REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT CAPE TOWN)

CASE NO: 0035/2018

(1) REPORTABLE: YES/NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED.

....
DATE SIGNATURE

In the matter between:

XYZ (PTY) LTD APPLICANT

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE RESPONDENT

J U D G M E N T

20 OCTOBER 2020

DAVIS J

Introduction

[1] This case raises the important question as to whether a taxpayer, in this case applicant, can be entitled to default judgment against the South African Revenue Service (the respondent) in terms of Rule 56 of the Tax Court Rules which were promulgated in terms of section 103 of the Tax Administration Act 28 of 2011 (the TAA). In particular, this dispute raises the further question as to the consequences of respondent not showing good cause for its default in complying with an order to respondent to applicant's letter of objection of a full bench of the High Court. Expressed differently, if respondent fails to comply with such a court order, does the taxpayer, which wishes to ensure regularity of its tax affairs, have a viable remedy?

A story of unresponsiveness

[2] This case has a long, torturous and extremely unfortunate chronology. Mercifully it is not necessary to do more than summarise the essential features which gave rise to the present litigation.

[3] In August 2000 the applicant and the Minister of Correctional Services concluded what is referred to as a concession contract, in terms of which applicant was contracted to design and construct and operate a correctional facility in Louis Trichardt. The contract was for a period of 25 years, at the end of which period the facility would be handed over to the State. The initial contract price for the entire project amounted to R303 million but the total contracted amount which was eventually incurred in respect of the construction including equipment costs and financial costs in respect of loan finance professional fees amounted to R460 million. In February 2002 the facility became operational. It seems that the success of the completion of the facility lay in inverse proportion to the difficulties which applicant encountered with regard to assessments raised by the respondent.

[4] After respondent disallowed applicant's objection to the assessment raised for 2002, applicant lodged an appeal with the Tax Court sitting in Pretoria which proved to be successful. That court held that expenditure in an amount of approximately R511 million, which applicant contended had been incurred in relation to the construction of the facility, was deductible, as have been argued by the applicant as it was expenditure which had been incurred in respect of materials and equipment which constituted trading stock in terms of section 22(2)(*a*) of the Income Tax Act 58 of 1962 (the Act).

[5] On 30 November 2011, the Supreme Court of Appeal upheld an appeal by the respondent against the order of the Tax Court, finding that the work of constructing the facility had been subcontracted to a construction company, which was the entity which undertook to provide the goods, material and labour necessary to perform the work concerned as an

independent contractor. Accordingly, it was not the applicant which provided these items used in the construction of the facility nor did it ever own them. It was therefore not permitted to claim a deduction for the costs of these items as they had not constituted part of its trading stock. Suffice to say that revised tax computations were produced in respect of the 2002 to 2004 years of assessment.

[6] The war between the parties was only warming up. A dispute then arose in relation to an assessment which were levied by the respondent on 2 and 3 November 2015 for the 2005 to 2010 and the 2011 to 2012 tax years of assessment respectively. Applicant requested reasons for these assessments to which the respondent replied on 15 December 2015. An application for further and better reasons was then dismissed on 3 June 2016 by the Tax Court in Cape Town.

[7] In May 2016 respondent requested certain information pertaining to the 2013 and 2014 years of assessment which information was duly supplied by the appellant a month later. On 5 July 2016 the applicant's attorney informed the respondent that objections to the 2013 and 2014 assessments would be filed on or before the deadline for doing so, which he calculated as being on 20 July 2016. Applicant's attorney contended that ,as the dispute relating to the 2005 to 2012 years of assessment was applicable to the subsequent years of assessment, an agreement should be reached for the years of assessment from 2013 until the last return filed prior to a "final decision" being reached in respect of the disputed years between 2005 to 2012 .That agreement would provide that in the light of the need for a decision as defined ,prescription should not begin to run from the normal three year period.

[8] On 23 August 2016 applicant's attorney proceeded to lodge identically worded letters of objection in respect of each of the 2013 and 2014 assessments, the express purpose of which was to align these years of assessment with the 2005 to 2012 years; that is to make the objections which had been filed in relation to the earlier years equally applicable to the later years of assessment.

[9] In effect, these letters reflected that applicant objected to the "add back" by respondent in these assessments of what was described as "the capital portion" of the fixed component of the contract price which applicant contended constituted "income" of a capital as opposed to a revenue nature. In addition applicant objected to an adjustment which respondent made whereby the latter had sought to disallow and to reverse an exemption previously granted, which the applicant had sought to claim as an adjusted building allowance pursuant thereto.

[10] According to applicant's calculations, the net effect of upholding these objections would be to reduce its taxable income by some R69.8 million in respect of the add backs and a further amount of R53 783 in respect of the proposed building allowance adjustments for the 2013 to 2014 years of assessment.

[11] Finally, some agreement was reached. On 19 October 2016 the parties entered into a so called prescription agreement, the purpose of which was to extend various time periods which were applicable to the further year of assessments (the 2013 and 2014 years and any subsequent years of assessment thereafter in respect of which a tax return had been filed) prior to a decision being arrived at in relation to the disputed assessments; that is assessments in respect of the 2005 to 2012 years of assessment. The agreement defined "a final decision" to mean a final decision as contemplated in section 100 of the TAA; that is an assessment would become final if an objection was made to it or if one was made, it was subsequently withdrawn or an objection was allowed no appeal was lodged in response thereto, or if an appeal was filed, it was finally determined or if the underlying dispute had otherwise been settled.

[12] The peace did not last long. Further disputes broke out. On 31 January 2017 the applicant lodged an appeal against disallowance of its earlier objections that is those which it had filed in respect of the 2005 to 2012 years of assessment. Notwithstanding various delays, at a meeting on 10 April 2017 it was agreed that respondent would file an opposing statement by 13 June 2017. On 31 May 2017 respondent advised the applicant's attorney that the opposing statement would not be forthcoming by 13 June 2017, as it was considering a without prejudice offer of settlement which had been made by the appellant a few days earlier. Notwithstanding the delay, on 1 June 2017 applicant's attorney advised that it would grant a final extension for the filing of the opposing statement to the 14 July 2017, respondent again did not comply with this deadline.

[13] On 17 July 2017 applicant gave notice that, unless respondent filed its opposing statement within 15 days, that is by 2 August 2017, it would make application for a final order by way of default, whereby the original assessments issued in respect of the disputed years of assessment would be revised and reduced in accordance with the applicants notice of appeal.

[14] Somehow this final notice percolated through the bureaucratic archipelago of respondent. It finally filed an opposing statement on 9 September 2017 without, in anyway, applying for condonation for the late filing thereof. What it did not do was file an answering affidavit by 12 September 2017. This prompted appellant on 13 September 2017 to request the registrar to allocate a date for the hearing of the application by default for a Tax Court.

[15] Sitting in the Tax Court, Cloete J held that respondent had made itself guilty of an egregious breach of the Tax Rules and thus exercised her discretion in favour of the appellant. Accordingly, judgment was granted against the respondent by default in terms sought by the applicant. As the respondent elected not to take this decision on appeal, the order had effectively became final in respect of the disputed assessment; that is between 2005 and 2012.

[16] In keeping with the general conduct of this matter, the order of Cloete J was not the end of the story. Eventually on 2 March 2018 respondent, consistent with its previous dilatory practice, finally confirmed that the 2005 to 2012 assessments has been revised in order to bring them into line with the order of Cloete J. However, insofar as applicant's requested similar revised assessments to be made in the subsequent years, respondent sought the basis upon which such request was made and an explanation as to why the grounds of appeal lodged in respect of the 2013 to 2014 years of objection should be applicable to the 2013 to 2016 years of assessment, in that the validity thereof have never been tested before the Tax Court.

[17] Again the matter came before the Tax Court. This time the applicant was unsuccessful. The Tax Court, per Nuku J, dismissed the application on the grounds that, inasmuch as the applicant's objections for the 2013 to 2014 years of assessment had been delivered out of time, they were invalid and therefore no application could be entertained which sought to uphold them.

[18] This decision was then appealed to the Full Bench of the High Court. It appears that after a brief hearing before the Court on 31 January 2020, the parties consented to an order proposed by the court. The order of the Court reads thus:

> "The respondent shall render a decision in terms of which the appellant is notified, within 60 days from date hereof, of the allowance or disallowance of the substance of the objections which were filed by the appellant in respect of the 2013-2014 years assessment, which notification shall in the case of any disallowance (either partially or wholly), fully set out the basis and ground therefore in terms of ss 106 (4) and (5) of the Tax Administration Act 28 of 2011, read together with Rule 9(1)(*a*) of the Tax Court Rules promulgated in terms thereof.
>
> In the event that the respondent fails to render a decision in terms of the preceding paragraph the appellant shall be entitled to make application in terms of Rule 56(2)(*b*) of the Tax Court Rules to the Tax Court having jurisdiction, on the same papers duty amplified, for a final order in terms of s 129 (2) of the Tax Administration Act 28 of 2011 and/or such further or alternative relief as the Court may deem fit or appropriate.
>
> Each party shall be liable for their own costs in the appeal and in the Court *a quo*."

[19] It is on the strength of this order that the applicant now seeks to invoke Rule 56 of the Tax Court Rules in support of its application for default judgment.

The appellant's case

[20] In terms of the order of the Full Bench, respondent was obliged to allow or disallow the objection within 60 days of the court order, which order was dated 31 January 2020. Computing the time period with reference to business days, respondent was obliged to make a decision and communicate that decision to applicant by no later than 29 April 2020, a date which is conceded to by Ms F, who deposed to an answering affidavit on behalf of respondent. Finally, on 7 July 2020 the respondent disallowed the objection, more than two months out of time.

[21] Mr E, who appeared together with Ms M on behalf of the applicant relied on the provisions of Rule 56 and section 129(2)(*b*) of the TAA to justify the application for default judgment. Rule 56 provides thus:

> "(1) If a party has failed to comply with a period or obligation prescribed under these rules or an order by the tax court under this Part, the other party may –
>
> (a) deliver a notice to the defaulting party informing the party of the intention to apply to the tax court for a final order under s 129 (2) of the Act in the event that the defaulting party fails to remedy the default within 15 days of delivery of the notice; and
>
> (b) if the defaulting party fails to remedy the default within the prescribed period, apply, on notice to the defaulting party, to the tax court for a final order under s 129 (2).
>
> (2) The tax court may, on hearing the application –
>
> (a) in the absence of good cause shown by the defaulting party for the default in issue make an order under s 129 (2); or
>
> (b) make an order compelling the defaulting party to comply with the relevant requirement within such time as the court considers appropriate and, <u>if the defaulting party fails to abide by the court's order by the due date, make an order under s 129 (2) without further notice to the defaulting party</u>."
>
> (My emphasis)

[22] Section 129(2) of the TAA provides as follows:

> "In the case of an assessment or 'decision' under appeal or an application in a procedural matter referred to in s 117(3), the tax court may—
>
> (*a*) confirm the assessment or 'decision';
>
> (*b*) order the assessment or 'decision' to be altered; or
>
> (*c*) refer the assessment back to SARS for further examination and assessment."

[23] Mr E submitted that respondent had responded more than two months late in complying with the order of the Full Bench, to which it had agreed. This dilatory response justified the application of Rule 56 read with section 129(2) of the TAA. In addition this fact needed to be considered against the date on which the applicant had initially filed its objection, namely 23 August 2016, itself a reflection of the unacceptable conduct of respondent.

[24] In support of his submission, Mr E referred to the judgment of Rogers J in the Tax Court (Case Number: 12013/2012; 13 February 2014) at page 3 of the judgment where the learned judge says:

> "SARS, in particular, should take the lead and should display efficiency in the conduct of litigation. It should comply with time periods, and where it does not, it should promptly raise the matter in correspondence, providing reasons and seeking written agreements for extension."

[25] Mr E contended that in the present case respondent had certainly not taken the lead. In its opposing affidavit, it provided two explanations for its clear default; that the request for an extension of time had been made as a result of the impact of the Covid 19 pandemic and secondly that it had requested copy of the concession agreement. In Mr E's view both were totally unacceptable. The difficulty with the first explanation was that the only written request generated by the respondent for an extension of time related to an entirely different dispute between the parties. In any event, there was no agreement to extend the dates. It is also significant that the order of the Full Bench was made on 31 January 2020. The lockdown commenced on 27 March 2020; there was a considerable time prior to the lockdown for the respondent to react to the order and duly comply.

[26] Turning to the question of the concession agreement, the papers indicate that the concession agreement was provided to the respondent in 2010. Mr E contended that the concession agreement did not relate to the issues that were raised in respect of the objections in for the 2013 and 2014 years of assessment. It was therefore irrelevant to the present dispute, a point which hardly was gainsaid by respondent.

[27] Significantly the concession agreement was requested on 21 May 2020 after this matter was set down and the first supplementary affidavit of the appellant filed, that is on 18 May 2020. In terms of Rule 8 where each respondent seeks substantiating documents, these must be requested with 30 days; in this case, given the date of the Full Bench order of 31 January 2020, respondent should have requested these documents by 13 March 2020. All of these facts support the submission of applicant that the request for a concession document was an attempt simply to generate a cause for a further delay, conduct which regrettably has characterised respondent's approach to these assessments from the commencement.

[28] In further support of applicant's case, Mr E referred to the judgment of Cloete J in the Tax Court who found that the dilatory approach of the respondent in the filing of the Rule 31 statement, which is designed to set out its grounds of assessment and its objections to the appeal, was sufficient to justify the application of Rule 56.

[29] In seeking to resist this application, Mr D who appeared together with Ms T and Ms R on behalf of respondents, raised the question of the administrative nature of an assessment. In other words he contended that, until set aside, the assessment of 7 July 2020 was valid. In debate before this court I took him to mean that the *Oudekraal/Kirland* doctrine was thus applicable.

[30] In essence, the doctrine laid out in *Oudekraal Estates (Pty) Ltd v City of Cape Town* 2004 (6) SA 222 SCA and confirmed in *MEC for Health Eastern Cape v Kirland Investments (Pty) Ltd* 2014 (3) SA 481 (CC) and later in *Merafong City Local Municipality v Anglo Gold Ashanti Limited* 2017 (2) SA 211 (CC) laid out a series of important administrative law principles, notwithstanding some blurring of the terrain by way of a series of minority judgments in *Kirland* and *Merafong*. At core the principle set out in *Oudekraal* and confirmed in the latter judgments recognises that administrative action, even though invalid, can give rise to consequences that must be held to lawful. The government, for example, cannot ignore its own binding decisions on the basis that they are invalid. The validity thereof has to be tested in appropriate legal proceedings before the Court.

[31] A decision erroneously taken may continue to hold lawful consequences until set aside properly by a court which considers an application to this effect. That would mean that allegedly unlawful action can only be challenged in properly constituted proceedings before a court and until that happens, in order to adhere to the principle to the rule of law, the decision must stand. The rule of law and the unilateral disregard for a decision simply are incompatible. Cameron J expressed the point thus in *Merofong* at para 43:

> "It expressly recognised that the Oudekraal principle puts a provisional brake on determining invalidity. The brake is imposed for rule-of-law reasons and for good administration. It does not bring the process to an irreversible halt. What it requires is that the allegedly unlawful action be challenged by the right actor in the right proceedings. Until that happens, for rule-of-law reasons, the decision sands."

[32] In the present case, it may well be argued that the effect of the application before this court which, although brought on the basis of a default judgment which is opposed by the respondent which was given notice and which then filed a comprehensive answering affidavit, constitutes the kind of proceedings envisaged. In other words these are proceedings which can result in a setting aside of an invalid administrative act on the part of the respondent which would include a decision to disallow the objection as contained in the letter of 7 July 2020.

[33] As Mr E submitted correctly, the invalidity or as he put it the “purported” disallowance of the objection was in violation of the court order of 31 January 2020. In the present dispute, the source of the invalidity is the late decision of the respondent coupled to what Mr E considered a hugely inadequate basis for condoning the late decision of respondent.

[34] In this case the legal basis by which to set aside that decision and effectively to declare it to be invalid is to be found in Rule 56 which, by virtue of its own wording, provides the Tax Court with a discretion Rule 56(2) provides that “the Tax Court may, on hearing the application …”. In this case there are a series of reasons to decline to exercise a discretion in favour of the applicant. In the first place, although the respondent’s grounds for condonation are not particularly weighty, it is correct that, for at least a month between 27 March 2020 to 29 April 2020 Covid 19, caused a lockdown and with it whole range of unpredicted consequences which affected the administration of respondent as it did the operation of the entire South African economy. In addition, although Cloete J in her judgement adopted the view that the merits of respondent’s case in respect of the years 2005 to 2012 were hardly powerful, there is no argument which was presented to this court as to the merits of the respective cases of the applicant and respondent which pertain to the present dispute.

[35] In short, it is difficult, without more, to assess the merits of the applicant’s case contained in the letter of objection without proper argument and legal justification presented on the papers. The fact that there was no appeal against the order of Cloete J hardly takes the evaluation of the merits of the tax case any further. Thirdly, the refusal to grant default judgment does not constitute the end of the road for the applicant. Far from it. It is entitled to take its case to the Tax Court where it can be properly ventilated and, if there is a merit in its arguments, not only will it succeed in having the assessments overturned but it may well be able to obtain a costs order in its favour in terms of section 130(1) of the TAA.

[36] There is an overarching principle that should guide a court in deciding these questions. The matter involves a significant amount of public money. To determine a case which involves such a significant sum without allowing a proper hearing before the Tax Court which will then determine the merits is to tilt the balance excessively in favour of the taxpayer.

Costs

[37] A significant measure of caution should be exercised in the discretion to award costs. Section 130(2) of the TAA provides that costs must be determined in accordance with the fees prescribed by the rules of the High Court, that is on an attorney and attorney basis and not on an attorney and client basis. However, the Tax Court in a number of cases has awarded costs on an attorney client basis. See ITC 1806; 68 SATC 117; ITC 1816; 69 SATC 62 and ITC 1821; 69 SATC 194.

[38] Manifestly this is a case which justifies a punitive costs order. The approach of respondent, as I have documented, has consistently been dilatory and utterly disrespectful of the rights of the applicant. Indeed, even respondent's heads were delivered 20 minutes before the hearing was to commence. The entire conduct of the litigation against applicant leaves much to be desired. The least that can therefore be done is to ensure that the applicant is not out of pocket for any of the costs that were incurred in the bringing of this application.

[39] Accordingly the following order is made:

1. The application is dismissed.
2. The respondent is to pay applicant's costs incurred in this application on the scale of attorney and client costs.

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DAVIS J