up his figures wrongly, or took something into account which he ought not to have taken into account, or conversely, or interpreted the agreement wrongly, or proceeded on some erroneous principle – in all these cases, the court will interfere'¹⁴.

The Tax Court was wrong in upholding that valuation. As a consequence, Stepney has failed to discharge its onus of proving the paragraph 29 market value and thus also the aggregate base costs of the relevant shares. But counsel for the Commissioner very properly conceded that the value of the shares cannot be nil. There was clearly considerable value attached to ELR's sole asset, the casino licence. It was not seriously disputed that a casino licence which grants the holder exclusive rights in respect of the specified area for a period of 15 years has considerable value and it is in the interests of justice that a proper valuation be calculated. The Tax Court should have remitted the matter to the Commissioner for further investigation and assessment in terms of s 83(13)(a)(iii) of the Act. The grounds of assessment were unreasonable in two respects, namely the incorrect utilisation of the Net Asset Value (NAV) methodology and the Commissioner's valuation of the shares as nil. The former was implicitly conceded in the Tax Court and the latter was conceded at the outset before us.

¹⁴ Per Denning LJ in *Dean v Prince* 1954 (1) All ER 749 at 758.

Stepney is therefore entitled to its costs in the Tax Court in terms of s 130(1)(a) of the Tax Administration Act 28 of 2011.¹⁵

[29] The following order is issued:

1. The appeal is upheld with costs, including those of two counsel.
2. The order of the Tax Court is substituted with the following:
 - ‘(a) The appeal is upheld.
 - (b) The additional assessments in respect of the 2002 and 2003 tax years of assessments are hereby set aside.
 - (c) The matter is remitted to the Commissioner for the South African Revenue Service for further investigation and assessment.
 - (d) The Commissioner is ordered to pay the costs, including those of two counsel where so employed’.

S A MAJIEDT
JUDGE OF APPEAL

¹⁵ Section 130(1)(a) reads as follows:

‘The tax court may, in dealing with an appeal under this Chapter and on application by an aggrieved party, grant an order for costs in favour of the party, if –
(a) the SARS grounds of assessment or ‘decision’ are held to be unreasonable . . . ;’

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