REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

HELD AT MEGAWATT PARK, JOHANNESBURG

CASE NO: IT 24606

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

In the matter between:

ABC MINING (PTY) LTD Appellant

and

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE Respondent

J U D G M E N T

Before: Windell J (President); Ms N Mdeletshe (Accountant member); Mr L Coetzee (Commercial member).

INTRODUCTION

[1] The appellant, ABC Mining (Pty) Ltd ("ABC"), appeals against the respondent's ("SARS"), raising of additional assessments and imposition of understatement penalties in terms of the Tax Administration Act 28 of 2011[1] ("the Tax Administration Act"), as well as the levying of interest in terms of section 89*quat*(2) of the Income Tax Act 58 of 1962 ("the Income Tax Act") in respect of the appellant's 2013 and 2014 year of assessment.

[2] In respect of the 2014 year of assessment, ABC claimed expenditure incurred by it in the amount of R287 274 458 for the purchase of, *inter alia*, prospecting rights ("the prospecting rights") from XYZ (Pty) Ltd ("XYZ") as a deduction in terms of section 15(*b*) of the Income Tax Act.[2] ABC contended that the aforementioned expenditure was deductible in terms of section 15(*b*), because it was incurred in relation to prospecting operations or, at the very least, was incidental to ABC' prospecting operations. SARS disallowed the deduction and raised the additional assessment.

[3] ABC objected to the additional assessments, the imposition of understatement penalties and the levying of interest. On 5 October 2017, SARS disallowed the objection and on 16 November 2017, ABC filed a notice of appeal.[3]

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1 Sections 92 and 222 of the Tax Administration Act.

2 **15. Deductions from income derived from mining operations.—**There shall be allowed to be deducted from the income derived by the taxpayer from mining operations—

(*b*) any expenditure incurred by the taxpayer during the year of assessment on prospecting operations (including surveys, boreholes, trenches, pits and other prospecting work preliminary to the establishment of a mine) in respect of any area within the Republic together with any other expenditure which is incidental to such operations: Provided that—

(i) except in the case of any person who derives income from mining for diamonds in the Republic, the Commissioner may determine that any expenditure referred to in this paragraph shall be deducted in a series of annual instalments, so that only a portion of such expenditure is deducted in the year of assessment in which it is incurred, and the residue in such subsequent years of assessment and in such proportions as the Commissioner may determine, until the expenditure is extinguished;

(ii) in the case of any company which derives income from different classes of mining operations, the deduction under this paragraph shall be made from the income derived from such class or classes of mining operations and in such proportions as the Commissioner may determine;

(iii) any expenditure which has been allowed to be deducted from the income of any person in terms of this paragraph shall not be included in such person's capital expenditure as defined in subsection (11) of section *thirty-six*.

3 SARS also disallowed deductions claimed by ABC in terms of section 15(*a*) read with s37(7C) and 36(11)(e) or alternatively, section 11(*a*) of the Income Tax Act in respect of expenditure incurred by it during the 2013 and 2014 years of assessment in the sums of R1 273 206 and R199 150 respectively. The expenditure was in connection with the building of five houses in the W Local Municipality at the request of the Provincial Government ("the donations"). ABC filed a notice of appeal against the disallowance of the donations but has abandoned its appeal in relation to the donations at the commencement of the trial.

[4] The R287 274 458 claimed by ABC included an amount of R3 905 759 for future environmental expenditure which ABC later conceded was not deductible under section 15 of the Income Tax Act. This concession reduced the amount involved in this appeal to R283 368 698.23 (the purchase price of the prospecting rights).

[5] The dispute between the parties ultimately crystallized into a very narrow legal issue, namely, the interpretation of section 15(*b*) of the Income Tax Act. But, before I turn to the interpretation of section 15(*b*), it is necessary to first deal with the pleadings, the evidence and the case the taxpayer was asked to meet. This is so because this appeal is a good example of what can go wrong when SARS adopts an erroneous approach in respect of the audit, the raising of the assessments, and the pleadings.

BACKGROUND FACTS

[6] ABC, is an underground coal mine. It is a South African resident subsidiary company of JKL Mining (Pty) Ltd ("JKL") and was incorporated by JKL in 2002 to house the coal mining operations which would be acquired by JKL from XYZ. On or about 2002, an agreement was entered into between XYZ, JKL and ABC in terms of which XYZ agreed to sell and transfer its mining rights and coal mining operations to ABC as a going concern.

[7] During 2011, XYZ and ABC entered into a further sale agreement in terms of which XYZ agreed to sell its prospecting rights. This agreement was amended and superseded by an "Amended and Restated Sale Agreement" which itself was amended in terms of a number of extension letters signed between 31 August 2012 and 28 March 2012. On 10 May 2013, the "Amended and Restated Sale Agreement" was replaced by the "Second Amendment and Restatement Agreement" which was again amended in terms of an extension letter signed on 23 July 2013.

[8] On 23 September 2013, the "Second Amendment and Restatement Agreement" was amended by the "Third Restatement Agreement". The "Third Restatement Agreement" recorded, *inter alia,* that XYZ was the holder of the "Sale Prospecting Rights" and that it had agreed to dispose of and alienate the Sale Prospecting Rights to ABC, which had agreed to purchase it from XYZ subject to the terms of the agreement and in consideration of the purchase price. To this end, XYZ undertook, to lodge applications with the Minister of Mineral Resources in terms of section 102 of the Mineral and Petroleum Resources Development Act 28 of 2002 ("MPRDA") to amend the "XYZ Prospecting Right" to incorporate and consolidate the "Balance of ABC Colliery North Portion" and "Balance of ABC Colliery South Portion". The "XYZ Prospecting Right", the "XYZ (Balance of ABC Colliery) Prospecting Right" and the "ABC Mining Right" were contiguous to one another. To give effect to the sale, XYZ agreed to cede and assign its prospecting rights and obligations to ABC under the Sale Prospecting Rights, who accepted such cession and assignment by means, *inter alia,* of ABC procuring the

execution of the necessary "Notarial Deed of Amendment" to create the "Consolidated ABC Colliery Mining Right". ABC would pay the purchase price, namely, an amount of R283 368 698.23, to XYZ in consideration of the Sale Prospecting Rights.

[9] On 1 October 2013, pursuant to the "Third Restatement Agreement", ABC made an application in terms of section 102 of the MPRDA to amend its mining right to incorporate the area covered by the Sale Prospecting Rights which was granted on or about 26 June 2014. During or about August 2013, ABC commenced prospecting operations in the areas that formed the subject of the Sale Prospecting Rights that were adjacent to its existing mine ("the XYZ area").

THE PLEADINGS

[10] Before this court examines the pleadings in this matter, it is important to have regard to the correspondence exchanged between the parties, and SARS' reasons for raising the assessment in its "Audit Findings" letter dated 9 February 2017 and in its "Finalisation of Audit" letter dated 23 June 2017. In its "Audit Findings" SARS contended as follows in relation to the prospecting rights:

> "**2.1 The facts**
>
> Capital expenditure in the sum of R362 544 816 was redeemed against mining taxable income in the 2014 year of assessment. Included in the capital expenditure was payment for the purchase of prospecting rights amounting to R287 274 458. On 25 April 2013, ABC entered into a purchase and sale agreement with XYZ in order to procure additional reserves that were contiguous to the current registered mining rights held by ABC. In terms of the agreement, ABC purchased certain prospecting rights amounting to R287 274 458 from XYZ.
>
> ABC made application for the conversion and consolidation of these rights to the current registered mining rights held by it in terms of section 102 of the MPRDA. You have indicated in your response that these were claimed under section 15(*b*) of the Income Tax Act.
>
> **2.3 Application of the law**
>
> From the information provided to the Commissioner, it is evident that ABC did not conduct prospecting operations and as such did not incur prospecting expenditure but instead purchased the prospecting rights from XYZ who conducted the prospecting activities.
>
> Section 15(*b*) provides for a 'deduction of <u>expenditure incurred by a taxpayer'</u> (emphasis added by SARS) against income derived from mining operations together with any other expenditure which is incidental to such operations. The purchase of the prospecting rights by ABC does not fall within the ambit of section 15(*b*) of the Act **because it did not conduct such prospecting operations**. Furthermore, it cannot be envisaged to form part of any other expenditure which is incidental to such operations."

(Emphasis added)

[11] In the "Finalisation of Audit", SARS advanced substantially the same contentions as set out in the "Audit Findings" but included the following additional statements:

"(i) According to ABC' response to the "Audit Findings", ABC "conceded to the fact that it did not conduct prospecting operations but instead merely purchased the prospecting rights from XYZ";

(ii) XYZ conducted the prospecting operations and incurred the prospecting expenses and "as such SARS' view remains that ABC did not incur expenses for conducting prospecting operations".

(iii) As stated in the facts above, "an application was made by ABC in terms of s 102 of the MPRDA for the conversion and consolidation of these to the current registered mining rights, [sic] this does not constitute expenditure 'incidental' to the prospecting operations";

(iv) S 15(*b*) provides for a 'deduction of <u>expenditure incurred by a taxpayer'</u> (emphasis added by SARS) against income derived from mining operations on prospecting operations together with any other expenditure which is incidental to such operations. **'The purchase of the prospecting rights by ABC does not fall within the ambit of section 15(*b*) of the Act because it did not conduct such prospecting operations;** (Emphasis added)

(v) The prospecting rights purchased amounting to R287 274 458 were therefore not deductible against income derived from mining operations under s 15(*b*) and 'moreover does not form part of capital expenditure as defined in section 36(11) read with section 15(*a*) and can therefore not be included in the calculation of the redemption allowance in terms of section 36(7C)'."

[12] In the disallowance of objection letter, dated 5 October 2017, SARS stated as follows:

"**2.3 Application of the law:**

The taxpayer conceded to the fact that ABC did not conduct prospecting operations but instead merely purchased the prospecting rights from XYZ, who conducted the prospecting operations and incurred the prospecting expenses.

The application made by ABC in terms of section 102 of the MPRDA for the conversion and consolidation of these rights to the current registered mining rights, does not constitute expenditure "incidental" to the prospecting operations.

Section 15(*b*) provides for a deduction of expenditure incurred by a taxpayer (my emphasis) against income derived from mining operations on prospecting operations together with any other expenditure which is incidental to such operations. The purchase of the prospecting rights by ABC does not fall within the ambit of section 15(*b*) of the Act because it did not conduct such prospecting operations.

2.4 Grounds for objection:

The taxpayer objects to the disallowance of the prospecting rights purchased being regarded as capital expenditure as defined and submits that these prospecting rights are deductible in terms of section 15(*b*) of the Act in that they are "incidental" to the prospecting operations.

2.5 Basis of disallowance of objection:

The taxpayer has submitted that the purchase of these prospecting rights would enable them to conduct further prospecting activities. However, it is evident from the information received as stated in the finalisation letter that an application was made by ABC in terms of section 102 of the MPRDA for the conversion and consolidation of these rights to the current registered mining rights (my emphasis), therefore does not constitute expenditure 'incidental' to the prospecting operations and as such the objection is disallowed."

[13] ABC responded to the disallowance of objection letter in the following manner:

"**Grounds for disputing the disallowance of the deductions ancillary to prospecting operations**

5.1 In the disallowance of the objection, SARS states that ABC Coal did not conduct prospecting operations with regard to the prospecting right it acquired from XYZ. As mentioned above, this is not correct as subsequent to the acquisition of the prospecting right, ABC has conducted prospecting operations in the areas authorised in the prospecting right and plans to drill more holes (for prospecting purposes) in the area.

5.2 Further, it is not clear to us why the fact that ABC has applied for the consolidation and conversion of the prospecting rights to the current registered mining right has any relevance to the issues in dispute. The fact remains that ABC acquired the prospecting right from XYZ in order to conduct prospecting operations in the areas adjacent to its existing mine. Of course, following successful prospecting, ABC intends to carry on mining operations in the area. Thus the consolidation and conversion of the right into ABC's current registered right makes commercial sense, but the consolidation does not mean it is not carrying on prospecting operations in the area."

[14] In the Rule 31 statement ("the Rule 31"), filed on 13 September 2018 in terms of the Rules of the Tax Administration Act,[4] SARS did not repeat the allegation made by it in the "Audit Findings" and "Finalisation of Audit" letters, in relation to the application of section 15(*a*) read with section 36(11) of the Income Tax Act. The relevant portions in the Rule 31 read as follows:

> **"B. ISSUES IN DISPUTE**
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> 9. The dispute is therefore in relation to the following issues:
>
> Prospecting Rights
>
> 9.3. Whether the Appellant was entitled to deductions of the purchase of prospecting rights, amounting to R287 274 458, in terms of section 15(*b*) of the Act, in respect of the 2014 year of assessment.
>
> 9.4. Whether the Respondent was justified in imposing a penalty of 50%, amounting to R40 218 424.12, for no reasonable grounds for tax position taken, in respect of the 2014 year of assessment.
>
> **C. CONSOLIDATED GROUNDS OF DISPUTED ASSESSMENT**
>
> 10. The consolidated disputed grounds of assessment are as follows:
>
> Prospecting Rights
>
> 10.9. The Commissioner determined that the Appellant overstated its capital expenditure, amounting to R287 274 458, by claiming the purchase of prospecting rights, in terms of section 15(*b*) of the Act, in respect of the 2014 year of assessment.
>
> 10.10. The Commissioner imposed an understatement penalty of 50%, amounting to [sic] R40 2218 424 as well as interest.
>
> **D. MATERIAL FACTS UPON WHICH THE RESPONDENT RELIES**
>
> 11. The Appellant is in the coal mining industry.
>
> Purchase and conversion of prospecting rights
>
> 12. On 13 September 2013, XYZ entered into an agreement with the Appellant for the sale and transfer of the JKL Prospecting Rights ("prospecting rights") amounting to R287 274 458.
>
> 13. **At the time of sale and transfer of the aforementioned prospecting rights, XYZ conducted the prospecting operations in terms of its registered prospecting rights, and incurred the prospecting expenses.**

[4] Government Notice No.550 dated 11 July 2014.

14. On 1 October 2013, the Appellant applied to the Department of Mineral Resources ("DMR") to amend its current mining right by incorporating the prospecting rights it acquired from XYZ.

15. On 26 June 2014, the application to include the prospecting rights into the mining right was approved by the DMR.

E. LEGAL GROUNDS

Purchase of prospecting rights

30. **The Appellant was of the view that its acquisition of prospecting rights from XYZ was deductible in terms of section 15(*b*) of the Act, as it was necessarily incurred in order to enable it to conduct prospecting operations in the relevant areas or at least incidental to the prospecting operations.**

31. **At the time of the purchase of the prospecting rights from XYZ, XYZ conducted the prospecting operations in the relevant areas and incurred the prospecting expenses.**

32. **Based on the fact that the prospecting activities, at the time of the purchase of the prospecting rights, was not carried out by the Appellant, the deduction in respect of the acquisition of prospecting rights was correctly disallowed by the Respondent in terms of section 15(*b*) of the Act.**

Understatement Penalties

The Appellant's behaviour is categorised as a 'standard case' of 'no reasonable grounds for tax position taken' in respect of the deduction of prospecting rights for the 2013 to 2014 years of assessment for the following reasons:

38.1. The Appellant failed to provide the Respondent with an opinion by a tax practitioner regarding the deductibility of the acquisition of prospecting rights.

The legislation is clear regarding the prospecting operations that must be carried out by the taxpayer in order to claim deductions. However, the Appellant claimed the deductions even though it was not actually carrying out prospecting operations on the relevant properties at the time the deductions were claimed.

(Emphasis added)

Purchase of prospecting rights

Based on the fact that the Appellant failed to demonstrate that the acquisition of prospecting rights was deductible in terms of section 15(*b*), the onus has not been discharged."

[15] ABC responded to the Rule 31 in a Rule 32 statement and stated that:

> "2.2. SARS disallowed the sum of R287 274 458 claimed by ABC in terms of section 15(*b*) of the ITA in its 2014 year of assessment in respect of expenditure incurred by it to acquire certain prospecting rights ('the Prospecting Rights');
>
> 4.2. SARS was not entitled to disallow the expenditure claimed by it in relation to the Prospecting Rights in terms of section 15(*b*) of the ITA;
>
> 26. Section 15(*b*) of the ITA permits the deduction of expenditure incurred by a taxpayer in respect of prospecting operations as well as 'any other expenditure which is incidental to such operations'.
>
> 31. Accordingly, the expenditure incurred by ABC for the Sale Prospecting Rights was deductible in terms of section 15(*b*) of the ITA, being expenditure that was incurred directly in connection with prospecting operations or, at the very least, was expenditure that was incidental to such operations."

[16] In terms of Rule 34 the issues in an appeal to the Tax Court will be those contained in the statement of the grounds of assessment and opposing the appeal (Rule 31), read with the statement of the grounds of appeal (Rule 32) and, if any, the reply to the grounds of appeal (Rule 33). Together these pleadings delineate the issues in dispute between the parties.

[17] In terms of section 102 of the Tax Administration Act, the taxpayer bears the *onus* to prove that an amount or transaction is not taxable or that it is deductible. It is trite that, for the sake of fairness and proper court procedure, SARS must clearly state, (1) the material facts and (2) the legal grounds on which it bases its assessment and make it clear to the taxpayer what it disputes so that the taxpayer knows what is required from it to discharge the *onus* of proof. In *CSARS v Pretoria East Motors (Pty) Ltd*,[5] the Supreme Court of Appeal ("the SCA") had the occasion to consider the need for additional assessments to be raised in an administratively fair manner and the importance of the pleadings in a tax appeal. In this matter the court found, *inter alia*, that the auditor had misunderstood the accounts; did not familiarise herself with the workings of the accounting system utilised by the taxpayer; and ignored certain provisions of, *inter alia,* the Value-Added Tax Act, 89 of 1991. Ponnan JA stated that whilst there are disputes in tax appeals, such as entertainment expenditure, where the production of invoices or vouchers is called for if the taxpayer is to discharge the *onus* of proof resting on it, that is not always the case and that "everything will depend upon the nature of the dispute between the parties as defined by the grounds of assessment and the grounds of appeal". The court found that the approach adopted by SARS in this instance "left the taxpayer none the wiser as to what was truly in issue and what needed to be produced in order for it to

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5 2014 (5) SA 231 (SCA).

discharge the burden of proof that rested upon it". The learned Judge held that if there were underlying facts in support of that explanation that SARS wishes to place in dispute, then it should indicate clearly what those facts are so that the taxpayer is alerted to the need to call direct evidence on those matters. He stated that:

> "Any other approach would make litigation in the Tax Court unmanageable, as the taxpayer would be left in the dark as to the level of detail required of it in the presentation of its case. It must be stressed that SARS is under an obligation throughout the assessment process leading up to the appeal and the appeal itself to indicate clearly what matters and which documents are in dispute so that the taxpayer knows what is needed to present its case." [6]

[18] Counsel for ABC, Mr B SC, argues that the only live issue in the appeal is whether ABC' deduction of R283 368 458 in respect of the 2014 year of assessment should have been disallowed on the basis of SARS' contention that prospecting activities were not being carried out by ABC at the time, and should the factual issue be determined in favour of ABC, the court should allow the appeal. He contends that SARS, in raising the assessment on the basis it did, which formed the basis upon which its Rule 31 was founded, accepted that section 15(*b*) would have applied if ABC, and not XYZ, conducted prospecting activities in the relevant area during the 2014 year of assessment. This was an express or implied admission. The assessment was accordingly issued based on a factual premise that did not entail an interpretation of section 15(*b*) of the Income Tax Act. In this regard, at no stage in the assessment itself or in the Rule 31, did SARS contend that the nature of the activities or operations conducted by ABC, which included the acquisition of the prospecting rights, disqualified it from claiming a deduction in terms of section 15(*b*). In other words, SARS was satisfied that section 15(*b*) would have applied but for its finding that XYZ and not ABC conducted the prospecting operations. Accordingly, SARS' pleaded case was that prospecting operations which included the acquisition of prospecting rights would qualify for deduction under section 15(*b*), but that XYZ and not ABC was carrying out those activities.

[19] SARS, in contrast to ABC' approach, contends that ABC bears the *onus* and the obligation in terms of section 102 of the Tax Administration Act, to prove that an amount or transaction is not taxable or that it is deductible. ABC must therefore prove that the sum of R287 274 458 relating to the purchasing of a prospecting right from XYZ was deductible. SARS submits that the vital question to be asked is whether the purchasing of a prospecting right from another (as opposed to conducting prospecting activities), qualifies for deduction under the provisions of section 15(*b*) of the Income Tax Act. SARS contends that ABC had *"devised a strategy"* to "deliberately avoid addressing this vital question", because if it attempted to answer the question frankly and correctly, its answer would expose the lack of merits in its case. SARS therefore submits that ABC is seeking to "canvass an entirely

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6 At [14].

irrelevant matter that **is not in dispute**" (emphasis added), namely, that it was ABC and not XYZ that actually conducted prospecting activities during the 2013 and 2014 tax year.

[20] But that was not SARS' case as set out in the grounds of assessment and pleadings. Upon a proper reading of the pleadings *in casu,* it is clear that the only factual issue before this court, and the case ABC was asked to meet, is whether ABC' deduction of R283 368 698 in respect of the 2014 year of assessment should be disallowed because prospecting activities were not being carried out by ABC at the time. In other words, was it ABC or XYZ that conducted prospecting on the relevant areas in the 2014 year of assessment? It is therefore clear that although the Rule 31 correctly identified the issue that was in dispute namely; whether ABC was "entitled to deductions of the purchase of prospecting rights, amounting to R287 274 458, in terms of section 15(b) of the Act, in respect of the 2014 year of assessment", SARS incorrectly stated that the issue in dispute depended on whether prospecting activities, at the time of the purchase of the prospecting rights, was carried out by ABC.

[21] SARS therefore asked the correct "legal question", but then proceeded to dispute the deduction and based its case on a totally incorrect and irrelevant factual basis. The error was compounded by the agreement reached at the pre-trial meeting held between representatives of ABC and SARS on 21 February 2020. In response to admissions sought by ABC, SARS was asked whether it agreed that the principle issue for determination in the appeal in relation to the prospecting rights was whether the deduction of R283 368 698 in respect of the 2014 year of assessment ought to be disallowed on the basis of SARS' contention that prospecting activities were not being carried out by ABC at the time. In particular, agreement was sought that the issue was whether ABC or XYZ was conducting prospecting on the relevant areas in the 2014 year of assessment. On 16 March 2020 SARS' representatives responded in writing and agreed that "the principal issue for determination in the appeal in relation to the prospecting rights was whether the deduction of R283 368 698 in respect of the 2013/14 year of assessment ought to be disallowed on the basis of SARS' contention that prospecting activities were not being carried out by ABC at the time". In particular, it was agreed that the issue was whether ABC or XYZ was conducting prospecting on the relevant areas in the 2014 year of assessment.

[22] Mr B contends that once it is accepted that ABC conducted the prospecting operations in the relevant area during the 2014 year of assessment, this court need not go any further and seek to interpret section 15(*b*) on any other basis which was not pleaded by SARS. He contends that this is particularly so when SARS itself would have granted the deduction on that very basis (as pleaded by it) if it accepted (as it should have) the true facts at the time. Importantly, so he argues, any contrary interpretation of section 15(*b*) of the Income Tax Act was not placed in issue by SARS, nor raised in the pleadings and as such, need not be considered by this court. In support of the appellant's argument, Mr B referred the court to the

recent matter of *Benhaus Mining (Pty) Ltd v Commissioner for the South African Revenue Service,*[7] in which SARS sought to rely on certain provisions in the Income Tax Act that had not previously been referred to or relied upon in its Rule 31. In this regard, the SCA stated as follows:

> "[38] The Commissioner thus argues that Benhaus did not comply with the provisions of s 36(7E) and (7F), and for that reason too should not be entitled to deductions. However, this ground of assessment was not pleaded by the Commissioner, who pleaded only that the business carried out by Benhaus did not constitute mining, or mining operations, as defined in s 1, and that it did not earn any income from mining operations as contemplated in s 15(*a*) of the Act. It therefore did not qualify for deductions of capital expenditure in terms of s 15(*a*) read with s 36(7C).
>
> [39] The Commissioner cannot raise new grounds of assessment without pleading them in express terms. Rule 31(2) issued under the Tax Administration Act requires that the statement of grounds for opposing the taxpayer's appeal must set out a clear and concise statement of the consolidated grounds of the disputed assessment, and the material facts and legal grounds upon which he relies in opposing the appeal. The Commissioner did not raise non-compliance with ss 36(7E) or (7F) in opposing Benhaus's appeal. The argument on non-compliance with s 36(7E) and (7F) must thus fail."

[23] The *Benhaus* matter is distinguishable from the matter *in casu*. SARS is not relying on a **new ground of assessment**. (Emphasis added). The Rule 31 in the present matter made two things clear: Firstly, the issue in dispute was whether ABC was entitled to deductions of the purchase of prospecting rights, amounting to R287 274 458, in terms of section 15(*b*) of the Income Tax Act, in respect of the 2014 year of assessment, and secondly, SARS disallowed the deduction because the prospecting activities, at the time of the purchase of the prospecting rights, was not carried out by ABC. SARS correctly identified the issue in dispute, but came to its conclusion on irrelevant facts.

[24] As previously stated, in terms of section 102(1)(*b*) of the Tax Administration Act, a taxpayer bears the *onus* to prove that an amount or item is deductible. The conundrum is the following; even if ABC is able to prove factually that it conducted prospecting activities on the relevant areas, is it entitled to a deduction in terms of section 15(*b*)? In *Africa Cash and Carry (Pty) Ltd v The Commissioner for the South African Revenue Service,*[8] the SCA reflected on the extent of the Tax Court's powers and function and stated as follows:

> "[52] The point of departure should always be that a Tax Court is a court of revision and 'not a court of appeal in the ordinary sense'. The legislature 'intended that there could be a re-hearing of the whole matter by the Special Court and that the court could substitute its own

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7 2020 (3) SA 325 (SCA).
8 2020 (2) SA 19 (SCA).

> decision for that of the Commissioner', if justified on the evidence before it. A Tax Court accordingly rehears the issues before it and decides afresh whether an estimated assessment is reasonable. It is not bound by what the Commissioner found. In rehearing the case it can either uphold the opinion of SARS or overrule it and substitute it with its own opinion. The powers of the Tax Court and its functions are unique. It places itself in the shoes of the functionary and re-evaluates the facts and circumstances of the subject-matter on which the assessments were based. By its very nature an estimated assessment is subject to change based on an evaluation of the evidence and any information that becomes available. What is important is that the methodology used and the assumptions on the strength of which the estimated estimates were made should remain the same, otherwise the conclusions reached by the Tax Court might not be procedurally fair. The Tax Court must place itself in the shoes of the functionary to determine whether the methodology followed and the assumptions on which the estimated assessment are based are reasonable and produce a reasonable result."

[25] The SCA emphasized that the Tax Court has a wide discretion and that it must observe an administratively fair process. This entails, *inter alia*, that the dispute must be resolved on the issues raised by the parties and the enquiry confined to the facts placed before court.[9] It is clear that the legislature intended that there should be a re-hearing of the whole matter by the Tax Court and that the court could substitute its own decision for that of the Commissioner, if justified on the evidence before it.[10] It remains the function of the Tax Court to make a determination of the issues that arise for decision on an objective review of all of the relevant facts and circumstances.[11]

[26] The appeal in the present matter can therefore not be limited to the factual issue. Mr B contended that should this court decide to interpret section 15(*b*) it can still only do so based on the facts as pleaded by the parties. I agree. With these principles in mind it is this court's task to evaluate the evidence presented by ABC and to establish whether it has discharged its *onus*. Although the factual dispute raised by SARS in the pleadings was no longer pursued during the hearing of the matter, it is still necessary to deal with the evidence in some detail, as it will explain the costs order granted against SARS at the end of the matter.

THE EVIDENCE

[27] ABC called two witnesses: Mr S and Mr T.

[28] Mr S is a mine engineer at ABC, but also acted as General Manager between 2010 and 2016. He testified that prospecting operations were carried out by ABC during the years 2013 and 2014. Mr S stated that XYZ did not conduct any prospecting since 2009 and that in the critical period it was only ABC that conducted prospecting. In his testimony he made

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9 At para [53].
10 *Rand Ropes (Pty) Ltd v Commissioner for Inland Revenue*1944 AD 142 at 150.
11 See *Pretoria East Motors* supra.

reference to maps and pinpointed where such operations occurred. He also referred to various invoices in support of his evidence that such operations occurred.

[29] To support Mr S's evidence, the evidence of Mr T was led. Mr T is a mine surveyor employed at ABC since January 2012. He testified that his duties included ensuring that the mine conducted operations within its authorised boundaries. He gave evidence relating to the positions of drill holes in relation to two maps which showed that drilling was undertaken by ABC during 2013 and 2014. He confirmed that ABC was the only entity that was prospecting in the relevant area in 2013 and 2014.

[30] The evidence of Mr S and Mr T was largely left unchallenged. Their evidence demonstrates that ABC conducted prospecting operations and incurred prospecting expenses in the areas falling within the ambit of the Sale Prospecting Rights during the relevant period. No facts to the contrary were put to the witnesses. In addition, documentary evidence in the form of the raw data files from GPS locations of the relevant boreholes; the map of the relevant mining area; the maps of boreholes sunk in 2013 on the portions of land which fell within the ambit of the Sale Prospecting Rights; and the invoices reflecting prospecting expenditure incurred by ABC in respect of prospecting operations undertaken on the areas falling within the ambit of the Sale Prospecting Rights during the relevant period, were presented.

[31] SARS also called two witnesses, Mr P, a mining specialist with the Large Business Center at SARS, and Ms Q, an auditor/operational specialist at SARS Investigative Audit Division and the person responsible for conducting the audit that gave rise to the assessments and the disallowance of the objections.

[32] Mr P testified that his role at SARS was to provide assistance to the audit team members of the mining division to ensure that audits were concluded correctly and at a certain standard. He was involved in the dispute between ABC and SARS from the initial stages of the audit to the conclusion thereof, and thereafter, the objection and appeal stages. He testified that SARS' original query related to ABC' unredeemed capital expenditure which included the prospecting rights in the sum of R283 368 698.23 which ABC was requested to substantiate as SARS was of the view that it was not allowable in terms of section 36(11) of the Income Tax Act.

[33] He stated that ABC, in its reply to the "Audit Findings" on 27 March 2017, indicated that the deduction was being claimed under section 15(*b*) of the Income Tax Act which deals with exploration activities or exploration expenditure. Mr P stated that the dispute between SARS and ABC was therefore the interpretation of section 15(*b*) and that the issue was purely an interpretational one. His conclusion in relation to section 15(*b*) was that the section deals only with exploration activities, such as trenching, drilling of boreholes and other expenses

incidental to the activity of exploration, that is, expenditure that flow from these activities such as having samples analysed. It was not something which related to the acquisition of prospecting rights. Mr P conceded that there was, however, within SARS, a discussion on the different interpretational approaches under section 15(*b*).

[34] Mr P confirmed that he co-signed the "Finalisation of Audit" letter with Ms Q as it was a SARS internal policy requirement that signified that he was in agreement with the technical merits and the basis upon which the assessment would be issued. His role in signing off on the "Finalisation of Audit" was to ensure that whatever was contained in the letter was accurate and complete and that when the taxpayer received the letter, there would be no doubt as to the basis of the assessment and no room for any ambiguity.

[35] Mr P testified that it was disclosed to SARS that there were "subsequent exploration activities" carried out by ABC after it entered into the purchase agreement with XYZ. These "*subsequent"* prospecting activities carried out by ABC in 2013 and 2014 was however never regarded as a risk by SARS in terms of the scope of the audit and SARS did not raise the assessment in respect of these subsequent activities. The subsequent exploration expenses were claimed against taxable income in terms of section 15(*b*) and SARS did not affect any disallowances or add-backs in relation to those expenses. Mr P was referred to page 24 of the Finalisation of Audit letter and was asked to explain what it meant. This paragraph reads as follows:

> "Section 15(*b*) provides for a deduction of expenditure incurred by a taxpayer against income derived from mining operations on prospecting operations together with any other expenditure which is incidental to such operations. The purchase of the prospecting rights by ABC does not fall within the ambit of section 15(*b*) of the Act because it did not conduct such prospecting operations."

[36] He testified that the meaning to be attributed to this paragraph was that prospecting rights did not fall within the ambit of section 15(*b*) of the Income Tax Act as the amount of R283 368 698.23 was incurred by ABC in acquiring an exploration right which was intellectual property and reflected as such in the annual financial statements. It was considered by Mr P that this finding did not have to be explained at 'that length' to ABC because it was a mining taxpayer.

[37] Mr P testified that at the time of the "Finalisation of Audit", namely, 23 June 2017, the assessment was going to be raised on the basis that the expense claimed by ABC could not be claimed because it related to purchasing an intangible asset and section 15(*b*) could not be used for that deduction. He, however, conceded that the letter did not say that, but contended that there was no need for SARS to give any further detail. He was adamant that the assessment was raised on the basis that section 15(*b*) did not allow a deduction in respect

of the acquisition cost of a prospecting right, but was unable to point to where this basis was set out in the letter. He also had no answer as to why reference was made in the letter to the expenditure incurred by XYZ in relation to prospecting cost when, according to him, that was irrelevant. He conceded that with hindsight the "Finalisation of Audit" letter could have been "worded better".

[38] Mr P stated that SARS placed no reliance on section 36(11) of the Income Tax Act in raising the assessment but relied only on section 15(*b*). He confirmed that by the time the "Audit Findings" and "Finalisation of Audit" letters were drafted, ABC had told SARS that it relied upon section 15(*b*) and that this fact had been conveyed to SARS as early as February 2017. When asked again whether SARS relied on section 36(11) in the "Finalisation of Audit", he then said that SARS had relied on section 36(11) as a "secondary argument".

[39] He testified that he provided no input in relation to the Rule 31, but had found it to be "a bit general and vague, not to the point". Asked as to what was vague and general about the Rule 31, he stated that he could not find any statement in the document to the effect that the expenditure incurred in acquiring the prospecting rights did not meet the requirements of section 15(*b*). If he was the drafter of the Rule 31 he would have elaborated on section 15(*b*), stating that the expenditure incurred in acquiring a prospecting right did not meet the requirements of the wording of section 15(*b*). He later conceded that the Rule 31 did not reflect the basis upon which he now stated the assessment was raised. Mr P however never raised his concerns with SARS' internal legal team or the State Attorney. When asked about why he did nothing to ensure that it correctly reflected the basis upon which SARS raised the assessments, Mr P stated that it "was too late". He could not explain why, if the Rule 31 was not accurate, he or anyone else at SARS took no steps to amend it.

[40] Mr P was asked whether he gave any input in relation to the admissions sought by ABC as set out in the pre-trial agenda. Mr P, whilst conceding that he and Ms Q were the only two people involved giving factual instructions in relation to the matter, did not give any definitive answer to the question and said that he could not recollect having done so.

[41] Mr P testified that he never saw any material or information that indicated that XYZ claimed deductions in the area in the 2013/14 years and that he had not seen any information which indicated that XYZ carried out prospecting in the area in 2013/14. When it was put to him that he could have had regard to XYZ's tax returns to determine whether it had claimed deductions for prospecting expenditure, he stated that he would have had to notify XYZ in terms of the Tax Administration Act. He however conceded that SARS would have had access to that information. In relation to the reference to the deductions claimed by XYZ in the "*Finalisation of Audit"* and the Rule 31, Mr P stated that such reference was made because of what was stated in the sale agreement in relation to the definition of sale assets and the

information and data that were included. He therefore assumed that XYZ must have incurred the prospecting expenses. He conceded that the assumptions made about XYZ were irrelevant but could not explain why these assumptions were included in the "Finalisation of Audit" and the Rule 31.

[42] Ms Q testified that she is an auditor employed as an operational specialist at SARS since February 2006. She stated that the scope of the audit was not to investigate whether ABC was conducting prospecting activities or operations in 2014 or 2013, as SARS had no problem with that and made no indication to ABC that it was disputing whether or not they "had these activities". This therefore did not form part of any decision that SARS made and was "irrelevant". SARS' basis for raising the assessment was that it was of the view that the R283 368 698.23, included in capital expenditure which related to the purchase of the prospecting rights from XYZ, did not qualify to be capital expenditure in terms of the definition (in section 36 of the Income Tax Act) and therefore should not have been included in the *"capex"* of ABC in the 2014 year.[12]

[43] After having received relevant material from ABC, an opinion was requested from SARS' specialist support, to review the documentation and to advise on whether SARS' treatment was correct. She consulted with Mr P and it was their view that the purchase of the prospecting rights did not qualify to be regarded as capital expenditure in terms of section 36(11) and would therefore be disallowed. After further consultations and having reviewed ABC's response, the "Finalisation of Audit" letter was issued to ABC. In the letter the conclusion reached was that the amount of R283 368 698.23 would be disallowed in terms of section 36(11), because she did not agree with ABC that the purchase of the prospecting rights was deductible in terms of section 15(*b*). Ms Q explained that this approach was taken because ABC "*included this specific purchase as an intangible asset"* in the 2014 annual financial statements and that "this specific right does not qualify in the definition of capital expenditure in terms of section 36." The main issue for SARS was therefore the fact that ABC purchased prospecting rights from XYZ and included that amount in their "capex schedule" and that it "did not qualify to be capex and therefore should not be included in the capex." Ms Q explained that if SARS had allowed the assessment in terms of 15(*b*) ABC would have had to move this from capex into the income statement.

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12 Capex is a generally understood abbreviation in the mining industry referring to capital expenditure as defined in and governed by section 36 of the Income Tax Act.

[44] Ms Q was referred to paragraph 3.3 of the "Finalisation of Audit" letter, wherein it was stated that "XYZ conducted the prospecting operations and incurred the prospecting expenses and as such the SARS' view remains that ABC did not incur expenses for conducting prospecting operations", and was asked to explain the meaning thereof. She explained as follows:

> "Generally the taxpayer before they get the right itself, they have to test a certain portion and then apply for the prospecting rights themselves, they would continue to prospect and accumulate prospecting expenses. Our assumption is that XYZ incurred these expenses and they added all the expenses in the amount of R287 million. The taxpayer [ABC] was still of the view that it's them conducting the operation of 287 million…we were trying to clarify that the purchase and the activity are two different things."

[45] Later in her evidence, when Ms Q was pressed on why she applied section 36(11) and not section 5(*b*), she stated that ABC had not claimed the deduction in terms of section 15(*b*). She could therefore not raise the assessment under section 15(*b*). In cross- examination she agreed that ABC clarified that it was not relying on section 36(11) but on section 15(*b*), but stated that the reason she was still applying section 36(11) was because section 36(11) was the "starting point" and one had to take into account "how it was claimed in the income statement". She also stated that both section 36(11) and 15(*b*) was included in the "Finalisation of Audit" letter because the two sections cannot be separated, and "consideration" was given to section 15(*b*). When asked to explain practically what it means to consider and then apply section 36(11), Ms Q stated as follows:

> "the taxpayer submits the return and submits a capex schedule and whatever you put in there has to be expenditure that qualifies in terms of section 36(11) and nothing else. Then the taxpayer says I relied on 15(*b*), you don't put an item in the capex schedule – even though I'm considering 15(*b*)…when I make the adjustments I have to reduce the capex schedule…in the R362 million capex schedule it included the R283 million. When I make the adjustment I have to reduce the R362 million. I cannot say I'm making the adjustment in terms of section 15(*b*)."

[46] Ms Q stated during cross-examination that she had never heard of a statement of grounds of assessment and appeal and that she had not seen the Rule 31 at any time before she gave evidence. She, however, stated that the Rule 31 was not wrong and accurately reflected the basis of the assessment which basis was contained in the disallowance of the objection.

[47] Ms Q further agreed that the disallowance of objection letter was a critical document which set out SARS' decision, the reasons for the disallowance and the basis upon which the matter would proceed. She also agreed that the disallowance of objection superseded the Audit Findings and Finalisation of Audit and would crystallize and set out SARS' final position

on the dispute. She also agreed that it would inform the taxpayer's decision in relation to noting an appeal.

EVALUATION

[48] As stated before, the evidence of Mr S and Mr T was mainly left unchallenged and there was no evidence to gainsay their testimony. SARS did not produce any evidence in support of its contention that it was XYZ that conducted the prospecting activities and not ABC. The evidence presented by ABC clearly showed that ABC carried on prospecting in the XYZ area in 2013 and 2014, and neither XYZ nor any other entity conducted prospecting in the XYZ area during that period.

[49] SARS contends that Mr P and Ms Q were reliable and credible witnesses. I disagree. The evidence of Mr P and Ms Q was riddled with contradictions, assumptions and inconsistencies. Their versions as to the basis of the assessment raised, differed materially. Mr P testified that the basis of the assessment was section 15(*b*), and that it was purely an interpretational issue. Ms Q testified that the sole and only basis on which the assessment was raised, was that the amount spent on the acquisition of the prospecting right did not qualify as capital expenditure in the definition of capital in section 36(11).

[50] From the evidence of Mr P and Ms Q it soon became clear that the factual basis SARS relied upon in raising the assessment as contained in the disallowance of objection and the Rule 31, (namely that XYZ and not ABC conducted prospecting operations in the relevant areas during the 2013/14 years), was incorrect and founded upon speculation and unsubstantiated inferences and could not be sustained. It is clear from the evidence that SARS disallowed the deduction based on a flawed factual premise.

[51] Ms Q was the auditor responsible for the raising of the assessment. She was the tax expert and the one person who had intimate knowledge of the audit and the reasons for the additional assessment raised. She testified that the reason why she applied section 36(11) in raising the assessment, was that ABC had included the amount in its capital expenditure schedule which formed part of its tax return. She later changed her evidence and stated that section 15(*b*) had also been 'considered'. She could however not identify where these bases were contained in the Rule 31. She could not do so because they were not there.

[52] In any event, it is clear from her evidence that she completely ignored the fact that at that time of the "Audit Findings" and the "Finalisation of Audit", ABC had already made it clear to SARS that it was relying on section 15(*b*) and not section 36(11). Mr P on the other hand, testified that SARS accepted and proceeded on the basis that ABC was claiming the deduction by relying on section 15(*b*) and not section 36(11). If Ms Q's evidence is to be believed, then the assessment raised, on the basis of section 36(11), was factually incorrect. This is so

because ABC never relied on section 36(11) in claiming the prospecting deduction, but relied on section 15(*b*). Ms Q's reliance on section 36(11) was therefore, under the circumstances, clearly erroneous and her reasons proffered during her evidence for raising the assessment based on 36(11) completely illogical. She clearly made an error in relying on section 36(11) in disallowing the deduction, and when confronted with the fallacies in her approach, was not prepared to play open cards with the court.

[53] In addition, Ms Q's alleged reliance on section 36(11) was contradicted by the evidence of Mr P who testified that the assessment was raised on an interpretative basis having regard to the provisions of section 15(*b*). He stated that SARS placed no reliance on section 36(11) in raising the assessment but relied on section 15(*b*). This is in stark contradiction to what Ms Q testified. Whilst he later tried to dilute this position by suggesting that section 36(11) was a secondary argument, his evidence was still in direct conflict with that of Ms Q. Both Mr P and Ms Q's testimonies do not stand up to scrutiny and cannot be relied upon.

[54] SARS, in a last desperate attempt to save the day, contends during argument that the Rule 31 is a document drawn up by legal professionals and somehow suggests that Mr P and Ms Q's evidence can be divorced from the Rule 31. This argument does not assist SARS. SARS is bound to the factual grounds for the assessment as set out in the Rule 31. Common sense dictates that the Rule 31 could only have been drafted after consultation with people involved in the actual audit of ABC. Mr P conceded that SARS had several opportunities to correct any 'mistakes' in relation to the basis of the assessment or any "vagueness" that might have been created. On a proper reading of the Rule 31 it is this court's finding that it clearly set out the grounds on which the assessment was raised. Coupled with the admissions made by SARS during the pre-trial conference there can be no doubt what case ABC was asked to meet.

[55] Lastly, SARS submitted that Mr P's evidence regarding the conclusions that SARS drew from the sale agreement about the value of the prospecting rights is valuable and of assistance to the court. Mr P's evidence is based on assumptions and there are no facts to support his view. His interpretation of the sale agreement is irrelevant and immaterial to the issue in dispute. His opinion was of no assistance to this court.

Conclusion on the factual issue

[56] The factual issue to be determined by this court is set out in the Rule 31 and confirmed between the parties during the pre-trial conference. SARS disallowed the deduction in respect of the acquisition of the "Sale Prospecting Rights" in terms of section 15(*b*), on the basis that, at the time of the purchase of the prospecting rights (i.e., 2013), the prospecting activities were not carried out by ABC but by XYZ.

[57] Despite the fact that this issue for determination by this court was clearly set out in the Audit Findings, the Finalisation of Audit letter, the Rule 31 and the pre-trial conference, SARS, at the commencement of the trial, disavowed any reliance on its contentions made in these documents and submitted that it was never disputed that ABC conducted prospecting operations pursuant to the purchase of the prospecting rights from XYZ; that this factual issue did not fall within the ambit of the audit; and that it was irrelevant.

[58] But, that was the case ABC was asked to meet, and that is the narrow factual issue this court must decide.

[59] The evidence given on behalf of ABC, which was not challenged in any way, demonstrates as an incontrovertible fact that ABC conducted prospecting operations in the relevant area during the 2013 and 2014 years. It therefore follows that SARS pleaded reason for disallowing the deduction claimed by ABC (that XYZ and not ABC did the prospecting during the relevant period) was based on erroneous assumptions. The only question that remains for determination is whether the expenditure incurred by ABC in the amount of R283 368 698.23 for the purchase of prospecting rights is deductible in terms of section 15(*b*) of the Income Tax Act. In order to answer this question the court has to engage in an interpretive exercise of section 15(*b*), with the parties contending for different interpretations.

Interpretation of section 15(*b*)

[60] The section that impacts upon the issue in this appeal is section 15(*b*) of the Income Tax Act. Section 15 is titled "Deductions from income derived from mining operations." and the relevant section provides that:

> "15. There shall be allowed to be deducted from the income derived by the taxpayer from mining operations—
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> (*b*) any expenditure incurred by the taxpayer during the year of assessment on prospecting operations (including surveys, boreholes, trenches, pits and other prospecting work preliminary to the establishment of a mine) in respect of any area within the Republic together with any other expenditure which is incidental to such operations:…."

[61] Mr B, counsel on behalf of ABC, contends that the expenditure of the R283 368 698.23 was clearly in respect of the purchase of prospecting rights, and, as such, constitutes expenditure incurred on prospecting operations. The deduction therefore has to be permitted under the first part of section 15(*b*) (on prospecting operations). However, so it is contended, if the court finds that the expenditure is not covered by the first part of section 15(*b*), ABC met the lower threshold set out in the said section (expenditure incidental to prospecting operations). Mr B submits that once it is accepted that the prospecting right is necessary to found and lawfully commence prospecting operations, the payment of the costs in acquiring the "right to prospect" is clearly incidental to the prospecting operations because it is an essential prerequisite to conduct such operations.

[62] Mr H, counsel on behalf of SARS, contends that the prospecting rights can only be regarded as a capital asset of ABC and the deduction of the purchase price of such prospecting rights is not allowable in terms of section 15(*b*) of the Income Tax Act. He contends that this is so, because, it is clear from the definition of prospecting operation that for any prospecting operation to be said to have taken place, there must have been some prospecting activity that must have been carried on. Therefore, the mere purchase of such a right does not qualify it to be classified as an activity that was carried on. It is further contended that the purchase price of the prospecting rights was clearly expenditure of an initial nature and no special deduction exists in the Income Tax Act for such expenditure.

[63] Mr H further contends that ABC purchased the prospecting rights from XYZ in order to extend the life of the ABC Colliery by at least 30 years. There can therefore be no doubt that the purchase created a new asset for ABC, one that would form part of its income-earning structure and was an investment to yield future profit. The expenditure was therefore closely linked to the income earning structure and the 2014 annual financial statements list the prospecting rights as a valuable intangible asset. The purchase price was therefore a non-recurrent payment that can only be regarded as a capital outlay. It is submitted that the purchase price cannot on any construction of the definitions and legislation, be regarded as constituting "prospecting operations" or "expenditure incidental to such prospecting operations".

[64] Mr B, in support of ABC' argument, referred the court to two cases: *Rand Mines (Mining & Services) Ltd v Commissioner for Inland Revenue*[13] and *ITC 1726.*[14] In *Rand Mines* the Appellate Division (as it then was) was called upon to interpret section 11(a) of the Income Tax Act and to consider whether expenditure incurred by a taxpayer for the acquisition of "management and service rights" was of a capital or revenue nature. Mr B contended that although the issue in that court was different from the facts in the present matter, namely whether the expenditure was of a capital or revenue nature (which does not arise in the present matter because the deduction is sought to be made under section 15(*b*) and not under section 11(*a*) of the Income Tax Act) the court recognised that without a management contract, the appellant would have no opportunity of doing that which generated its income namely, that of managing mines. The court found '[t]he contracts in themselves generate no income but they do provide appellant with the opportunity of generating income by providing the management services for which payment will be made'. Thus, so it is argued, whilst the court took the view that the expenditure on the management contract could not be a cost incurred in the actual performance of the taxpayer's income earning operations it was nevertheless a cost incurred in acquiring the right to perform those operations. Accordingly, so it is submitted, it was clearly necessary for the income generating activity or at the very least, was incidental thereto.

[65] Mr B contends that by the parity of reasoning employed in the *Rand Mines* case, this court must found that without the acquisition of the right to prospect (akin to the acquisition of management and service rights in *Rand Mines*) ABC could not conduct the physical prospecting activities. Put differently, without the acquisition of the prospecting rights, ABC would have no opportunity of doing that which generates its income, namely, mining. It is submitted that the prospecting rights, akin to the management contract in *Rand Mines*, provided ABC the opportunity to generate income by allowing it to prospect and thereafter mine for coal. Therefore, based on what the court accepted in the *Rand Mines* case, this court should find that the expenditure to acquire the prospecting rights was incurred in acquiring the right to perform prospecting operations.

[66] In *ITC 1726* the taxpayer was a cellular telephone service operator. The expense in issue was a fee of R100 million paid for a non-exclusive right to conduct its business for 15 years, subject to an annual license fee amounting to 5% of net revenue. The license was automatically renewable unless it was expressly terminated. The court found that the annual fee was deductible as a recurrent expense with no enduring benefit. As far as the initial payment of R100 million was concerned, the court found that this payment had acquired for the taxpayer an enduring advantage, that of being able to operate its business for 15 years.

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13 1997 (1) SA 427 (A).

14 64 SATC 236.

As such, it was closely connected with the structure rather than with the operations and was therefore capital in nature. The court also held that a license fee is regarded as expenditure which is incidental to operations because it is paid for the right to conduct the business. The court held that the license fee constituted "expenditure that was incurred to found and lawfully commence the operation of the appellant's income earning structure. The cost was not a cost incurred in the actual performance of the appellant's income-earning operation but a cost in acquiring the right to perform these operations".[15]

[67] Mr B also referred the court to a matter that was dealt with by the Supreme Court of Nigeria, namely *Shell Petroleum Development Corporation v FBIR*[16] which concerned the scope of activities falling within the definition of '*petroleum operations*' in section 2 of the Petroleum Profits Act[17]. The definition reads as follows:

> " **'petroleum operations'** means the winning or obtaining and transportation of petroleum or chargeable oil in Nigeria by or on behalf of a company for its own account by any drilling, mining, extracting or other like operations or process, not including refining at a refinery, in the course of a business carried on by the company engaged in such operations, and all operations incidental thereto and any sale of or any disposal of chargeable oil by or on behalf of the company;"

[68] The Supreme Court of Nigeria stressed that "petroleum operation", for the purpose of payment of profits tax by companies in that sector, includes not only "winning or obtaining" petroleum oil by drilling, mining, extracting, etc, but all operations that are incidental to such operations. The court further held that the definition of the phrase "all operations incidental thereto" in section 2 of the Petroleum Profits Tax Act, cannot be circumscribed to "drilling, mining, extracting or other like operations." To do so would be to do "violence to the true meaning of the definition of petroleum operations". It held therefore, that the payment of tax to the Federal Government by a petroleum mining company, was incidental to the business of the company.

[69] I have no issue with the reasoning adopted by the courts in all three matters referred to above. Each case must however be determined on its own facts. Context is everything and the present matter can only be approached through the prism of the relevant sections in the Income Tax Act applicable to **the mining industry**. The wording and purpose of section 15 is different from that of section 11 of the Income Tax Act. Section 11 deals with "general deductions" from the taxable income derived by any person from carrying on **any trade**, excluding capital expenses, whilst section 15 exclusively deals with deductions from income derived from mining operations, including capital expenses. In terms of section 11(*a*), in

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15 At p 242.
16 (1996) 8 NWLR 256.
17 22 of 1990.

determining the taxable income derived by any person from carrying on any trade, "there shall be allowed as deductions from the income of such person so derived expenditure and losses actually incurred **in the production of the income**, provided such expenditure and losses are not of a capital nature". Section 15 allows for capital expenses incurred to be deducted from income derived from mining operations under very specific conditions set out in section 15(a) and section 36(11). Section 15(*b*), however, specifically identifies expenditure incurred on or incidental to prospecting operations and does not refer to expenditure incurred in the production of the income (as it does in section 11). Therefore, the only issue for present purposes is for this court to give meaning to the specific words used in section 15(*b*) and to determine the legislature's intention in the use of the words **expenditure on or incidental to prospecting operations** and not whether it provided ABC the opportunity to generate an income or determining whether the expenses was incurred in the production of the income. (Emphasis added)

CONCLUSION

[70] As alluded to above, the capital expenditure incurred for the right to carry out particular income-producing activities would not ordinarily qualify for deduction. The legislature however allowed, as a special dispensation, the deduction of capital expenditure in relation to mining operations and enacted certain tax incentives which are available exclusively to mining taxpayers. The rationale for the special incentives given to miners is explained in the Davis Tax Committee's report as follows: [18]

> "Mining involves very substantial upfront investment costs at the development phase of the mine, typically followed by a prolonged time lag before mining production (and hence generation of income) commences. This prolonged interval between upfront investment and generation of income is subject to heightened risks posed by adverse changes in commodity prices, and geological risks. These incentives provide for upfront capital allowances for exploratory and development expenditure, and for deductions which are designed to ensure adequate provision is made for the closure and rehabilitation of mines."[19]

[71] These special incentives are given effect to in various different parts of the Income Tax Act such as section 15 and section 36. The sections applicable to capital expenditure is found in section 36(11) read with section 15(*a*) of the Income Tax Act, most notably in the application of section 36(7C), 36(7E), 36(7F), 36(7G) and 36(11). According to the Davis Tax Committee, "it effectively provides for a 100% write off of capital expenditure incurred against taxable income from mining operations (which are subject to various ring-fencing requirements)."[20]

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[18] Davis Tax Committee, "*Second and Final Report on Hard-Rock Mining*", December 2016, p 5, para 5.

[19] B. Executive Summary, para 5.

[20] Davis Tax Committee p49 para 2.3.2.1.1

[72] It is trite that statutory interpretation involves a host of considerations. In the matter of *Natal Joint Municipal Pension Fund v Endumeni Municipality*,[21] Wallis JA stated that interpretation is the process of attributing meaning to the words used, having regard to the context provided, by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed; and the material known to those responsible for its production. The process is objective, not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Wallis J further warns that Judges must be alert to, and guard against the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument, is to cross the divide between interpretation and legislation.

[73] Further, in interpreting section 15(*b*), I am mindful of what was referred to by Conradie JA as the "golden rule" in *Western Platinum v Commissioner for SARS:*[22]

> "The *fiscus* favours miners and farmers. Miners are permitted to deduct certain categories of capital expenditure from income derived from mining operations. Farmers are permitted to deduct certain defined items of capital expenditure from income derived from farming operations. These are class privileges. In determining their extent, one adopts a strict construction of the empowering legislation. That is the golden rule laid down in Ernst v Commissioner for Inland Revenue 1954 (1) SA 318 (A) at 323C-E and approved in *Commissioner for Inland Revenue v D & N Promotions (Pty) Ltd* 1995 (2) SA 296 (A) at 305A-B."

[74] It is clear from a reading of section 15(*b*) that the purpose of the section is to address expenditure which does not relate to mining operations, but was incurred for the purpose (and not the right) to carry out prospecting operations. The deduction includes expenditure incurred on surveys, boreholes, trenches, pits and other prospecting work preliminary to establishing a mine. Thus, unlike other sections of the Income Tax Act which permits a deduction depending on the categorisation of the nature of the expense, section 15(*b*) permits the deduction of both capital and revenue expenditure provided that the expenditure was incurred in relation to prospecting operations or incurred in relation to any activity which is incidental to prospecting operations.[23]

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21 2012 (4) SA 593 (SCA) ([2012] 2 All SA 262; [2012] ZASCA 13).

22 *Western Platinum Ltd v Commissioner for SARS* [2004] 4 All SA 611 (SCA) at para 1.

23 As confirmed in the Second and Final Report of the Davis Tax Committee on Hard-Rock mining at para 2.3.3, p.53.

[75] It is further clear from a reading of section 15(*b*) that the legislature intended to cater for two scenarios: Firstly, any expenditure incurred on prospecting operations, and secondly, any other expenditure which is incidental to prospecting operations. The term "prospecting operations" is not defined in the Income Tax Act. The terms '"prospecting" and "prospecting operations" are, however, defined in the MPRDA as follows:

> " **'prospecting'** means intentionally searching for any mineral by means of any method—
>
> (*a*) which disturbs the surface or subsurface of the earth, including any portion of the earth that is under the sea or under other water; or
>
> (*b*) in or any residue stockpile or residue deposit, in order to establish the existence of any mineral and to determine the extent and economic value thereof; or
>
> (*c*) in the sea or other water on land"
>
> " **'prospecting operations'** means any activity carried on in connection with prospecting".

[76] In section 15(*b*) the legislature specifically refers to "*prospecting operations"* which means any activity **carried on** in connection with **prospecting**. (Emphasis added). The meaning of "carried on" is "to continue doing something". Therefore, any expenditure incurred on any activity **carried on** in connection with prospecting can be deducted. The legislature do not only leave it at that, but continues by identifying what constitutes 'the activities carried on". That is surveys, boreholes, trenches, pits and **other prospecting work** preliminary to the establishment of a mine. In *Attieh v Commissioner for the South African Revenue Service*,[24] the court had to consider the meaning of the phrase "any other event" in para 35(1) of the Eighth Schedule of the Income Tax Act. The court held that the words, "any other event", are *ejusdem generis* with the immediately preceding words in that paragraph. The meaning of the *ejusdem generis* rule was explained by Innes CJ in *Director of Education, Transvaal v McCagie and others*[25]

> "General words following upon and connected with specific words are more restricted in their operation than if they stood alone. *Noscuntur a sociiis*; they are coloured by their context; and their meaning is cut down so as to comprehend only things of the same kind as those designed by the specific words- unless of course, there is something to show that a wider sense was intended."

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[24] 2018 JDR 0013 (GJ).

[25] 1918 AD 616, at 623

[77] The court in *Attieh supra* held that the general words, "or any other event", are therefore restricted by the context and that there is nothing to show that a wider sense was intended. The court concluded that the interpretation of the words "*or any other event',* must be affected by what precedes them.[26]

[78] There must be a distinct *genus* or category for the *ejusdem generis* rule to find application. In the present matter I am of the view that the words "other prospecting work" are affected by the words preceding them namely, surveys, boreholes, trenches, and pits. In order to qualify as an expenditure on prospecting operations, the expenditure had to be directly connected to the "prospecting work", in other words, activities akin to surveys, boreholes, trenches, and pits. I cannot therefore accept the argument that section 15(*b*) contemplates as expenditure the purchase of prospecting rights. Taking into account the context, purpose and background of the Income Tax Act, ABC approach to section 15(*b*) is too generous. If the legislature intended the meaning of prospecting operations to include the purchase of prospecting rights it would have simply said so. In light of the special incentives already allowed for by the legislature to the mining industry, an indirect connection or a remote one will not suffice under the circumstances. The only sensible meaning therefore to be ascribed to the phrase "any expenditure incurred … on prospecting operations" is that it will only include expenditure that is incurred on any activity done in connection with prospecting.

[79] The word 'incidental' is also not defined in the Income Tax Act. According to the Oxford English Dictionary, one of the meanings of the word 'incidental' is "occurring by chance" and "in connection with something else". In the Collins English Dictionary it is defined as "happening in connection with", "found in connection (with)"; "related (to)", and "concomitant with". According to the Oxford South African Concise Dictionary, the word "incidental" refers to a "minor accompaniment", and "occurring by chance". The expenditure must therefore be happening in connection with the carrying on of the activity. For the same reasons set out above, 'incidental' in the context of section 15(*b*) cannot refer to expenditure incurred for the purchasing of prospecting rights. The initial purchase of prospecting rights is therefore, in my view, not incidental to prospecting operations.

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[26] The *ejusdem generis* rule was also referred to in *Buglers Post* (*Pty*) *Ltd v SIR*, wherein Rumpff ACJ, as he then was, delivering the judgment of the Appellate Division, said:

> 'The improvements set out in para 12(1)(*d*) [of the First Schedule to the Act; see § 15.30] are of a particular nature. They deal with means or methods by which water, the availability of which is reasonably anticipated, may be used. To that extent they constitute a genus, I think, from which may be inferred that, under the *ejusdem generis* rule, an irrigation scheme is a species of improvement by which land can be irrigated with water, if its availability is reasonably anticipated.'

[80] In an article titled *'An analysis of the Tax Implications of Prospecting Expenditure incurred by Junior Exploration Companies in South Africa',*[27] the authors Sturdy and Conradie pointed out that a prospecting right is included in the definition of an asset in accordance with the Eighth Schedule of the Income Tax Act. This is so because the definition of an asset in accordance with the Eighth Schedule of the Income Tax Act includes property of whatever nature, whether moveable or immovable, and a right or interest, of whatever nature, to or in such property. They opine that although there is no capital allowance in accordance with the Income Tax Act for expenditure incurred on prospecting rights, the expenditure will form part of the base cost of an asset in terms of the Eighth Schedule of the Income Tax Act. Their interpretation also accords with an article titled '*A guide to mining taxation in South Africa'*[28] in which the authors held the view that the deduction allowed according to section 15(*b*) of the Income Tax Act does not apply to expenditure of an initial nature.[29]

[81] The expenditure under section 15(*b*) can only be deducted from the income derived by a taxpayer from mining operations, which indicates the strong link and/or relationship between prospecting and mining. It is noteworthy that the Income Tax Act does not allow the initial purchase of mineral rights to be deducted in terms of section 15(*a*) read with 36(11). This begs the question as to why would the initial purchase of prospecting rights be any different. The Davis Tax Committee also stated that unless specifically legislated for in law, South Africa's courts do not recognise a tax deduction for this type of expenditure since it is regarded as being capital in nature. In *Matla Coal v Commissioner for Inland Revenue*, the Appellate Division held that "mining and mineral rights, like any other property, may be acquired and held by a taxpayer with a view to exploiting the rights themselves as income-producing capital assets or alternatively with a view to realization as part of a profit-making scheme, in which case they assume the character of trading stock."[30]

[82] The purchase of prospecting rights is being claimed in circumstances that go beyond the policy intent of prospecting activities. Based on the legal principles outlined above, the prospecting rights can only be regarded as a capital asset of ABC and the deduction of the purchase price of such prospecting rights is not allowable in terms of section 15(*b*) of the Income Tax Act.

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27 Sturdy & Cronje 'Journal of Economic and Financial Sciences' JEF July 2013 6(2) at page 342.

28 KPMG. (1993). A guide to mining taxation in South Africa. South Africa: KPMG Aiken & Peat.

29 KPMG. (1993). A guide to mining taxation in South Africa. South Africa: KPMG Aiken & Peat. See also Van Blerck, M.C. (1992). Mining Tax in South Africa. Rivonia: Taxfax CC.

30 1987 (1) SA 108 (A) at para 37.

THE UNDERSTATEMENT PENALTY ('USP')

[83] Pursuant to the revised assessments concerning the deductions in respect of the donations and prospecting rights, SARS imposed USP's on ABC. In respect of the prospecting rights, SARS imposed a USP of 50% in the amount of R40 218 424.12. In the Rule 31, SARS categorized ABC' behaviour in relation to the prospecting rights as a 'standard case' of 'no reasonable grounds for tax position taken'. [31]

[84] In terms of section 102(2) of the Tax Administration Act,[32] the burden of proof is on SARS to prove that there has been an understatement (section 222(1) of the Tax Administration Act) and that the relevant behavior (as set out in section 223 of the Tax Administration Act) applies. Section 222(1) of the Tax Administration Act provides that "In the event of an 'understatement' by a taxpayer, the taxpayer must pay the understatement penalty determined under subsection (2), unless the 'understatement' results from a bona fide inadvertent error." No understatement penalty is therefore payable if the understatement results from a *bona fide* inadvertent error.

[31] **223 Understatement penalty percentage table**
(1) The understatement penalty percentage table is as follows:

1	2	3	4	5	6
Item	**Behaviour**	**Standard case**	**If obstructive, or if it is a 'repeat case'**	**Voluntary disclosure after notification of audit or criminal investigation**	**Voluntary disclosure before notification of audit or criminal investigation**
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	'Impermissible avoidance arrangement'	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi	Intentional tax evasion	150%	200%	75%	10%

[32] SECTION 102(2): The burden of proving whether an estimate under section 95 is reasonable or the facts on which SARS based the imposition of an understatement penalty under Chapter 16, is upon SARS.

[85] An 'understatement' means any prejudice to SARS or the *fiscus* as a result of –

(a) failure to submit a return required under a tax Act or by the Commissioner;

(b) an omission from a return;

(c) an incorrect statement in a return;

(d) if no return is required, the failure to pay the correct amount of 'tax'; or

(e) an 'impermissible avoidance arrangement'.

[86] There is no doubt that there was an "understatement" in the amount of R287 million in that there was (c) "an incorrect statement in a return". The prejudice to the *fiscus* is substantial.[33] The issue is whether the incorrect statement constitutes a *bona fide* inadvertent error.

[87] In an article "Understatement penalty in terms of the Tax Administration Act- a critical analysis of the interpretation of a bona fide inadvertent error", the author opine that the *onus* is on SARS to firstly identify the understatement by the taxpayer and secondly, before the imposition of the understatement penalty, determine whether or not the understatement is due to a *bona fide* inadvertent error, before the understatement penalty can be levied. Van Zyl in an article titled "The new understatement penalty regime: a sharp 'sword'?",[34] is of the view that this is an "implied" burden of proof that rests upon SARS and that the specific facts and circumstances that resulted in the understatement by the taxpayer must be taken into account by SARS.

[88] Section 129(3) of the Tax Administration Act states that, in the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the Tax Court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or increase the understatement penalty imposed. In my view this includes the *onus* of proving that the understatement was not as a result of a *bona fide* inadvertent error.[35]

[89] There is no definition of "*bona fide* inadvertent error" in the Tax Administration Act, or for that matter, in any other Act. Applying the principles in *Endumeni Municipality supra*, consideration must be given to the phrase "*bona fide inadvertent error"* by examining the language, the context and the purpose of the provision in which the words are found. It is the error that must be *bona fide* and inadvertent. "*Bona fide*" in this context means 'genuine' and

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33 In *Purlish Holdings (Pty) Ltd v SARS* 2019 JDR 0301 (SCA) the court found that prejudice is not only determinable in financial terms, but includes the time and human capital resources employed in conducting the audit into the Taxpayer's tax affairs.

34 2014 Journal of Economic and Financial Sciences 909.

35 See *Purlish Holdings* supra at [24] wherein the court held that it was satisfied that SARS had proven that there were understatements as contemplated by section 221, which understatements were not as a result of a *bona fide* inadvertent error.

'real'. Synonyms include authentic, true, actual, and legitimate. The word "inadvertent" is defined as 'not deliberate' or 'unintentional. Synonyms for the word inadvertent are, 'accidental', 'unintentional', 'unintended', 'unpremeditated', 'unplanned' and 'unwitting'.[36] "Error" is defined by the Oxford Dictionary as 'a mistake'. It also gives the following synonym: 'the state or condition of being wrong in conduct or judgement'. No distinction is made in section 222 between mistake of fact and mistake of law. In the "Guide to Understatement penalties"[37], SARS describes "*bona fide* inadvertent error" as an understatement that must result from an unintentional default, an accidental omission, an unplanned statement, an involuntary failure to pay the correct tax, and an unpremeditated impermissible avoidance arrangement.

[90] In *ABC Holdings (Pty) Ltd and The Commissioner for the South African Revenue Service*[38] the court held that a *bona fide* inadvertent error is "an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive." The court found that there was "merit in excusing the appellant for its reliance on Prof T's opinion on the basis of it being lay on issues of tax and the law" and remitted the penalties imposed.

[91] It is common cause that ABC claimed the expenditure incurred under section 15(*b*) because it was of the opinion that the interpretation of "prospecting operations" includes the purchase price of prospecting rights. In the Rule 32 Statement, ABC stated that if it was found that there was an understatement, all understatement penalties ought to be remitted on the basis that the "understatement" resulted from a *bona fide* inadvertent error.

[92] In the Rule 32 Statement, ABC also referred to the applicable sections in the Income Tax Act and stated the reasons why it was of the opinion that it was entitled to a deduction under section 15(*b*). ABC specifically disputed the penalty imposed and stated that it acted reasonably by adopting the tax position for the following reasons:

(i) It acted in good faith in accordance with its own understanding of the fiscal legislation that applied to the applicable facts;

(ii) Its tax returns for the relevant years of assessment were completed and submitted to SARS;

(iii) It acted *bona fide* in all respects, including the *bona fide* belief that its tax affairs were up to date and that it correctly interpreted the fiscal legislation in question;

(iv) It had no intention to evade or avoid any taxation or to defraud the fiscus; and;

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36 See Merriam-Webster online dictionary.
37 Dated 28 March 2018.
38 ITC 189079 SATC 62 at para [45].

(v) There was no negligence on its part.

[93] In the Rule 31, SARS did not deal with whether ABC reliance on section 15(*b*) was a *bona fide* inadvertent error or not. It merely stated that there was an understatement and categorized ABC' behaviour in relation to the prospecting rights as a 'standard case' of 'no reasonable grounds for tax position taken'. SARS stated the two factors it considered before imposing the USP of 50 %: (1) ABC has failed to provide SARS with an opinion by a tax practitioner regarding the deductibility of the acquisition of prospecting rights, (2) ABC claimed the deductions even though it was not actually carrying out prospecting operations on the relevant properties at the time the deductions were claimed.

[94] Firstly, in terms of section 223(3)(*b*) of the Tax Administration Act, the provision of a tax practitioner's opinion is only of relevance in the context of a 'substantial understatement' and not an 'understatement'. As indicated, SARS did not impose the USP on the basis of a 'substantial understatement' but just an 'understatement'. Although the amount involved is clearly a substantial understatement, an opinion from a tax practitioner regarding the deductibility of the prospecting rights is not required in terms of section 223. Secondly, since it has been factually established from the unchallenged oral and documentary evidence presented by ABC that it was ABC that actually carried out the prospecting operations in the relevant areas at the time the deductions were claimed, the basis for imposing the USP as set out in paragraph 38.2 of the Rule 31 is erroneous and cannot sustain the imposition of the USP as aforesaid.

[95] However, the proceedings before the Tax Court involve a rehearing of the evidence and the Tax Court do not operate in the same manner as conventional appeal or review proceedings.[39] Appeals are heard *de novo* as a court of first instance to revisit the decision of the Commissioner and this court is not bound to SARS' reasons for the decision to impose the USP. The question that therefore needs to be answered by this court is the following: If a taxpayer adopts an incorrect tax position does it constitute a *bona fide* inadvertent error as contemplated in section 222?

[96] I agree with what is stated in SARS' *"Guide to Understatement Penalties",* namely, that all understatements result from a trigger that has already been determined to be a mistake – a default, an omission, an incorrect statement, a failure to pay the correct tax, and an impermissible avoidance arrangement. The error from which the understatement results, is therefore insufficient to exempt it from a penalty – the trigger must be ***bona fide* inadvertent**.[40]

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39 ITC 1806 68 SATC 117.

40 At page 15.

What constitutes a *bona fide* inadvertent error will depend on the circumstances of the taxpayer and must be assessed on a case by case basis.

[97] Grammatically contextualized, an inadvertent error, in the context of Chapter 16 of the Tax Administration Act, and specifically section 222 and 223, is an unplanned, accidental, involuntary, uncalculated mistake. By intentionally adopting a certain tax position, albeit *bona fide*, can never be regarded as "inadvertently". If it was the intention of the legislature that the adoption of a specific tax position should be construed as a *bona fide* inadvertent error, there would have been no need to include item (iii) in section 223 of the Tax Administration Act, namely "no reasonable grounds for tax position taken". It is under this section that the *bona fides* **of the taxpayer** will be examined to determine whether the adoption of a specific tax position was reasonable (Emphasis added).

[98] I am therefore not satisfied that the understatement was as a result of a *bona fide* inadvertent error.

[99] When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice.[41] There is no evidence to suggest that ABC intentionally devised a plan to deceive the *fiscus*. On the contrary, Mr P testified that within SARS there has been debate as to the scope and application of section 15(*b*). The debate is whether the deduction is confined to expenditure incurred in the physical acts of prospecting (such as drilling boreholes etc), or whether it applies to the broader aspects of conducting prospecting activities. He accepted that at the very least the section was open to different interpretations and confirmed that at the time of the deduction, there was no guidance in the case law. It is agreed between the parties that there has not been any decided case on which this issue has been pronounced by the courts.

[100] I can find no factual basis for the imposition of a USP in terms of item (iii) (standard case) – "*No reasonable grounds for 'tax position' taken*". SARS, in its "Guide to Understatement Penalties" states that the purpose is not to levy a penalty when SARS disagrees with a position adopted by a taxpayer, but to attach a penalty where a taxpayer assumes a position unreasonably. The incorrect interpretation of legal provisions does not automatically comprise negligence on the part of the ABC, or means that ABC did not have any reasonable grounds for its tax position. In the present matter the court was faced with two competing interpretations of section 15(*b*). ABC' tax position has been advanced in terms of well-reasoned arguments that supported its views. Given these factors, ABC' interpretation of the section and reliance on it to deduct the prospecting expenditure was, although mistaken,

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41 See *Estate of Spruill v Commissioner* 88 TC 1197 (1987), a decision of the Tax Court in the United States of America.

at the very least, reasonable. SARS failed to discharge its *onus* in convincing the court that ABC had no reasonable grounds for the tax position taken.

[101] There is however an understatement by ABC. The question is which penalty should have been imposed by SARS?

[102] In the light of the evidence and the legal principles outlined above, SARS should have imposed the USP based on item (i) "substantial understatement" column 3 (standard case) of the table in section 223 of the Tax Administration Act. The USP should therefore be reduced to 10%.

SECTION 89QUAT(2) INTEREST

[103] Section 89*quat*(2) provides that interest shall, subject to the provisions of subsection (3), be payable by the taxpayer at the prescribed rate on the amount by which such normal tax exceeds the credit amount, such interest being calculated from the effective date in relation to the said year until the date of assessment of such normal tax. Subsection (3) provides that where the Commissioner having regard to the circumstances of the case is satisfied that the interest payable in terms of subsection (2) is as a result of circumstances beyond the control of the taxpayer, the Commissioner may direct that interest shall not be paid in whole or in part by the taxpayer. Any decision of the Commissioner in the exercise of his discretion under subsection (3) shall be subject to objection and appeal.

[104] ABC avers that the Commissioner for SARS ought to have remitted the said interest in terms of section 89*quat*(3) of the Tax Administration Act, because it acted reasonably, in accordance with its own understanding of the relevant tax laws, and the interest was as a result of circumstances "beyond its control". ABC submits that its tax returns for the relevant years of assessment were completed and submitted to SARS and that it acted *bona fide* in all respects. It is submitted that there was no intention on the part of ABC to evade or avoid any taxation or to defraud the fiscus.

[105] In *Juta's Income Tax*,[42] Dennis Davis commented on section 89*quat*(3) and stated that:

> "The test as to whether the grounds are reasonable, is objective, in relation to actions of the taxpayer. A mere subjective belief by the taxpayer that a deduction should be allowed, without taking advice on the matter, is unlikely to be reasonable. On the other hand, the reliance by the taxpayer on expert advice, even if this is wrong, will in most cases constitute reasonable grounds for the action taken.'

[42] *Juta's Income Tax* Vol 2 at 55-3.

[106] I am satisfied, on the facts in the present matter as set out above, that ABC' reliance on section 15(*b*) was reasonable. Thus, the interest should not be charged in terms of section 89*quat*(2) of the Tax Administration Act.

COSTS

[107] ABC has failed to discharge the *onus* that it bears in respect of the deduction relating to the purchase of the prospecting rights. SARS has failed to discharge the *onus* that it bears in respect of the understatement penalties.

[108] The court has a discretion to award costs in favour of the aggrieved party and on application by that party, if either the grounds for assessment or appeal, whichever is applicable, are held to be unreasonable.

[109] A substantial part of this court case could have been avoided, if SARS adopted the correct factual approach to the assessment and the appeal. SARS factual grounds for the assessment was based on assumptions and was devoid of any merit. In addition, despite the fact that this issue for determination by this court was clearly set out in the documents and pleadings and the pre-trial conference, SARS, at the commencement of the trial, disavowed any reliance on its contentions made in these documents. This resulted in unnecessary costs and a considerable waste of time.

[110] In light of the erroneous factual basis for the issuing of the assessment in relation to the prospecting rights, SARS' grounds of assessment were clearly unreasonable, thereby warranting an order for costs against it. SARS' conduct, both in raising the assessment and its reliance on statements of grounds of assessment, which were not sustained in the course of evidence, falls within the parameters of section 130(1)(*a*) of the Tax Administration Act. SARS should therefore be held liable for costs, which includes the costs of two counsel.

[111] ABC has however withdrawn its ground of appeal relating to donations in the eleventh hour and should be liable for costs consequent upon such late concession. ABC also included unnecessary documents in the trial-bundle relating to a failed ADR process. These bulky documents served no purpose in the present proceedings and the appellant did not refer to them.[43]The appellant was well aware that ordinarily, the proceedings under the ADR rules are not to be one of record, and any representation made or document tendered in the course of those proceedings should not be disclosed in any subsequent proceedings. The costs incurred by ABC in relation to these documents are disallowed.

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[43] The appellant included in the trial bundle no less than 101 pages relating to the failed ADR process, namely, pages, 73 – 84, 93 -95, 103 – 176 and 186 – 199.

[112] In the result the following order is made:

(i) The appeal is dismissed in respect of the acquisition of the prospecting rights;

(ii) The imposition of Understatement Penalties in relation to the prospecting rights in terms of section 221 and 223 of the Tax Administration Act is amended to reflect a 10% penalty;

(iii) The levying of interest in terms of section 89*quat*(2) of the Income Tax Act is remitted; and

(iv) The respondent to pay the costs of the appeal, including the costs of two counsel, but excluding the costs incurred in relation to the documents concerning the ADR process.

(v) The appellant to pay the costs incurred in relation to the abandoned of its appeal on the donations.

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L. WINDELL
JUDGE OF THE HIGH COURT
GAUTENG LOCAL DIVISION, JOHANNESBURG

Delivered: This judgement was prepared and authored by the Judge whose name is reflected and is handed down electronically by circulation to the Parties/their legal representatives by email and by uploading it to the electronic file of this matter on CaseLines. The date for hand-down is deemed to be 25 February 2021.

Date of hearing: 1 July 2020 to 3 July 2020 and 27 to 28 July 2020.
(Supplementary heads of argument filed on 25 November 2020 and 2 December 2020 by the Appellant and Respondent respectively)

Date of judgment: 25 February 2021