IN THE TAX COURT OF SOUTH AFRICA

HELD AT DURBAN

Case Nos: IT12951
VAT855

In the matter between:

ABC (PTY) LIMITED (In Liquidation) Appellant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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JUDGMENT

Vahed J:
((Accountant Member) *et* (Commercial Member) concurring):

[1] The appellant was placed under liquidation by special resolution registered on 30 April 2010. Prior thereto it had traded as importers and manufacturers of household linen products, which it sold to the retail industry. On 1 March 2006 the appellant disposed of its business operations and inventory to D Entity CC ("D Entity"). Upon liquidation the respondent was the only creditor who had any interest in the appellant's affairs. The current dispute between the parties arises from the additional income and value-added tax assessments issued by the respondent in respect of the Appellant's 2004, 2005 and 2006 years and periods of assessment.

[2] The disputes range over many aspects of the appellant's business, accounting and tax affairs for the relevant periods and include challenges

relating to the respondent's views as to how the appellant treated claims and/or deductions relating to casual wages, wear and tear on vehicles, settlement discounts, rebates, bad debts, claims for repairs, overseas travel, and corrections (journal entries) to stock records during the relevant years of assessment. Those in turn resulted in affecting, in addition to income tax, the appellant's Pay As You Earn ("PAYE"), Skills Development Levies ("SDL") Unemployment Insurance Contributions ("UIC") and Value Added Tax ("VAT") returns for the relevant periods of assessment.

[3] At a pre-trial conference the parties agreed that should I permit same, the issue of prescription would be dealt with as a preliminary point *in limine*. I agreed to do so and as the issue relates to a legal point, I decided the issue alone, without input from the additional members of the Court. At the conclusion of argument on the preliminary issue of prescription I ruled that the matters relating to Income Tax for the 2004 and 2005 years of assessment had become prescribed in terms of s 79 of the Income Tax Act, 1962 ("the IT Act") and indicated that the reasons for that ruling would be included in this judgment. They now follow, after which the rest of the appeal will be dealt with.

[4] The 2004 original assessment was issued on 23 January 2006 with a due date of 1 March 2006.

[5] The additional 2004 assessment was issued on 2 October 2009 with a due date of 1 November 2009.

[6] Accordingly, more than three years had elapsed since the original 2004 assessment was issued and, unless the proviso to section 79 of the IT Act is applicable, that assessment would have prescribed.

[7] The 2005 original assessment was issued on 22 March 2006 with a due date of 1 May 2006.

[8] The 2005 additional assessment was issued on 2 October 2009 with a due date of 1 November 2009.

[9] Accordingly, more than three years have elapsed since the original 2005 assessment was issued and, unless the proviso to section 79 of the IT Act is applicable, this assessment would have prescribed.

[10] The 2005 income tax return was lodged on 22 February 2006 and the appellant argues that all of the relevant questions requested by the Commissioner in the 2005 return of income had been duly completed and answered.

[11] The amounts that are in dispute are the sums of R1 265,00, R1 265,00 and R1 542,00 for Income Tax, Additional Tax and interest as at 30 September 2011 respectively for the 2004 year of assessment and R119 483,00, R119 483,00 and R120 380,00 for Income Tax, Additional Tax and interest as at 30 September 2011 respectively for the 2005 year of assessment and these amounts relate to alleged unsubstantiated wear and tear on vehicles in the sums of R4 217,00 and R49 426,00 for the 2004 and 2005 years respectively and the sum of R348 852,00 in respect of alleged unsubstantiated expenditure on casual wages and salaries for the 2005 year.

[12] In a letter of audit findings dated 12 August 2009, the respondent did not give any consideration to the issue of prescription and concluded that "…It is my intention to adjust for wear and tear on assets not owned by the taxpayer..." and then simply referred to the two amounts of claims referred to above and then went on to say that as "…the taxpayer did not maintain records to substantiate casual wages paid of R348 852 in the 2005 tax year … [i]t is my intention to adjust for 2005 income by R345 852 …. as the onus of proof of deductibility of the expenditure has not been discharged.".

[13] Again in the assessment letter that followed those audit findings, dated 30 September 2009, the respondent made no reference to prescription in finalising the adjustments for the wear and tear and salary expenditure.

[14] In a request for reasons dated 7 October 2009, the appellant requested "…any other reasons other than the issue of onus for the adjustment of the 2005 wages.".

[15] The respondent responded on 3 November 2009 to the request for reasons as follows:

> "Please be advised no evidence was provided for the use of staff – please refer to your assumption of about five containers per week, R40 per shift and about ten workers per container.
>
> We are unaware of any income tax provisions that require reliance on the taxpayer's *ipse dixit* when adequate records and documentation are not maintained. In fact, in terms of section 69 the Commissioner is entitled to information in such form as he requires.
>
> We are unable to provide any reason other than onus and we believe that the onus provision suffices as a basis for the assessment."

[16] The appellant argues that it is therefore clear that the appellant did not give consideration at all to the issue of prescription and relied solely on the issue of onus and that it is also clear that the appellant could not have been satisfied as to the fact that the necessary factors had occurred to lift the veil of prescription.

[17] It is plainly apparent that the respondent acted only on the basis of onus and did not consider any other or further factor prior to the raising of the assessment.

[18] On 4 December 2009 the appellant lodged an objection and specifically lodged objection in respect of the 2004 and 2005 years of assessment on the basis of prescription, noting that "[t]he Commissioner has placed on record that the only reason for the adjustment is one of onus and, accordingly, is now precluded from relying on the proviso to section 79 to open this assessment.".

[19] As far as I can tell from the dossier and the documents, the first occasion that the respondent attempts to rely on section 79 is in the notice of disallowance of the objection where the respondent notes the following:

> "1.5 Basis of disallowance of objection – it is submitted that wear and tear claimed on assets purchased on behalf of the taxpayer's consultants and employees amounted to misrepresentation and in terms of section 79, the veil of prescription was lifted and the assessments correctly raised."

[20] With regard to the issue of salaries and wages the notice of disallowance does not, however, rely on the issue of prescription being lifted but continues to assert the issue of onus where the following is noted:

> "2.5 Basis of disallowance of objection – the taxpayer did not provide any supporting records to discharge the onus of proof and the objection is, therefore, disallowed."

[21] Accordingly it was submitted that the respondent had failed to assert even at this stage that there was a basis for lifting the veil of prescription and was relying solely on the issue of onus in respect of salaries and wages. I agree with this submission. I also agree with the submission that the necessary tests to lift the veil of prescription have not been met in respect of the 2005 salaries and wages adjustment.

[22] On 22 June 2010 the appellant noted an appeal in respect of these matters and re-emphasised the issue of prescription. The appellant noted the following:

> "It is the taxpayer's position, therefore, that the Commissioner should be limited to the reason provided in his response to the request for reasons, which is that 'we are unable to provide any reason other than onus and we believe that the onus provisions suffices as a basis for the assessment'".

and

> "In the notice of disallowance, the Commissioner is now attempting to lift the veil of prescription in respect of the 2005 fiscal year without due regard to the provisos to that section and still regarding the basis of disallowance as 'the taxpayer did not provide any supporting records to discharge the onus of proof and the objection is, therefore, disallowed."

and

> "It is submitted that in terms of the 2005 year, the Commissioner is precluded from using the issue of onus in respect of a year of assessment which has in fact prescribed in law in which the Commissioner accepts as prescribed other than in respect of the vehicle expenses which were adjusted due to the lifting of the veil as a consequence of misrepresentation alleged by the Commissioner in respect of that specification of expenditure."

and

> "No such contention is made in respect of salaries and wages for the 2005 year and it is submitted in terms of the request for reasons and the reasons provided that no such contention can in fact be made."

[23] In its statement of grounds of assessment, when dealing with salaries and wages, the respondent notes the following:

> "The Respondent contends that the Appellant failed to show that the Respondent was incorrect in including into the Appellant's gross income sums claimed as a deduction for salaries and wages and, furthermore, failed to keep proper records so as to substantiate the alleged expenses. In addition, the Appellant inflated its claim if regard is had to the reconciliation between the Appellant's payroll and the financial statements for the 2006 year of assessment. The Respondent puts the Appellant to the proof of the contrary."

[24] The Respondent again does not assert the issue of prescription being lifted in respect of the salaries and wages adjustment.

[25] The appellant analysed the total expenditure in the 2004 and the 2005 years as follows:

	2005	**2004**
Opening stock	3 749 820	2 739 258
Purchases	42 260 885	26 933 049
Expenditure	19 615 628	11 819 289
Total	65 626 333	41 491 596

and analysed the adjustment by respondent:

	2005	**2004**
Wear and tear	49 426	4 217
Salaries	348 852	-
Total	398 278	4 217

and contended that the "error" as a percentage of the expenditure is:

	2005	**2004**
Percentage	0.606%	0.010%

[26] The submission accordingly was that this amount cannot be considered material and as a consequence should not result in the violation of the fundamental right of prescription and closure.

[27] In *Natal Estates Limited v SIR* 1975 (4) SA 177 (A) the following extract is noteworthy:

> "I shall assume, without deciding, in favour of the respondent, that, once he is satisfied that an amount was not previously assessed because of fraud or misrepresentation or non-disclosure of material facts, his decision is unappealable. However, there must be some evidence before the Special Court that he was so satisfied, otherwise there is no displacement of the immunity conferred on the taxpayer by the proviso to s 79(1) and the opening words of para (*a*) thereof. A convenient time and place for indicating the Secretarial satisfaction would be in the additional assessment itself, or in a covering letter; or in the notice which the respondent is required by s 81(4) to send to the taxpayer, if the latter's objection to the assessment is disallowed. And it should state the particular conduct of the taxpayer to which it relates, ie whether fraud or misrepresentation or non-disclosure of material facts."

[28] The appellant submits that the respondent failed to meet the requirement of satisfaction. The respondent failed to address the issue of prescription at all in the letter of findings or in the letter of assessment. In addition, the respondent confirmed in the response to the request for reasons that the only reason was that of onus. In fact, on the aspect of the salaries

and wages, the notice of disallowance again fails to address the issue of prescription at all.

[29] It must be emphasised that at the time of *Natal Estates* it was not possible to request reasons from the tax authorities. In present time a fundamental new step in the process has been introduced with the ability to request reasons from the respondent. At that stage, fairness demands that it pins its colours to the mast.

[30] In the result it is my view that at no such time does the respondent meet the causal test requirement.

[31] *Natal Estates* goes further:

> "It is common cause that in the present case (which lasted for four days before the Special Court) there was neither testimony nor any document stating that the Secretary satisfied himself as to the requirements of s 79(1)(*a*). All that happened in this regard in the Special Court was that, during the argument stage after the cases had been closed, the representative of the respondent (who was not counsel in this court) made the *submission* that the Secretary was satisfied that there had been a material non-disclosure. With all respect, that is not the way to establish it."

[32] In my view further the respondent has not met the requirements of establishing such satisfaction and, based on the relative amounts in dispute, it is unable satisfy the requirement of it being a material non-disclosure.

[33] Still further in *Natal Estates*:

> "Counsel for the respondent in this court recognized all the foregoing, but he contended that (a) the correspondence between the parties prior to the issue of the additional assessment, and (b) the maxim *omnia praesumuntur rite esse acta* gave rise to the inference that the Secretary

had indeed applied his mind to the requirements of s 79(1)(*a*) and had satisfied himself thereanent. I am unpersuaded that the correspondence has the effect contended for. With regard to the maxim relied upon, in *Byers* v. *Chinn and Another*, 1928 AD 322 at 332 Stratford JA, giving the judgment of the court, had this to say about it:

> 'In Wigmore on *Evidence* vol 4 para 2534 the author says: "The general experience that a rule of official duty, or a requirement of legal conditions, is fulfilled by those upon whom it is incumbent, has given rise occasionally to a presumption of due performance. This presumption is more often mentioned than enforced; and its scope as a real presumption is indefinite and hardly capable of reduction to rules. It may be said that most of the instances of its application are found attended by several conditions; first, that the matter is more or less in the past, and incapable of easily procured evidence; secondly, that it involves a mere formality, or detail of required procedure, in the routine of a litigation or of a public officer's action; next, that it involves to some extent the security of apparently vested rights, so that the presumption will serve to prevent an unwholesome uncertainty; and, finally, that the circumstances of the particular case add some element of probability." '

In the present case none of these conditions can be said to apply. Nor, in particular, is this a case of a merely formal decision: on the contrary, the Secretary's 'satisfaction' is a substantive and far-reaching determination, which should be communicated to the taxpayer, if not before, then at the very latest at, the hearing in the Special Court. In these circumstances I do not consider that the maxim rescues the Secretary in this case.

Once it is recognized that there should be some evidence of the Secretary's satisfaction, the taxpayer should be informed of it plainly, and of the particular conduct in respect of which he is satisfied, e.g., fraud, or material non-disclosure. The taxpayer should not have to grope inferentially for the Secretarial satisfaction, or the particular form of dereliction of duty to which it relates. In particular he should not be left to infer from the mere receipt of an additional assessment, after the expiration of three years from the date of the original assessment, that the Secretary, after applying his mind to the matter, is satisfied that the taxpayer's fraud or misrepresentation or material non-disclosure caused a non-assessment. For one thing (and it was common cause in this appeal that the material non-disclosure could be innocent) the taxpayer is entitled to know whether fraudulent conduct—a grave and ugly imputation—is being held against him."

[34] In the present matter, the respondent did not contend anything with regard to the issue of prescription prior to the additional assessments being issued and, in fact, when asked whether there were any reasons other than that of onus, confirmed categorically that there was no other reason beyond onus and, as such, cannot be said to have applied his mind to the issue of prescription prior to the raising of the additional assessment.

[35] I can find nothing to infer that the respondent was satisfied at the time of the assessment or during the process because it is fair to say that the question of prescription was not part of the respondent's focus.

[36] *Natal Estates* goes further:

> "Lastly, counsel for the respondent sought refuge in terms of s 82 of the Act, which *inter alia* casts upon the taxpayer the burden of proving non-liability. As to that, because three years had expired since the original assessment, the taxpayer enjoys statutory immunity from further assessment. If the Secretary wished to displace that immunity, it was for him to state that he was "satisfied" that the non-assessment in question was caused by the taxpayer's fraud or misrepresentation or non-disclosure of material facts. This is because the proviso to s 79(1) of the Act read with para (*a*) thereof prohibits the Secretary from raising an additional assessment, after the lapse of three years, unless he is so satisfied. In the present case, there is no evidence of such 'satisfaction' on his part, and the taxpayer's immunity stands. The appellant has therefore shown that the secretary's decision to assess him further was wrong."

[37] It was submitted that the respondent has not shown any evidence of this satisfaction and, as such, the statutory immunity ought to prevent the raising of the additional assessment. I agree.

[38] My attention was also drawn to *ITC 1637* 60 SATC 413 (1997 (5) JTLR 157) where Selikowitz J noted the following:

> "In order for the Commissioner to avail himself of the right to reopen an assessment in terms of s 79, he must be satisfied that an amount was subject to tax and that it should have been assessed or that an amount of tax was chargeable and should have been assessed under the Act. The requirement in sub-s (*c*) is not relevant here.
>
> I am satisfied that the time at which the amount was subject to tax and should have been assessed, or was chargeable and should have been assessed, can only be the time when the assessment was made which it is sought to re-open. Indeed, there is nothing in the Act, and more particularly in ss 11(*a*), 11(*p*) or 23B to indicate that the Legislature had any other intention."

[39] It is clear that the respondent had not made such a determination before the raising of the additional assessment and, as such, the statutory immunity ought not to be disturbed. The belated reference in the correspondence to a material non-disclosure was, in my view, clearly an afterthought, made only after the appellant had raised the issue. The passage from *Natal Estates* referred to in paragraph [33] above was also relied upon by counsel for the respondent to contend that the belated reference in the correspondence to material non-disclosure satisfied the requirements of the section as explained in *Natal Estates*. I do not agree. That assertion in and of itself does not provide sufficient and adequate evidence that the "satisfaction" was established at the relevant time. As I have said: it was an afterthought.

[40] In *SIR v Trouw* 1981 (4) SA 821 (A) Wessels JA said the following:

> "It follows, in the circumstances of this case, that the additional assessment could only have been raised if the Commissioner were to have satisfied himself (1) that there had been a non-disclosure of material facts by the taxpayer, and (2) that the fact that the profit in question was

not assessed to tax prior to the expiration of the relevant period of three years was *due* to such non-disclosure, ie, that the non-assessment was causally related to the non-disclosure of material facts."

[41] Here the respondent has asserted only the issue of onus in respect of the salaries and wages and has not asserted non-disclosure or non-disclosure of material facts. In addition the respondent has also failed to assert that initially the non-assessment was, in fact, causally related to the disclosure or non-disclosure of material facts.

[42] In *Trouw* it was held that:

"In claiming that he had satisfied himself as to the matters referred to in s 79(1)(i) of the Act, the Secretary relies upon the evidence afforded by a letter dated 25 January 1978 addressed to the taxpayer's accountants. The letter reads as follows:

> 'I wish to inform you that in terms of section 79(1) of the Income Tax Act of 1962, as amended, I am satisfied that there was non-disclosure of a material fact in the appellant's 1971 income tax return as regards the sale of property and that it was on this basis that the revised assessment issued on the 1st December was raised.'

After dealing with certain submissions made by the taxpayer's counsel regarding the evidential value of the letter, the following is stated in the judgment of the court *a quo*:

> 'However, what seems to me to be of crucial importance is an analysis of the contents of the letter. All that the respondent says therein is that he is satisfied that there was non-disclosure in the 1971 return and, therefore, the disputed assessment of December 1976 was raised. What he does not say is whether he is satisfied that it was that non-disclosure which caused him not to assess the profit to tax in the original and revised 1971 assessments. It was only the respondent's satisfaction on this latter score that could have displaced the immunity conferred on the appellant by the proviso in question. The respondent's satisfaction as to the fact of the non-disclosure was not enough. The satisfaction he expressed was that referred to in the opening sentence of s 79(1) not the satisfaction referred to in the proviso … That being so, the satisfaction expressed in the letter was not the satisfaction required by the proviso and, in the absence of any other evidence before the Court *a quo* establishing the required satisfaction either directly or inferentially, the respondent failed to displace the immunity to which I have referred.'

> I am in respectful agreement with the reasoning set out in the above passage, and with the conclusion that the evidence before the Special Court did not establish Secretarial satisfaction in regard to the question whether the non-assessment was *due* to the taxpayer's non-disclosure of material facts in his income tax return for the year ending 28 February 1971."

[43] Here, the respondent has not only failed to show satisfaction at the time of the additional assessment but also at the time when it might have expressed some satisfaction in the notice of disallowance. The respondent fails to meet all the requirements of that satisfaction and, as such, the statutory immunity ought not to be displaced.

[44] In *Commissioner, SARS v Brummeria Renaissance (Pty) Ltd & Ors* 2007 (6) SA 601 (SCA) it was stated:

> "It is obviously in the public interest that the Commissioner should collect tax that is payable by a taxpayer. But it is also in the public interest that disputes should come to an end – *interest reipublicae ut sit finis litium*; and it would be unfair to an honest taxpayer if the Commissioner were to be allowed to continue to change the basis upon which the taxpayer were assessed until the Commissioner got it right – memories fade; witnesses become unavailable; documents are lost. That is why s 79(1) seeks to achieve a balance: it allows the Commissioner three years to collect the tax, which the legislature regarded as a fair period of time; but it does not protect a taxpayer guilty of fraud, misrepresentation or non-disclosure. If either of the Commissioner's arguments were to be upheld, this balance would be unfairly tilted against the honest taxpayer."

[45] For those reasons I made the ruling that I did and found that the statutory immunity ought not to be displaced.

[46] For what remained (which I shall outline later) the appellant called in aid the evidence of Mr X. He joined the appellant during 1997 and was later

a director, but is no longer. His area of involvement was the operational side of the business of the appellant which consisted essentially of the manufacture of non-woven textiles into linen such as sheets, duvets, comforters and curtains and which were sold, in the main, to the large chain store retailers.

[47] Mr X was the only witness in the case (the respondent having called no evidence) and no purpose would be served by summarising his evidence at this point. Instead, where he gave relevant evidence, this will be alluded to when dealing with the relevant issue as necessary.

[48] The remainder of the dispute also arises from the additional income and value-added tax assessments issued by the respondent in respect of the appellant's 2003; 2004; 2005 and 2006 years and periods of assessment (the assessments).

[49] The assessments were issued on the basis that, having regard to:

a. Sections 11(*a*), 11(*e*), 11(i), 22(1) and 82 of the IT Act the appellant had not proved that the amounts claimed as deductions and/or provisions were subject to a deduction under the IT Act;

b. Paragraph 2(1) of the Fourth Schedule to the IT Act, the appellant had failed to properly deduct, withhold or pay over the appropriate employees tax to the respondent;

c. Paragraphs 3(1) and (4) of the Skills Development Act, 1999 ("the SDL Act"), the appellant had failed to properly deduct, withhold or pay over the appropriate skills development levies to the respondent;

d. Section 6 of the Unemployment Insurance Contributions Act, 2002 ("the UIC Act"), the appellant had failed to properly deduct, withhold or pay over the appropriate unemployment insurance fund contributions to the respondent;

e. Sections 10(13) and 18(3) of the Value Added Tax Act, 1991 ("the VAT Act"), the appellant had failed to declare value added tax in respect of the fringe benefit resulting from its employees being granted use of company owned motor vehicles; and

f. Section 17(2)(*a*) of the VAT Act, the appellant had claimed input tax in respect good and/or services not acquired in the course of making taxable supplies.

[50] The respondent imposed additional tax at the rate of 200% and levied interest in respect of all taxes; the levies and contributions.

[51] As indicated earlier, the appellant lodged an objection against the assessments. Save for:

a. reducing the rate of additional tax from 200% to 100% in respect of all taxes, the levies and contribution; and

b. withdrawing the audit item relating to the fringe benefit from the use of company motor vehicles in respect of the PAYE assessments,

the respondent disallowed the appellant's objection and the appellant noted this appeal against the disallowance.

[52] The essence of the dispute is set out in a minute of the pre-trial meeting held between the parties in terms of Rule 38 of the Rules

promulgated in terms of section 103 of the Tax Administration, 2011 ("the TAA") dated 9 July 2015. In addition, the issues in the appeal can be discerned from the Statement of Grounds of Assessment and the Statement of Grounds of Appeal as follows:

a. The appellant carries on the business of the manufacture; distribution and sales of duvets, pillows, cushions, and bed linen.

Income Tax

b. The appellant claimed a provision for settlement discounts amounting to R840 869,47 and the amount represented:

   i. R170 186 in respect of credit notes passed after year end;

   ii. R670 684 in respect of rebates granted in terms of trade agreements. The question relating to whether the rebates are subject to taxation and the concomitant additional tax imposed is no longer an issue in the appeal. In this regard, the respondent has accepted that the amount is not subject to taxation and has waived the additional tax imposed.

c. The appellant claimed a provision for bad debts amounting to R333 778. The respondent asserts that not only could the appellant not provide sufficient records to substantiate that the debts had indeed become bad but it agreed that the claims properly construed did not constitute bad debts.

d. The appellant claimed wear and tear in respect of vehicles that it did not own but that it had purchased on behalf of its consultants. The question relating to whether this claim should be permitted is

no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

e. The appellant claimed the following expenses:

i. Salaries and wages said to be in respect of casual workers amounting to R258 316 but failed to provide records to substantiate the payments. The respondent further alleges that the appellant further failed to explain the reconciliation differences amounting to R86 697.

ii. Interest said to be paid to an associate company amounting to R30 703. The question relating to whether this claim should be permitted as a deduction is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

iii. Costs said to be in respect of machine installation amounting to R23 200 (i.e. R24 000 less wear and tear amounting to R800).

iv. Costs incurred in respect of building improvements amounting to R144 465 but claimed as repairs. The question relating to whether this claim should be permitted as a deduction is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

v. Private audio expenses amounting to R7 013. The question

relating to whether this claim should be permitted as a deduction is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

vi. Overseas travel amounting to R209 916 but failed to provide sufficient records to substantiate the payments.

f. The appellant passed the following three journal entries in respect of its trading stock:

i. Journal entry 14 in the amount of R1 042 793,86 and said that it was to reduce trading stock to physical count;

ii. Journal entry 16 in the amount of R1 143 500 and said that it was a provision for obsolescence; and

iii. Journal entry 25 in the amount of R2 622 559 and said that it was a correction of an incorrect valuation of trading stock.

Pay As You Earn

g. The appellant incorrectly treated employees as independent contractors and thereby failed to deduct the correct PAYE from employees' remuneration. The question relating to the appellant's failure is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

Skills Development Levies

h. The appellant failed to levy the correct skills development levies in respect of its employees' remuneration. The question relating to the

appellant's failure is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

Unemployment Insurance Contributions

i. The appellant failed to provide the correct unemployment insurance fund contributions in respect of its employees' remuneration. The question relating to the appellant's failure is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

Value Added Tax

j. The appellant failed to account and declare the output tax on the fringe benefit in respect of the right of use of the motor vehicles. The question relating to the appellant's failure is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

k. The appellant claimed input tax in respect of personal audio expenditure. The question relating to whether this claim should be permitted is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the additional tax imposed.

l. The appellant claimed input tax in respect of DStv entertainment expense. The question relating to whether this claim should be permitted is no longer an issue in the appeal. In this regard, the appellant has conceded the issue and only appeals against the

additional tax imposed.

ISSUES IN DISPUTE

[53] The dispute between the respondent and appellant relates to the following:

a. Whether in respect of **income tax**:

i. the appellant should be permitted a provision in respect of the credit notes that were passed after year end;

ii. the appellant should be permitted a provision in respect of bad debts in circumstances where it has failed to show that any attempts at recoveries were made to result in the amounts being bad; and where it admits that no legal proceedings were instituted to recover the debts;

iii. the appellant should be permitted a deduction in respect of salaries and wages in circumstances where it has failed to provide records to substantiate the claim;

iv. the appellant should be permitted a deduction in respect of the costs for machine installation in circumstances where the appellant has failed to provide records to substantiate the claim;

v. the appellant should be permitted a deduction in respect of overseas travel in circumstances where the appellant has failed to provide sufficient records to substantiate the claim;

vi. the appellant has proved that all the stock was sold at year end and that the journal entries reducing stock were passed

to reduce the stock value to net-realisable value;

vii. additional tax should have been imposed at all, at the current rate of 100% or alternatively at a lower rate in accordance with section 76 of the IT Act; and

viii. interest imposed in terms of section 89*quat*(2) should be waived in terms of section 89*quat*(3) of the IT Act.

b. Whether, in respect of **PAYE**, additional tax should have been imposed at all, at the current rate of 100% or at a lower rate in accordance with paragraph 6(2A) of the Fourth Schedule to the IT Act;

c. Whether, in respect of **SDL**, additional tax should have been imposed at all, at the current rate of 100% or at a lower rate in accordance with section 12(3) of the SDL Act;

d. Whether, in respect of **UIC**, additional tax should have been imposed at all, at the current rate of 100% or at a lower rate in accordance with section 6 of the UIC Act;

e. Whether, in respect of **VAT**, additional tax should have been imposed at all, or at the rate of 100% or at a lower rate in accordance with section 60 of the VAT Act.

2006 TRADING STOCK

[54] The most significant issue that is in dispute in the 2006 year of assessment is the issue of trading stock.

[55] The appellant valued the closing stock at R7 330 135 and the respondent alleges that the stock has been undervalued by the sum of R4 808 851.

[56] One of the reasons for this provided by the respondent is the audit qualification in respect of the stock count.

[57] The audit qualification reads as follows:

> "We were not able to observe the counting of the physical inventories at the previous year end, since that date was prior to the time we were initially engaged as auditors for the company. Owing to the nature of the company's records, we were unable to satisfy ourselves as to the opening inventory quantities by other audit procedures."

[58] The documents and the evidence revealed that this qualification was as a consequence of the non-attendance by the auditors of the 2005 stock count. However, it has no impact on the 2006 stock count. There is no qualification in respect of the stock count procedures for the 2006 year of assessment.

[59] The second qualification in respect of stock reads as follows:

> "Furthermore, the company did not value its inventory at 28th February, 2006 at the lower of cost or net realisable value in terms of IAS 2. Instead, finished goods were valued at selling price less 37%, consequently, we did not obtain all the information and explanations we considered necessary to satisfy ourselves as to the valuation of inventory nor could we reasonably determine possible adjustments that may be necessary to reflect inventory at cost."

[60] The qualification is in respect of the determination of the cost of the finished goods. The qualification is not in respect of the raw materials or work in progress. The concern expressed is whether the selling price less 37%

amounts to the lower of cost or net realisable value in that the auditors were not able to satisfy themselves of the cost of that stock. The qualification is such that the stock could have been recorded at higher than cost.

[61] International Accounting Standard 2 ("IAS 2") deals with the issues of inventory valuation. The objective of IAS 2 is to prescribe the accounting treatment for inventories. In terms of paragraph 6 of IAS 2, inventories are assets held for sale in the ordinary course of business. In this particular matter the appellant was not holding inventory for sale in the ordinary course of business as it was clear from the documents and from the evidence that they had disposed of their business on 1 March 2006, and were in the process of disposing their inventory to the purchaser of that business, ie D Entity.

[62] IAS 2, at paragraphs 21 and 22, provides methods for the measurement of cost. Paragraph 21 reads as follows:

> "Techniques for the measurement of cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost".

[63] Thus IAS 2 allows for the use of the retail method, which may be used for convenience as a technique to measure cost. Paragraph 22 defines the retail method as follows:

> "The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory that has been marked down to

below its original selling price. An average percentage for each retail department is often used."

[64] The use of the gross profit margin of 37% to reduce the selling price to determine the approximate cost or net realisable value is in accordance with the terms of paragraph 22 of IAS 2. The method used by the appellant to determine the cost of the finished goods is not unique and is thus supported by the accounting standard, ie IAS 2.

[65] Paragraphs 28 to 33 of IAS 2 deals with net realisable value and paragraph 30 reads as follows:

> "Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount of the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period."

[66] The evidence and the documents demonstrate that the offer made by D Entity to purchase the appellant's stock was as follows:

> "1. Goods in good conditions, current, sellable or usable, and for what orders are foreseeable;
> 2. Imported goods valued at cost and exchange rate as per bill of entry and invoices;
> 3. Finished goods manufactured locally, valued at selling price less 44%;
> 4. Local purchases from local suppliers at cost as per invoice."

[67] The discount to selling price was agreed at 37% instead of at the offer of 44%.

[68] The evidence and the documents revealed that the appellant was in negotiation with the purchaser for the disposal of the assets and the 37% gross profit was agreed upon between the parties and as such the requirements of paragraph 30 of the IAS 2 have been met in determining the net realisable value.

[69] In my view, the 37% discount to selling price was the negotiated position of the appellant and as a result, the use of this same method to value the stock makes commercial sense. That much was established by Mr X's evidence.

[70] The auditor's qualification continues:

> "The company disposed of its business operations on 1st March, 2006, together with the inventory. The purchaser only purchased R4 million of the stock and the balance of the inventory is subject to a restraint in that the company is not able to dispose of it without the written consent of the purchaser. At the time of this report, such consent has not been given and consequently we are unable to satisfy ourselves as to the valuation of the inventory."

[71] At the time of the audit only R4 million of the stock valued in total at some R7.3 million had been disposed of and there was a restraint in place on the disposal of the balance. Consequently the auditors were concerned that the stock was overvalued in that should the restraint not have been lifted the company would not have been able to dispose of the stock at all and as such stock would have been overvalued in that its realisable value would have been limited to the stock that was sold which was R4 million.

[72] In terms of the grounds of assessment the respondent questions the valuation of stock in terms of s 22 of the IT Act.

[73] In terms of s 22 of the IT Act trading stock is valued in terms of s 22(1)(*a*), which is in essence the lower of cost or net realisable value. The section reads as follows:

> "Amounts to be taken into account in respect of values of trading stocks –
>
> (1) The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be –
>
> (a) in the case of trading stock other than trading stock contemplated in paragraph (*b*), the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock, not being any financial instrument, has been diminished by reason of damage, deterioration, change of fashion, decrease the market value or for any other reason satisfactory to the Commissioner;"

[74] The appellant submits that as the stock was disposed of to two separate and independent parties acting at arms-length both in terms of the bulk disposals to D Entity and in terms of the stock that they did not require to a lock, stock and barrel disposal of the remainder, that there is an objective determination as to the net realisable value of the stock that was on hand at 28 February 2006. That submission was supported by Mr X's evidence and there was no evidence to the contrary.

[75] In my view there is no reasonable or rational basis to dispute the independent valuation of the stock as at that date. It was not a subjective determination of net realisable value but an objective determination based on

the actual disposal of all of the trading stock of the company after year end. The respondent did not lead any evidence to challenge the sale proceeds.

[76] In **Meyerowitz on Income Tax 2007 – 2008**, at paragraph 9.9.6 the following is stated:

> "In practice, the taxpayer takes his trading stock either at cost or at what he considers net realisable value …"

[77] In my opinion the appellant prepared its valuation of closing stock on that basis.

[78] In **Silke on South African Income Tax – Volume 2** – Divaris and Steyn, commenting on slow moving and obsolete stock at page 8 – 304 note the following:

> "It has been held that there is no need to speculate about the value of stock *'when the march of events has made uncertain things certain'*; nor is there any need to *'value stock on a calamity basis if, through hindsight, there is no need to do so'*."

[79] With the benefit of hindsight there is now no need to speculate about the value of stock in that it is known as to what the stock was ultimately disposed of to two independent entities and the fact that the proceeds from the sale of that stock approximates the value as set out by the appellant.

[80] There is no evidence to dispute the disposal of stock after year end.

[81] The respondent drew my attention to Practice Note 36, which reads as follows:

> "It is evident that a variety of questionable methods are used by taxpayers to write-off slow-moving and obsolete stock, without reference

> to its actual net realisable value. It has, therefore, become necessary to explain Inland Revenue's standpoint in this regard."

[82] In my opinion the valuation of the trading stock at the 2006 year-end is supported by the actual net realisable value in that the appellant is able to substantiate the write-off that was made to the net realisable value, with reference to the two disposals of the stock on hand.

[83] Practice Note 36 also states that:

> "Amounts written off, for instance on a fixed percentage basis, which cannot reasonably be justified will not be allowed to be deducted from the cost price of such stock held and not disposed of at the end of the year of assessment in terms of section 22(1) of the Income Tax Act."

[84] However, it has been established by the evidence that the 50% write-off of the warehouse stock was justified in terms of the actual disposal of that stock after the year end which in turn supports the valuation of that stock at year end.

[85] Practice Note 36, referring to Income Tax Case No. 1489 (53 SATC 99), also establishes:

> "That if a method of reducing the cost of stock by a percentage is adopted, the percentage reduction should not only be supported by trading history and, where appropriate, post-balance sheet experience, but the Receiver of Revenue should be told how that percentage is arrived at."

[86] It was submitted that the post-balance sheet experience has confirmed that the stock was valued at the net realisable value. That submission is undoubtedly correct.

[87] The common-cause documents demonstrate that the detailed ledger with D Entity reflect the disposals of stock subsequent to the year-end and the payments that have been received in that regard.

[88] The sale of stock to D Entity is recorded at R7 294 513.44 and of this only an amount of R6 091 669.49 had been paid prior to the appellant instituting recovery measures. The appellant instituted recovery measures through its attorneys and it was settled that the amount in dispute of R1 202 843.95 would be reduced to R666 531.88 payable in instalments.

[89] In the result, the appellant asserted that the stock sold to D Entity ought to be valued at no more than R7 294 513.44 but ought, more correctly, to be valued at the net amount realised of R6 758 251.37. I cannot fault that assertion.

[90] The only other stock that was disposed of by the appellant was a "lock, stock and barrel" disposal of the remaining stock that D Entity did not wish to acquire. This stock was disposed of for R500 000.00 plus VAT.

[91] In the result the appellant contends that the net realisable value of the stock on hand as at 28 February 2006 can be summarised as follows:

Invoice to D Entity:	R7 294 513.44
Less invoices in dispute:	(R1 202 843.95)
Add settlement of invoices in dispute	R 666 581.88
Sub Total	R6 758 251.37
Add lock, stock and barrel disposal	R 500 000.00
Net realisable value of stock	**R7 258 251.37**

[92] Thus, in my view, the appellant has met the required onus to show the net realisable value of the stock held at the year-end 28 February 2006 based on the disposal of the stock subsequent to year-end.

[93] The gross profit percentage reflected in the 2006 Annual Financial Statements is consistent with the gross profit percentage in 2005-2004. If it is accepted that the understatement of stock of R4 808 851 is as set out in the assessment letter then the cost of sales would reduce from R30 821 517 to R26 012 666 and the gross profit would increase to 46.72% as opposed to 36.87%. There is no evidence to support the enhanced gross profit percentage suggested by the respondent. If anything, the old “dead stock” was disposed of at less than its original cost (as established by the evidence) thereby reducing the gross profit percentage. The discussions and resultant agreement on a 37% discount on the selling price of the stock supports the gross profit percentage in the region of 36% to 37% as opposed to being in the region of 45%.

[94] Additionally, there was evidence confirming that all the stock was disposed of on a category by category basis and this correlates with the value of the stock as recorded in the financial statements in terms of s 22 of the IT Act and the accounting policy of the lower of cost and net realisable value.

[95] Based on this analysis the only reasonable conclusion is that the stock was valued at the net realisable value as that was in fact realised after the year end.

[96] I turn now to deal with the question of onus, which is covered by s 82 of the IT Act. The onus of proof that an amount is exempt from or not

liable to any tax chargeable under the IT Act or is subject to any deduction, abatement or set-off in terms of the IT Act, ought to be disregarded or excluded in respect of capital gains or losses, is upon the taxpayer, and no decision of the Commissioner will, on appeal, be reversed or altered unless it shown by the taxpayer that the decision is wrong.

[97] In **Meyerowitz on Income Tax 2007 – 2008**, the following appears:

> "I consider, in view of the regulations which now bind the Commissioner to his written grounds for his assessment, unless he obtains the permission of the taxpayer or the Special Court that it is no longer open to the Court *mero motu* to decide the correctness of the assessment on grounds not advanced by the Commissioner."

[98] As far as the trading stock issue is concerned, the respondent's argument is limited to the s 22 valuation dispute.

[99] **Meyerowitz** continues:

> "The onus is discharged or not on the balance or preponderance of probability. In regard to this the following *dictum* in ITC 743 18 SATC 294 sets out, with respect, the position with clarity.
>
> > *'…* In the determination of a *purely factual issue* there are two main lines of approach which are not mutually exclusive, namely, credibility and probability. In determining whether a witness is to be believed or not, the Court must have regard to the probabilities of his story. But there may be cases probability will have to yield to credibility; for a Court may believe a witness in spite of improbabilities in his evidence. And where it does so, it may find that any burden of proof resting on him has been discharged. An illustration may provide greater clarity. A taxpayer deposes to a certain transaction which has produced a profit which, if his evidence is believed, would be a capital profit. The Court, even though it considers that in the ordinary course of events such a transaction would be unlikely, finds the taxpayer to be an honest and credible witness. In such circumstances – on a purely factual issue – it could hardly be said that he had not discharged the onus. Where the probabilities are evenly balanced, a finding of credibility might well be the determining factor.'
>
> …

> When one comes to weigh up the probabilities it must also be remembered, in the works of Wessels CJ in *Bitcom v Rosenberg,* 1936 AD at 396, that –
>
> > 'the trial judge is not concerned with what is or it not probable when dealing with abstract businessmen or normal men but he is concerned with what is probable and what is not probable as regards the particular individuals situated in the particular circumstances in which they were.'
>
> …
>
> In *Malan v CIR* 1983 (3) SA 1 (A), 45 SATC 59, the court said in relation to the taxpayer's *ipse dixit* that it was proper to say that because the taxpayer was in the unfavourable position of having to discharge the *onus* of proving the assessment wrong, it was in the interest of fairness that his evidence and his credibility should be weighed with great care and that a finding of credibility can be conclusive (citing *ITC 743*).
>
> …
>
> In *CIR v Middleman* 1991 (1) SA 200 (C), 52 SATC 323, the court held that the *onus* is discharged where the court has no reason to disbelieve the taxpayer and his evidence is not contradicted by the objective facts."

[100] The respondent has not led any evidence to contradict the appellant's evidence. I pause to add that I found Mr X to be truthful and credible. I also recognise the length of time that this matter has taken to come to Court and the fact that the appellant had ceased trading prior to the commencement of the income tax audit.

[101] In my view the appellant has met the onus required to establish the valuation of stock based on the disposal of the stock after year end.

[102] The issue is accordingly decided in the appellant's favour.

SETTLEMENT DISCOUNTS

[103] The appellant claimed a provision for settlement discounts of R840 869.47 for the 2006 tax year. R170 186 related to credit notes passed after year-end and the balance of R670 684 related to rebates granted in terms of the trade agreements.

[104] The respondent conceded the issue of the R670 684 relating to the rebates.

[105] The appellant contends that the credit note reflects a correction of the amount that ought to have been accrued at the year-end 28 February 2006, arising from a dispute as to price or quality of the product for which a credit note was passed after the year-end. It submits that if there was a dispute as to the pricing charged or the quality of the stock provided, which resulted in a credit note then there was an overstatement of the amount that had been accrued for as income and consequently the adjustment ought to be allowable.

[106] The relevant credit notes passed are as follows:

a. Y: Credit Note No. 002089 dated 31 March 2006 in respect of invoice 071341 in the amount of R79.23 inclusive.

b. Z: Credit note dated 11 May 2006 – CCV Credit Claim in the amount of R4 274.37 inclusive.

c. J: Credit Note No. 002107 dated 25 April 2006 in respect of invoice 065448 in the amount of R41 850.88 inclusive. In respect of this credit note an adjustment ought to be made in respect of the

VAT portion that was claimed in error as an income tax deduction as opposed to a VAT input.

d. K: Credit Note dated 01 May 2006 - CCV Credit Claim in the amount of R76 095.12 inclusive and 15 May 2006 – CCV Credit Claim in the amount of R49 447.12 inclusive. Totalling R125 542.24 inclusive.

e. L: Credit Note No. CN002108 dated 25 April 2006 in respect of invoice 069805 in the amount of R11 400.00 inclusive.

f. M CC: Credit Note No. 002111 dated 08 May 2006 in respect of invoice 069875 in the amount of R2 137.50 inclusive.

g. N: Various credit notes in the range CN002090 to CN002095 dated 31 March 2006 totalling R2 868.24 inclusive.

[107] The appellant submits that there ought to be no distinction between the treatment of the rebates and the credit notes in the particular circumstances of this case given that the appellant had ceased trading. Whilst the narration was a provision for credit notes, the provision was not based on speculation but on the actual credit notes passed after the year end.

[108] The respondent is of the view that the provision for credit notes is an expense which must be incurred in the year of assessment for it to be deductible.

[109] The appellant, however, views the provision for credit notes as an adjustment to correct the amount accrued as sales and gross income for the relevant year of assessment and, as such, submits that one can make use of

information obtained after the end of the year of assessment to determine the correct amount of gross income in the year of assessment. In the peculiar circumstances of this case I accept this submission and find for the appellant on this issue.

PROVISION FOR BAD DEBT

[110] Section 11(*i*) of the IT Act provides as follows:

> "For the purpose of 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—
>
> (i) the amount of any debt due to the taxpayer which have during the year of assessment become bad, provided such amount is included in the current year of assessment or was included in previous years of assessment in the taxpayer's income;"

[111] In terms of section 11(*i*) of the IT Act, three requirements have to be present in order for an amount to be regarded as a bad debt and these are that:

a. The amount should be due to the taxpayer.

b. The amount should have become bad in the year of assessment in which it is claimed.

c. The amount should have been included in the current year of assessment or in previous years of assessments.

[112] The respondent submits that assuming, as was done for purposes of the income tax audit, that the amounts claimed as bad debts were amounts due to the appellant and had been included in the current or previous years of assessment, the only determination to be made is whether the amounts had indeed become bad. The debt should become irrecoverable in the year of

assessment in which the deduction is being claimed so as to warrant being regarded as bad.

[113] The respondent is obliged to grant a deduction in terms of section 11(*i*) of the IT Act where the facts indicate that the amount is indeed irrecoverable and in those circumstances, the deduction will be allowed in the year in which the taxpayer realised that the debt was bad.

[114] In terms of section 82 of the IT Act, a taxpayer bears the burden of proving that any amount is subject to a deduction; exempt from or not liable to any tax chargeable under the IT Act.

[115] Mr X's evidence was that legal proceedings were not instituted in order to collect the amounts due to the appellant. He testified that this course of action was adopted in an effort to foster better business relations with those debtors.

[116] The respondent contends that in light of:

a. the admission by Mr X that no legal recoveries were made;

b. the appellant's admission that properly construed, the amounts claimed as bad debts in its financial statements, did not constitute bad debts; and

c. the appellant's admission that the amounts claimed as bad debts were actually price and quality disputes that have resulted in the amounts not being paid;

the appellant is not entitled to a deduction for bad debts.

[117] Accordingly, the respondent contends that the appellant has failed to prove that the provision that it claimed for bad debts and which the respondent added back and subjected to income tax constituted a permissible deduction in terms of the IT Act.

[118] In its reply to the respondent's request for trial particulars, the appellant seeks to amend its claim and states:

a. The amount is claimed as a provision for doubtful debts in accordance with section 11(*j*) of the IT Act. The respondent contends that this is the first time and opportunistic of the appellant (seeing as this was not an independent assertion but in light of the respondent's request for trial particulars) to attempt to claim the deduction on the basis of this provision. The respondent contends further in this regard that:

    i. The issues in appeal are those as contained in the statement of grounds of assessment read with the statement of grounds of appeal. As the provision of doubtful debts is not contained in the statements, it is not an issue in appeal.

    ii. Alternatively, section 11(*j*) of the IT Act permits an allowance to be granted in respect of so much of any debts as the Commissioner considers as being doubtful, if they would have been allowed as a deduction had they become bad. The proviso being that the allowance is included in the income of the taxpayer in the following year of assessment. The respondent contends that:

1. The permitting of the allowance is at the discretion of the respondent which discretion it has not been able to exercise as it was never brought to its attention;

2. The appellant has, despite the matter being heard by the Court approximately 10 years after its liquidation, failed to provide proof that the allowance was included as income in its 2007 year of assessment. In the circumstances, the appellant has failed to show that the amount added back and subjected to tax constituted a permissible deduction in term of the IT Act.

[119] The appellant claimed as a provision for bad debts in respect of three amounts for which it did not anticipate payment.

[120] As at 1 May 2006 M CC owed an amount of R105 691.11. A payment of R95 262.96 was received and a credit note was processed. The remaining balance of R8 290.65 was provided for as the appellant did not expect to receive payment in respect of this amount in that there were underlying disputes and the company had ceased trading.

[121] There was a balance due from N of R75 487.51 for which payment had not been received when the appellant wound itself down and a provision for a bad debt was made.

[122] In respect of another N account there was a balance of R335 756.55 for which a provision of R250 000 was made as a provision for

bad debts. This provision was made by the auditors after reviewing the recoverability of the debtors.

[123] The documents also reveal that in reality a further amount of R85 756.55 was also not recovered.

[124] The amount has been claimed in the appellant's income tax return as a provision for a doubtful debt and not as an actual bad debt. Accordingly, only 25% of the amount would have been allowed as an income tax deduction.

[125] There is no evidence that the amounts have been received by the appellant and there is no evidence to demonstrate that the appellant was not justified in making a provision for the non-recoverability of amounts in its final balance sheet where it had no intention of taking legal action against the customers. There is also no evidence that the appellant's liquidators were able to recover any of these amounts.

[126] I am of the view that this issue, based on those arguments, falls to be decided in the appellant's favour.

SALARIES AND WAGES

[127] The appellant claimed a deduction in respect of salaries and wages but could not provide records to substantiate that the amounts were actually incurred and that they were incurred for purposes of trade. The respondent has disallowed wages – casuals R240 046 and other salaries R18 270 totalling R258 316 in 2006 year of assessment.

[128] The respondent accepts that the nature of the appellant's business may involve the engagement of casual labour but contends that the appellant is required to do much more than to provide its 'say so' that it engaged the labour at the expense claimed. According to the respondent no evidence has been place before the court that the rates claimed to have been paid to the casual labourers was in fact paid and the court has not been provided with proof that the expense was actually incurred in respect of that work force.

[129] In this regard the respondent asserts that the appellant failed to show that an amount of R258 316 was expended in paying casual labour. The respondent contends that appellant relies on its *ipse dixit* for claiming the expense was incurred. It submitted that all that *ipse dixit* implies is a dogmatic assertion without proof and relied on the *dictum of* Ponnan JA in *SARS v Pretoria East Motors (Pty) Ltd* 2014 (5) SA 231 (SCA) where he stated that:

> "[8] It is so that the taxpayer's *ipse dixit* will not lightly be regarded as decisive. But it must be considered together with all of the other evidence in the case. And, given the unfavourable position of having the onus resting upon it – a 'formidable and difficult' one to discharge (per Trollip JA; *Barnato Holdings Ltd v Secretary for Inland Revenue* 1978 (2) SA 440 (A) at 454A-B) – the interests of justice require that the taxpayer's evidence and questions of its credibility be considered with great care. Indeed the taxpayer's evidence under oath and that of its witnesses must necessarily be given full consideration by the court, and the credibility of the witnesses must be assessed as in any other case that comes before the court. (See *Malan v Kommissaris vir Binnelandse Inkomste* 1983 (3) SA 1 (A) at 18E.) It thus remains the function of the court to make a determination of the issues that arise for decision on an objective review of all of the relevant facts and circumstances. Not the least important of the facts, according to Miller J (ITC 1185 (1972) 35 SATC 122 (N) at 124), 'will be the course of conduct of the taxpayer in relation to the transactions in issue, the nature of his business or occupation and the

> frequency or otherwise of his past involvement or participation in similar transactions. The facts in regard to those matters will form an important part of the material from which the court will draw its own inferences against the background of the general human and business probabilities'."

[130] The respondent argued that Mr X could not provide documentary evidence, for example in the form of cheques; casual labourers details etc, showing that payments were made to casual labourers but simply relied on his *ipse dixit* to the effect that such expenses would have been incurred in the nature of the appellant's business. It accordingly contends that the appellant has failed to substantiate that it incurred expenditure related to salaries and wages and that such expenditure was incurred for purposes of trade.

[131] In the final analysis the respondent therefore contends that the appellant has failed to prove that the deduction in respect of salaries and wages and which the respondent added back and thereafter subjected to income tax was a permissible deduction in terms of the IT Act.

[132] The appellant has given evidence that these amounts were actually incurred in respect of the offloading of containers of stock during the year of assessment. The nature of the taxpayer's business supports these contentions on a balance of probabilities. In my view, given the nature of the appellant's operations, as testified to by Mr X, the general human and business probabilities sustain the claim. I have already found Mr X to be a credible witness and have no reason to reject his *ipse dixit* on this score.

[133] Accordingly I hold that the amounts ought to be deductible in terms of s 11(*a*) (the general deduction formula) as these amounts are not of a

capital nature, have been incurred in the year of assessment and have been incurred in the production of income.

[134] The respondent has also sought to make an adjustment of R86 697 in respect of a payroll reconciliation.

[135] In the reconciliation the respondent has failed to consider the expenses to NULAW of R26 429 and the expenditure paid to SACTWU of R11 612. These were payments to legitimate employee organisations.

[136] In my view the issue of Salaries and Wages must also be resolved in the appellant's favour.

OVERSEAS TRAVEL

[137] The appellant claimed a deduction for overseas travel expenditure R209 916, which the respondent has disallowed.

[138] The overseas travel costs relate to trade visits to China, India and Germany with the various buyers of the chain store customers of the appellant. The appellant contends that the amounts have been actually incurred in the production of income and are not of a capital nature. The nature of the taxpayer's business requires such overseas buying trips and the expenditure, given the nature of the appellant's operations, as testified to by Mr X, the general human and business probabilities appear to sustain the claim and ought to be allowed as a deduction on a balance of probabilities. However, it was common cause that and amount R41 368,66 fell to be disallowed.

[139] In the result, but for an amount of R41 368,66, this issue is resolved in the appellant's favour.

MACHINE INSTALLATION

[140] The respondent is of the view that costs of R24 000 incurred in December 2005 were for the installation of a machine and has therefore made an adjustment to capitalise such expenditure and allow the related wear and tear allowance.

[141] The appellant has disputed that this was for the installation of machinery and asserts rather that this was for the movement of the machine from one part of the factory to another, and its repainting during the December shutdown period.

[142] The appellant has supported this assertion by evidence which has not been challenged. Additionally, the documents and the evidence demonstrate that no new machinery was acquired during the relevant period. The probabilities also support the notion that it was highly unlikely and very shortly before it disposed of its business the appellant would have incurred such installation costs.

[143] In my view the repairs and maintenance ought to be allowed as a deduction and that no adjustment ought to be made in this regard. This issue is accordingly resolved in the appellant's favour.

BUILDING IMPROVEMENTS

[144] The respondent contends that the appellant incurred various building improvement costs of R144 465, which were instead claimed as

repairs. The taxpayer however contends that this was for the restoration of the leased premises at the termination of the lease and was therefore a repair and restoration rather than an improvement and ought to be deductible in terms of s 11(*d*) of the IT Act.

[145] The relevant section reads as follows:

> "11(*d*) - Expenditure actually incurred during the year of assessment on repairs of property occupied for the purpose of trade or in respect of which income is receivable, including any expenditure so incurred on the treatment against attack by beetles of any timber forming part of such property and sums expended for the repair of machinery, implements utensils and other articles employed by the taxpayer for the purposes of his trade"

[146] ITC 617 14 SATC 474 (U) summarised the principles relating to repairs as follows:

> "(1) That repair is restoration by renewal or replacement of subsidiary parts of a whole, while renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject matter under discussion.
>
> (2) that in the case of repairs effected by renewal it is not necessary that the materials used shall be identical with the materials replaced; and
>
> (3) that repairs are to be distinguished from improvements, the tests for this purpose being; has a new asset been created resulting in an increase in the income earning capacity, or does the work undertaken merely represent the cost of restoring the asset to a state in which it will continue to earn income as before?"

[147] It was submitted that the expenditure ought to be allowable as a deduction having regard to the definition of repair.

[148] The evidence established that D Entity operated from the same premises as the appellant previously operated from and it is, therefore, not probable that the appellant would have incurred capital expenditure. It is more probable that the taxpayer had to restore the premises in terms of the lease agreement.

[149] This issue must be resolved in the appellant's favour.

VAT
FRINGE BENEFIT ON USE OF MOTOR VEHICLE

[150] The fact that a fringe benefit ought to have been accounted for has been accepted by the appellant. The value of that benefit is in dispute.

[151] The benefit relates to the use of a vehicle by Mr Q, a director of the appellant, and Mr X's father. Mr X was intimately familiar with Mr Q's routine and testified as much. Mr Q resided at O Place during the period of the audit. The distance from home to work was 8.4 kilometers. The vehicle was only used for business other than the travel from home to work and return. During the period the vehicle travelled some 100,000 kilometers and it was submitted that the private use was purely incidental to the business use.

[152] At most the private use of the vehicle was 8.4 kilometers x 2 x 3 days per week x 40 weeks which equals 2,016 kilometers.

[153] In terms of paragraph 7 of the Seventh Schedule to the IT Act ("the Seventh Schedule") the fringe benefit would at most be 20% of the amount set out in the letter of findings.

[154] The VAT consequences of a fringe benefit are set out in terms of s 10(13) of the VAT Act:

> "Where goods or services are deemed to be supplied by a vendor under section 18(3), the consideration in money for the supply shall be deemed to be an amount equal to the cash equivalent of the benefit or advantage granted to the employee or office holder, as contemplated in section 9(7): Provided that where such benefit or advantage consists of the right to use a motor vehicle as contemplated in paragraph 2(*b*) of the Seventh Schedule to the Income Tax Act, the consideration in money for the supply shall be deemed to be the amount determined in the manner prescribed by the Minister in the *Gazette* for the category of motor vehicle used."

[155] Paragraph 2(*b*) of the Seventh Schedule reads as follows:

> "The employee has been granted the right to use any asset (other than any residential accommodation or household goods supplied with such accommodation) for his or her private or domestic purposes either free of charge or for a consideration payable by the employee which is less than the value of such use, as determined under paragraph 6(2) in the case of an asset other than a motor vehicle or under paragraph 7(4) or (7) in the case of a motor vehicle."

[156] Paragraph 7(7) of the Seventh Schedule reads as follows:

> "Where it is proved to the satisfaction of the Commissioner that accurate records of the distances travelled in such vehicle for private purposes (including travelling between the employee's place of residence and his place of employment) are kept, the Commissioner may upon the assessment of the employee's liability for normal tax reduce the value placed on the private or domestic use of the vehicle to such amount as appears to the Commissioner to be fair and reasonable in the circumstances of the case if the total distance so travelled during the year of assessment was less than 10,000 kilometers or, where the period in that year during which the vehicle was available for the employee's use was less than 12 months, the distance which bears to 10,000 kilometers the same ratio as the said period bears to 12 months."

[157] Paragraph 7(9) of the Seventh Schedule provides that a decision made in terms of paragraph 7(7) shall be subject to objection and appeal.

[158] The appellant contends that nothing has been led in evidence to show that the view of the appellant that the fringe benefit ought to be no more than 20% of the amount so determined is incorrect.

[159] The adjustment thereof will impact upon the determination of the VAT liability.

[160] It was submitted that if the determination that the valuation of fringe benefit is adjusted in terms of paragraph 7(7) for the purpose of determining the value added tax, then it ought also to be adjusted in terms of the determination of the SDL levies.

SDL AND UIF

[161] The issues that the taxpayer had with regards to the fringe benefit remain equally applicable for SDL and UIF. I accept the submission as to the reduction of the fringe benefit for VAT purposes and this would have a similar result on the SDL and UIF.

ADDITIONAL TAX

[162] The discussion that follows on additional tax applies equally to income tax, VAT, PAYE, SDL and UIF.

[163] In the letter of assessment the respondent raised additional tax at 200%.

[164] In the request for reasons the appellant requested the following:

"5. ***Additional Tax***

It is noted that 200% additional tax has been imposed.

If the South African Revenue Service has in fact taken a decision in respect of the penalties and has concluded that penalties are applicable please provide the following: -

5.1 Did the South African Revenue Service consider the taxpayer's record and history with the South African Revenue Service. If these were considered what impact did this have on the decision. If not considered please provide reasons why not.

5.2 When did the South African Revenue Service take the decision.

5.3 Who at the South African Revenue Service took such decision? Please identify the names of the persons and the capacity in which they took the decision.

5.4 The South African Revenue Service is required to provide a copy of the Minutes of that decision clearly reflecting the reasons for the imposition of a penalty and interest.

The levying of 200% additional tax is generally reserved for cases where the Commissioner cannot find extenuating circumstances or where he can find intent to evade.

5.5 Please provide reasons for the opinion that there was intent to evade.

5.6 Please provide reasons why you do not consider there to be extenuating circumstances."

[165] In the reply to the reasons the respondent noted the following:

"The taxpayer did not provide extenuating factors why additional tax of 200% should not be imposed and as a result extenuating circumstances could not be considered.

The factors that were taken into consideration by the penalty committee:

- Failure to account for stock and the audit qualification received on the stock disclosure in the financials;
- Failure to maintain adequate records in respect of casual wages;

- Failure to provide the required documentary proof in respect of credit notes and bad debts;
- Failure to explain why PAYE was not deducted from employees that were incorrectly treated as independent contractors;
- Failure to explain why wear and tear was claimed on vehicles belonging to the employees."

[166] In the notice of objection the appellant noted the following:

> "The taxpayer notes that they provided substantive replies as to why no adjustment should be made in respect of the stock as the stock was sold for less than the realisable value estimate of 2006, the credit notes as these represented price adjustments and the casual wages actually incurred.
>
> It was not considered necessary, nor was it previously requested, that a representation be made for the waiver of the additional tax.
>
> The South African Revenue Service has not advised as to when the decision was made, by whom and whether the past compliance history of the taxpayer was considered and what impact this made on the decision. The South African Revenue Service has also not provided a response as to why it did not consider any extenuating circumstances to be present."

[167] In the notice of disallowance of objection the respondent reduced the penalties to 100%.

[168] In the draft Explanatory Memorandum on the Draft Tax Administration Bill, 2009 the respondent noted (in October 2009 in respect of Chapter 16 of the Tax Administration Bill) dealing with additional tax the following comments which the appellant submitted are relevant:

> "The open-ended discretion to impose additional tax up to 200% under current law is now fettered as it conferred too broad a discretion on a SARS official who may not have had the required expertise or guidance for this purpose. The fettering of a too wide discretion is not only permitted but mandated by the Constitution, mostly in order to give effect

to the right to equality (by ensuring consistent treatment of taxpayers in comparable circumstances) and the right to administrative justice."

[169] When the Tax Administration Act was first introduced the table of penalties applicable was as follows:

Substantial understatement	25%
Reasonable care not taken in completing a return	50%
No reasonable grounds for a tax position	75%
Gross negligence	100%
Intentional tax evasion	150%

[170] In terms of assessments issued on or after 16 January 2014 the table has been adjusted as follows:

Substantial understatement	10%
Reasonable care not taken in completing a return	25%
No reasonable grounds for a tax position	50%
Gross negligence	100%
Intentional tax evasion	150%

[171] It was submitted that in terms of the consistency of treatment provision it would not be correct to assume that the appellant has been grossly negligent in the completion of its tax return. To the extent that one can draw from the benefit of hindsight and the understatement penalty provisions currently operating where the unfettered discretion of a SARS official needs to be tempered it was the appellant's position that the extent that any understatement penalty is required to be imposed that such a penalty ought reasonably not be more than 10% by a substantial understatement.

[172] The Tax Court (Johannesburg) in the unreported matter of *Mr Z v CSARS* (Case No. 13272 – 18 November 2014) considered the understatement penalty and the reasonable care test and quoted with approval the following from the **Juta's Income Tax Guide,** Vol 2 in the notes pertaining to s 89*quat*(3):

> "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."

[173] In respect of all of the matters it is clear from the evidence and the documents that the appellant took implicit advice in the preparation of its return and as such no penalty ought to be imposed on the grounds of these being *bona fide* errors (where there were errors) with no intent to evade or postpone the tax.

[174] Accordingly, and on such issues not resolved in the appellant's favour the penalty ought not to be more than 10%.

89quat INTEREST

[175] The discussion concerning interest applies equally to income tax, VAT, PAYE, SDL and UIF.

[176] Section 89*quat*(3) provides the respondent with a discretion in respect of interest leviable in terms of s 89*quat* of the IT Act.

[177] The provision reads as follows:

> "(3) Where the Commissioner having regard to the circumstances of the case is satisfied that any amount has been included in the taxpayers taxable income or that any deduction, allowance, disregarding or exclusion claimed by the taxpayer has not been allowed, and the taxpayer has on reasonable grounds contended that such amount should not have been so included or that such deduction, allowance, disregarding or exclusion should have been allowed, the Commissioner may, subject to the provisions of section 103(6), direct that interest shall not be paid by the taxpayer on so much of the said normal tax as is attributable to the inclusion of such amount or disallowance of such deduction, allowance, disregarding or exclusion."

[178] The appellant in the request for reasons sought clarity on the issue of s 89*quat*. The request for reasons noted the following:

> "Your letter of 30 September 2009 indicates that a statement of account with interest will be issued.
>
> If the South African Revenue Service has in fact taken a decision in respect of interest and has considered that interest is applicable please provide the following: -
>
> 6.1 Did the South African Revenue Service consider the taxpayer's record and history with the South African Revenue Service? If these were considered what impact did this have on the decision? If not considered please provide reasons why not.
>
> 6.2 When did the South African Revenue Service take the decision?
>
> 6.3 Who at the South African Revenue Service took such decision? Please identify the names of the persons and the capacity in which they took the decision.
>
> 6.4 The South African Revenue Service is required to provide a copy of the Minutes of that decision clearly reflecting the reasons for the imposition of a penalty and interest.
>
> The test for section 89*quat* is the reasonable contention of the taxpayer.

> 6.5 Please provide reasons why you do not consider that the taxpayer has reasonably contended that stock is fairly valued at net receivable value, credit notes are to be adjusted for, bad debts are to be provided for and casual wages have been incurred."

[179] The respondent, in the response, included a paragraph headed Additional Tax and Interest but did not respond to the issue of interest.

[180] The appellant noted an objection to the decision not to waive the interest and indicated that the appellant had reasonably contended that no adjustment be made to stock, credit notes and salaries and that accordingly the interest ought to have been waived.

[181] The respondent disallowed the objection to the s 89*quat*(3) decision.

[182] The appellant noted an appeal in respect of the interest.

[183] The respondent, however, in the grounds of assessment provides no reasons for the determination that the s 89*quat* interest ought not to be remitted.

[184] It was submitted that the test for s 89*quat*(3) interest being waived would be reasonable grounds for the contention of the taxpayer that the amount ought to have been allowed as a deduction or that the income ought not to have been so included. The test is not the correctness of that determination but that there ought to be some reasonable grounds for having so contended initially.

[185] The appellant submits that this reasonable contention can be found in the evidence led and in the submissions made by way of the objection.

[186] In respect of the stock and other material issues the matters have already been disposed of above in the appellant's favour.

[187] To the extent applicable, the relevant interest levied must be remitted.

COSTS

[188] The parties reached no agreement as to costs but the appellant only sought costs for the successful conclusion of that aspect of the appeal relating to prescription.

[189] In the exercise of my discretion as to costs I consider it appropriate that each party bear its own costs.

_____
Vahed J

_____
(Accountant Member)

_____
(Commercial Member)

CASE INFORMATION:

Date of Hearing	:	30 November, 1 & 2 December 2015
Date of Judgment	:	12 January 2016