REPUBLIC OF SOUTH AFRICA

TAX COURT OF SOUTH AFRICA

GAUTENG DIVISION, JOHANNESBURG

CASE NO: IT 25242

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

……………………… DATE ………………………… SIGNATURE

In the matter between:

ABC TRADING Appellant

and

THE COMMISSIONER FOR

THE SOUTH AFRICAN REVENUE SERVICE Respondent

J U D G M E N T

THIS JUDGMENT HAS BEEN HANDED DOWN REMOTELY AND SHALL BE CIRCULATED TO THE PARTIES BY WAY OF EMAIL. ITS DATE ANDTIME OF HAND DOWN SHALL BE DEEMED TO BE 31 MAY 2021 AT 10H00

MALI J with

Mr S.C. NHLEKO ACCOUNTANT MEMBER and

Mr T. TSEKOA COMMERCIAL MEMBER

[1] There are three questions raised in this appeal. They are:

(i) whether the appellant is entitled to claim a deduction for depreciation of 20%, in respect of assets it acquired from a connected person, a going concern; namely JKL (Pty) Ltd ("JKL Co.*")* in terms of section 12 C of the Income Tax Act 58 of 1962 ("the Act"). The assets comprise stock, aircraft parts, furniture, tools and equipment, (including computers).

(ii) whether the appellant is entitled to claim a deduction in respect of finance charges, in terms of section 11(*a*) of the Act. The finance charges arose from loan initially acquired by JKL Co. from B Bank, which the appellant allegedly took over as a liability; and finally,

(iii) whether the understatement penalty, ("USP") was appropriately imposed, as sanctioned in section 222 read with section 223 of the Tax Administration Act 28 of 2011 ("TAA").

[2] The undisputed facts can be summarised as follows: On 14 April 2010 the appellant acquired assets such as, stock, aircraft parts, furniture, computers, tools and equipment from JKL Co. as a going concern. JKL Co. and the appellant are connected persons in that Mr DD is a Director of both entities.

[3] The assets acquired were acquired by means of a sale of agreement between the two entities. Included therein are three aircraft which were said to be valued at R36 211 367.00 (thirty-six million two hundred and eleven thousand three hundred and sixty-seven rand). Instead of receiving payment for assets, JKL Co. was allotted 200 ordinary shares in the appellant.

[4] The share premium, as reflected in the financial statements, was R34 376 192.00 (thirty-four million three hundred and seventy-six thousand one hundred and ninety-two rand). There was a difference of R1 835 175 (one million eight hundred and thirty-five thousand one hundred and seventy-five rand) between the value of the assets and the share premium of the 200 ordinary shares. The appellant explained that the difference was an on-going liability on the assets which the purchaser would assume.

[5] In 2014 a tax enquiry in terms of section 50 of TAA into the tax affairs of the appellant was held. The appellant through its director was subpoenaed to appear and make available certain documentation and information to the enquiry. The documentation and information obtained during the tax enquiry and from third parties was reviewed and analysed, amongst

them were annual financial statements, general ledgers, bank statements, invoices and tax returns.

[6] The respondent in investigating the tax affairs of the appellant and its connected entities raised a query regarding the value placed on tools and equipment. The tools and equipment were initially acquired by JKL Co. from a connected entity named Executive Helicopters. The query raised by the respondent in relation to the transaction involving the acquisition of these tools and equipment had not been resolved as at the day of hearing this appeal.

[7] The issues raised at the enquiry and imported to the appeal are that the appellant was dormant since it had not traded during the 2010 year of assessment. The appellant had no assets at all during the 2010 tax year up to the date of the sale transaction.

[8] The assessment document referred to as ITA34 dated 29 March 2012, being for the 2011 year of assessment, reflected zero tax payable due to the large taxable loss reported by the appellant. ITA34 dated 25 March 2013, being the original assessment for the 2012 tax year was issued, reflecting net payable amount of R NIL.

[9] On 31 October 2017, after the respondent performed audit; the respondent issued an additional assessment for 2011 period. The assessment reflects a net amount payable of R2 827 984.00 (two million eight hundred and twenty-seven thousand nine hundred and eighty-four rand). On 16 April 2019 a reduced assessment of just over R500 000 (five hundred thousand rand) was issued. Subsequent to the audit of 2012 assessment, additional assessment was issued on 31 October 2017. The net amount payable was R841 449.00. (eight hundred and forty-one thousand four hundred and forty-nine rand). The appellant was afforded an opportunity to consider the above mentioned audit findings and to submit further documentation as required. The appellant did not respond, and instead filed this appeal.

[10] The provisions of section 12C(1) which are relevant read as follows:

> "(1) In respect of any—
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> (*a*) machinery or plant (other than machinery or plant in respect of which an allowance has been granted to the taxpayer under paragraph (b)) owned by the taxpayer or acquired by the taxpayer as purchaser in terms of an agreement contemplated in paragraph (*a*) of the definition of 'installment credit agreement' in section 1 of the Value-Added Tax Act and which was or is brought into use for the first time by the taxpayer for the purposes of the taxpayer's trade (other than mining or farming) and is used by the taxpayer directly in a process of manufacture carried on by the taxpayer or any other process carried on by the taxpayer which is of a similar nature;

> a deduction of 20 percent of the cost of such machinery, plant, implement, utensil, article, ship or aircraft (hereinafter referred to as an asset) shall, subject to the provisions of subsection (4) , be allowed in the year of assessment during which the asset is brought into use and in each of the four succeeding years of assessment.
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> …
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> (4)(*b*) where such asset was previously brought into use by any connected person in relation to such person."

Depreciation of assets

[11] In terms of section 82 of the Act and section 102 of TAA the appellant bears the burden to prove that the assessment issued by the respondent is incorrect.

[12] Two witnesses testified on behalf of the appellant. The first witness, Mr F, was called as an expert. He admitted that he is not qualified to give an opinion on the market value of tools and equipment save to say that such items still had a value which is a replacement value. The key question to be answered requires a value in rand. Since the witness could not provide the value, his evidence is of no assistance and therefore irrelevant.

[13] The second witness, Mr DD, the director of the appellant, testified that he represented the appellant and connected entities at the tax inquiry. He also represented the appellant and JKL Co. in the sale of business agreement in his capacity as director of both companies.

[14] He testified that appellant reflected in its 2011 financial statements the cost of the tools and equipment under plant and machinery at R11 666 667.00 and claimed depreciation at a rate of 20% on a straight line basis. He provided the respondent with a list of tools and equipment acquired in respect of which the appellant claimed depreciation when it lodged its objection.

[15] He stated that in the aforesaid list there were no values and no cost attached to the individual items. This is because all the tools and equipment were acquired in one composite transaction in terms of the sale of business agreement, at a depreciated tax value in terms of the books of JKL Co..

[16] He further testified that while some of tools and equipment may depreciate in value, there were some that may increase in value due to the fact that they can be used over a long period coupled with the fact that their value is positively impacted by the Dollar/Rand Exchange Rate.

[17] When the appellant submitted its statement of grounds for appeal, Mr DD prepared a complete list of the aforesaid tools and equipment wherein he inserted “new prices” for each item, on the basis that the goods were new and because second hand prices could not be obtained.

[18] He attested on how he obtained new prices, amongst others he checked prices from websites and contacted manufactures. He also made reference to photographs of big cost items and their usage. In fact, the document with “new prices” quotes prices as at March 2020. He placed the total value at R28 103 885 based on an exchange rate of 17.06 to 1 US Dollar. The price is determined on the value of new items that are similar to the second-hand items.

[19] He did not provide proof of his communication with manufactures or any agent and their responses to his pricing queries. Mr DD’s methodology has no legal basis as it is based on his experience of being in the aircraft business since 1983. The new list is thus irrelevant for purposes of the price of the tools and equipment as at the years of assessment concerned. The new list does not assist the appellant’s case.

[20] It is not in dispute that aircraft machinery and equipment can be re-introduced to use when calibrated. Nevertheless, proof of same should be supported by a calibration certificate of usefulness for the purposes of ascertaining value. No calibration certificates were produced for the relevant tax periods. This added another difficulty for the appellant in establishing the values of calibrated and non-calibrated assets.

[21] For the foregoing the evidence of Mr DD falls to be rejected because it lacks corroboration and the document referred to as new price list cannot be relied upon as it is not authenticated. Furthermore, he failed to justify the determination of the share price.

[22] One witness, Ms S, testified on behalf of the respondent. She is the one who audited the tax affairs of the appellant. She stated that she raised the assessment/s in dispute. She testified that during the audit process she requested information from the appellant. The information related to, amongst others, an explanation on how the share premium of R34 million (thirty-four million rand) was established. Upon the appellant’s unsatisfactory clarification, she proceeded to issue a letter of audit findings.

[23] The effect of the letter referred to above was that the depreciation of the tools and equipment was not taken into account as there was neither proof of nor payment related to the transaction. Moreover, the tools and equipment stated in the original list, there were no values included.

[24] She further testified that the appellant was afforded an opportunity to make representations, which opportunity was not taken up. She then proceeded to issue the letter of assessment disallowing depreciation of tools and equipment and finance charges claimed, and further imposed 100 % understatement penalty, based on the appellant's negligence in claiming the above mentioned deductions.

[25] Under cross examination Ms. S's evidence was not seriously challenged; except for her reasons to close the audit and not to invoke anti-avoidance provisions. She explained that she closed the audit on the basis of information at hand at the time. The division she was placed in was shutting down and all the employees in the division were instructed to finalise all outstanding assessments.

[26] Ms S further stated under cross-examination that she did not apply the anti-avoidance provisions because she was satisfied with the charging provisions in terms of section 12C. She further stated that she did not take into consideration the issue of the value of the shares used as payment by the appellant to JKL Co.. This is because she was not getting any further information from the appellant and had to finalise the assessment on the basis of what was before her.

[27] There is no acceptable evidence to gainsay Ms S's evidence. Furthermore, as will be shown below she applied the law correctly. Her evidence cannot be faulted.

[28] Section 12C makes it clear that a deduction is allowed on the machinery owned or acquired by the taxpayer. One of the considerations in the present matter is how the appellant determined the value of shares. Respondent submitted that when the sale was concluded the appellant had 1000 authorized ordinary shares. By implication with 200 shares being equivalent to R34 million (thirty-four million rand), the appellant's 1000 shares were as the date of sale transaction worth about R170 million (one hundred and seventy million rand). The amount of R170 million (one hundred and seventy million rand) is made from R34 million divided by 200 (shares). There is no explanation on behalf of the appellant as to how the shares were determined. The appellant's witness simple stood by the amount of R34 million (thirty-four million rand) as the value of the shares despite the undisputed calculation and or illustration.

[29] As gleaned from the evidence of the appellant above the appellant had no assets at the date of the alleged purchase. It follows that it was in no position to conclude the sale transaction. The appellant could not pay the purchase price when the appellant was worth nothing at all.

[30] In the *Accounting Tools, the International Accounting Standards (IAS) 16*[1] that prescribes the accounting treatment of Property Plant and Equipment, depreciation is described as the gradual systematic charging to the expense of a fixed asset's cost over its useful life. The *accounting standard, IAS16 para 43 to 49*, does not permit the bundling of assets for purposes of valuation. The accounting standard does, however, allow for these to be regarded as one provided that the useful life is regarded as the same, and that they will be sold as a batch. If the provisos are met, then depreciation on the above is allowed.

[31] It is not in dispute that the tools and equipment which are subject of this appeal are not similar and their useful life is not the same; therefore, they do not qualify for bundling. Each item need to be accorded its value in order for it to be considered for depreciation.

[32] In the present matter appellant did not discharge the burden; as it did not provide values for the assets for depreciation and it neither satisfied the requirements of acquisition of assets through the alleged allotment of shares.

Finance charges

[33] The legal framework referred to in paragraph 14 above pertaining the burden of proof is equally applicable herein.

[34] The claim in respect of deduction for finance charges is in terms of section 11(*a*) of the Act. Section 11(*a*) provides for deduction of expenses incurred in the production of income.

[35] Mr DD testified that in 2008 JKL Co. concluded a loan agreement with B Bank, a financial service provider. The loan agreement was to finance the purchase of an aircraft. The appellant then assumed liability in terms of the sale agreement between appellant and JKL Co.. The deduction arises from the assumed liability in terms of the sale agreement between appellant and JKL Co.. The appellant's version pertaining the financing of the transaction between JKL Co. and appellant has been rejected. Therefore, any liabilities emanating from same cannot be in the production of income of the appellant.

[36] He further testified that the original copy of the loan agreement signed by all the parties could not be found at B Bank. In further support for the existence of loan he referred to journal entries by the book keepers.

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[1] *IAS 16: Property, Plant, and Equipment,* published by the International Accounting Standards Board on 18 December 2003, amended on 14 May 2020.

[37] Ms. S stated that she disallowed the claim for the following: (i) the loan agreement provided by the appellant was not signed by either of the parties to the agreement. (ii) The amount claimed was not reflected on the General Ledger. (iii) Furthermore, the loan agreement account number is reflected as 77161258 in the unsigned document; whereas the account number on the settlement letter and bank statement is reflected as 77196230. She could not ignore this anomaly.

[38] Even if the court was persuaded that the loan was in the production of income, it would not have ignored some of the undisputed irregularities pointed in paragraph 40 above. In the result of the appellant did not discharge the burden of proof, that it was entitled to a deduction in terms of section 11(*a*) of the Act.

Understatement Penalty ("USP")

[39] Section 222(1) provides:

> "In the event of an un 'understatement' by a taxpayer, the taxpayer must pay, in addition to the 'tax' payable for the relevant tax period, the understatement penalty determined under section (2) unless the 'understatement' results from a *bona fide* inadvertent error."

[40] Understatement is defined in section 221 of the TAA inter alia, as including an incorrect statement in a return. Section 223 of TAA provides for the imposition of USP on negligent behavior on a standard case at 100%. For ease of reference it is apposite to quote the table of illustration as depicted in TAA.

(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 investigation	Voluntary disclosure before notification of audit or 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)	Gross negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

[41] The respondent imposed 100% on the basis of gross negligence on a standard case. In my view, the appellant's conduct of not correcting the statements made on the returns, despite being afforded an opportunity to do so, constitute negligence. The respondent is found to have appropriately imposed the penalty.

COSTS

[42] Section 130 of the Tax Administration Act ("TAA") provides as follows:

> "(1) The tax court may, in dealing with an appeal under this Chapter and on application by an aggrieved party, grant an order for costs in favour of the party, if—
>
> (*a*) the SARS grounds of assessments or 'decision' are held to be unreasonable;
>
> (*b*) the 'appellant's' grounds of appeal are held to be unreasonable;"

[43] The respondent made it as clear as early before the stage of enquiry what was required from the appellant in order to consider its claims. The appellant persisted with its claims even after it was afforded opportunity subsequent to audit findings. Instead of responding to audit findings it proceeded to launch the appeal, without success. In the result appellant's grounds of appeal are found to be unreasonable.

[44] In the result the following order is granted:

ORDER

1. The assessments raised for 2011 and 2012 are hereby confirmed.
2. The understatement penalty imposed against the appellant is hereby confirmed.
3. The appellant is ordered to pay costs.

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N.P. MALI

JUDGE OF THE HIGH COURT

Date of Hearing: 15-19 FEBRUARY 2021