**IN THE HIGH COURT OF SOUTH AFRICA**
**WESTERN CAPE DIVISION, CAPE TOWN**

**REPORTABLE**

**CASE NO: A 211/2021**

In the matter between:

**LANCE DICKSON CONSTRUCTION CC** Appellant

and

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

Coram: P.L. Goliath AJP, P.A.L. Gamble and D.S. Kusevitsky, JJ.
Date of Hearing: 16 January 2023
Date of Judgment: 31 January 2023

This judgment was handed down electronically by circulation to the parties' representatives via email and release to SAFLII. The date and time for hand-down is deemed to be 10H00 on Tuesday 31 January 2023.

**JUDGMENT DELIVERED ON TUESDAY 31 JANUARY 2023**

**GAMBLE, J:**

INTRODUCTION

1. The appellant, Lance Dickson Construction CC ("the taxpayer"), seeks to appeal the judgment of the Tax Court (Cloete, J and two assessors) handed down on 18 June 2021, in which the determination by the respondent ("SARS") that the taxpayer was liable to pay a 25% penalty for the understatement of its liability for capital gains tax ("CGT") in its 2017 tax return, was confirmed.

2. The appeal served before this Court pursuant to the provisions of s133 (2) of the Tax Administration Act, 28 of 2011 ("the TAA"). The taxpayer was represented in this Court by Adv. P-S. Bothma and SARS by Advs. O. Mogatle and T. Tsoai. All of these counsel appeared before the Tax Court. In addition, Mr. Bothma was lead in that court by Dr. A. Marais, a Cape Town based specialist tax practitioner.

RELEVANT FACTUAL BACKGROUND

3. The taxpayer is a corporate entity which previously owned immovable property (Erf [....], Brackenfell) over which certain development rights had been procured. It concluded a written agreement of sale in September 2016 with a related entity, Kwali Mark Construction CC ("KMC")[1] in terms whereof the latter purchased the property for the sum or R25, 2m. The said sum of R25, 2m was calculated on the basis that the property, once sub-divided, would comprise 72 individual erven each valued at R350 000, 00.

[1] The membership of the corporations was identical

4. Included in the terms of the agreement of sale was a provision whereby KMC would pay to the taxpayer the sum of R350 000, 00 when each erf in the development (which had been fully developed with a residential dwelling thereon) was on-sold to the ultimate purchaser. The agreement of sale provided further that CGT on the entire transaction would be paid by the taxpayer on an ad hoc basis, as and when each individual erf was so on-sold by KMC and the relevant amount had been received by the taxpayer.

5. The property was transferred to KMC in October 2016 but when the taxpayer rendered its 2017 tax return none of the individual erven had been on-sold by KMC and, for that reason, said the taxpayer, it did not disclose the sale thereof. SARS picked up this omission when it reviewed the 2017 tax return in conjunction with earlier tax assessments and also with the taxpayer's Value Added Tax ("VAT") returns. SARS was also alerted to a significant drop in turn-over for the 2017 tax year.

6. In response to a query by SARS, the taxpayer's auditors provided the following explanation on 16 May 2018. I cite the letter in full (in the form in which it was written) as it sets out the taxpayer's stance throughout this matter.

> "We are not in agreement with the decision made by SARS and also obtained a legal opinion in this matter.

According to paragraph 39A of the Eight Schedule to the Income Tax act this capital gains should have been ring-fenced and the loss carried over to the subsequent tax year.

The reason for this is that none of the 72 erven that were transferred to Kwali Mark Construction CC was sold. Paragraph 6 of the deeds of sales clearly states that all conditions for the transfer must be met before the capital gains can be realised.

As these erven were not sold, this is not the case and the capital gains has to be ring fenced until the erven are disposed of.

No proceeds on disposal had been declared as no monies have been received for this transaction and this is also one of the conditions for the sale of the property. Only when the final transfer of the erven takes place to an unrelated 3rd party will capital gains come into effect.

We, therefore, request that the income tax on the capital gains of R 14 224 568 be ring fenced until the erven are sold and cash flow have taken place."

7. SARS did not accept the position adopted by the taxpayer and took the view that it was liable to pay the full amount of CGT (R11 405 319, 40) to SARS during the 2017 tax year, when the taxpayer transferred the asset to the purchaser. In light of the taxpayer's understatement of its liability for CGT, SARS imposed an understatement penalty of 25% (R798 371, 36) pursuant to the provisions of s222 of the TAA.

8. Dissatisfied with SARS' determination, the taxpayer lodged an objection under s104 of the TAA, which objection eventually found its way via the Tax Board to the Tax Court. After hearing evidence adduced on behalf of SARS and argument on behalf of the parties, the Tax Court upheld the determination.

THE RELEVANT PROVISIONS OF THE TAA

9. The issue of the entitlement of SARS to impose a penalty for the understatement by a taxpayer in its tax return is governed by Chapter 16 of the TAA. S221 makes provision for internal definitions of words and phrases in that Chapter. Of relevance to this case is the definition of understatement:

> "**understatement"** means any prejudice to SARS or the *fiscus* as a result of –
>
> (a) a default in rendering a return;
>
> (b) an omission from a return;
>
> (c) an incorrect statement in a return;

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

(e) an 'impermissible avoidance agreement'."

10. There was some debate before the Tax Court as to whether there had been an understatement (as defined) by the taxpayer in the 2017 tax return. However, on appeal, Mr. Bothma made plain that the taxpayer accepted that there had been an understatement as defined, and in particular as categorized in subparagraph (b) of the definition thereof.

11. Once an understatement has been established by SARS, the provisions of s222 of the TAA come into effect.

"**222. Understatement penalty**

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

S 222(2) and (3) set out the formulae for the calculation of the understatement penalty which need not be repeated herein.

12. S223(1) contains the following table in which the relevant penalty payable by the taxpayer is calculated with reference to the specific category of alleged non-compliant tax behaviour on its part.

| **1** | **2** | **3** | **4** | **5** | **6** |
|---|---|---|---|---|---|
| *Item* | *Behaviour* | *Standard Case* | *If obstructive, or it is a 'repeat* | *Voluntary disclosure after notification* | *Voluntary disclosure after notification* |

[2] The use of inverted commas in the text is intended to refer to internal definitions in the TAA.

| | | | | | |
|---|---|---|---|---|---|
| | | | *case'* | *of audit or criminal investigation* | *of audit or criminal investigation* |
| (i) | 'Substantial understatement' | 10% | 20% | 5% | 0% |
| (ii) | Reasonable care not taken in completing return | 25% | 50% | 15% | 0% |
| (iii) | No reasonable grounds for 'tax position' taken | 50% | 75% | 25% | 0% |
| (iv) | 'Impermissible avoidance arrangement' | 75% | 100% | 35% | 0% |
| (v) | Gross negligence | 100% | 125% | 50% | 5% |
| (vi) | Intentional tax evasion | 150% | 200% | 75% | 10% |

13. It follows that in circumstances where an alleged understatement of tax has occurred, a three phase process is contemplated by the Legislature. Firstly, SARS must consider whether the understatement constitutes an "understatement" as defined in s221 of the TAA. If it does, SARS must then consider whether the understatement results from a "*bona fide* inadvertent error". If such an error is established, that is the end of the inquiry, and no understatement penalty may be

levied. However, where there is no such error, SARS is then required to identify the appropriate behavioral category under which the taxpayer's conduct allegedly resorts in terms of the table set out in section 223 before it can impose a penalty.

14. In the instant case, SARS elected to levy a penalty of 25% under Item (ii) of the table because it held the view that the taxpayer's understatement resulted from it not having taken reasonable care in the completion of its 2017 tax return. I shall deal with the proceedings in the Tax Court shortly, but it is apposite to note at this stage that in terms of s102 (2) of the TAA, SARS attracted the onus to justify its imposition of the relevant penalty i.e. 25% under item (ii) in the table.

> "102(2) The burden of proving whether an estimate under section 95 is reasonable or **the facts on which SARS based the imposition of understatement penalty** under Chapter 16, is upon SARS." (Emphasis added)

PROCEEDINGS BEFORE THE TAX COURT

15. Proceedings before the Tax Court are conducted in accordance with the rules promulgated under s103 of the TAA. Accordingly, prior to a hearing before the Tax Court, SARS is obliged to file a document under Rule 31 entitled "Statement of grounds of assessment and opposing appeal". Thereafter the taxpayer must file its "Statement of grounds of appeal" under Rule 32. SARS is entitled (but not obliged) to file a "Reply to statement of grounds of appeal" under Rule 33. It was common cause that these documents constitute the parties' respective pleadings before the Tax Court and are to be treated as such as if they were litigating in the High Court.[3]

16. In the event that a party wishes to amend its respective statement under Rules 31 – 33, it may do so under Rule 35 (1) with the agreement of the opposing party. If there is no such agreement, the party seeking to amend may invoke the provisions of Rule 52 and apply to the Tax Court for leave to amend.

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[3] In terms of Rule 42 of the Tax Court Rules, if such rules *"do not provide for a procedure in the tax court, then the most appropriate rule under the…High Court [Rules]… may be utilized by a party or the tax court."*

17. In formulating their pleadings, the parties are bound by the factual and legal bases upon which the disputed assessment was initially made and challenged. A change of tack requires a revised assessment.[4]

18. In this matter, SARS filed its Rule 31 Statement and the taxpayer replied thereto through its Statement under Rule 32. SARS did not file a reply under Rule 33. Neither party sought to amend its pleadings at any stage.

SARS' RULE 31 STATEMENT

19. The relevant allegations in SARS's founding statement filed under Rule 32 are to the following effect. For the avoidance of confusion the parties are referred to personally.

"Capital

5.1 [The taxpayer] disposed of **Erf [....] Brackenfell** in the 2017 year of assessment and did not declare the proceeds of **R22 105 263** (VAT excl.) from such disposal for capital gains tax purposes in its 2017 income tax return;

5.2 [SARS] has included the taxable capital gain from the disposal of the asset into [the taxpayer's] taxable income for the 2017 year of assessment in terms of section 26A of the [Income Tax Act, 58 of 1962].

Understatement Penalty

5.3 The omission of the proceeds of **R 22 105 263** (VAT excl) from the disposal of an asset in the [taxpayer's] income tax return for the 2017 year of assessment for capital gains purposes, resulted in a loss to the prejudice of the *fiscus,* rendering [the

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[4] Rule 31(3) provides that "*SARS may not include in the [Rule 31] statement a ground that constitutes a novation of the whole of the factual or legal basis of the disputed assessment or which requires the issue of a revised assessment.*"
Rule 32(3) similarly provides that the taxpayer "*may not include in the [Rule 32] statement a ground of appeal that constitutes a new ground of objection against a part or amount of the disputed assessment not objected to under rule 7.*"

taxpayer] liable for the payment of an understatement penalty at the rate of 25% for a behaviour category of 'reasonable care not taken in completing a return' on a standard case imposed in terms of section 222 read with section 223 of the TAA.

Understatement penalty

88. Understatement is defined in section 221 of the TAA to mean any prejudice to SARS or the *fiscus* as a result of *inter alia: -*

- an omission from a return…

99. SARS applied the understatement penalty table in section 223 of the TAA and imposed an understatement penalty of 25% as per item (ii) – 'standard case' of reasonable care not taken in completing a return during the 2017 year of assessment.

100. In applying its mind to the facts and circumstances of the case, SARS determined that the taxpayer's actions of not declaring the proceeds of R22 105 263 (VAT excl) for capital gains tax purposes constitute a behaviour that amounts to 'no reasonable care taken in completing a return' on a standard case and warranted the imposition of understatement penalties at 25%.

Reasonable care

101. Reasonable care requires the taxpayer to take the same care in fulfilling his tax obligations that could be expected of a reasonable ordinary person in the same position.

102. The [taxpayer] did not declare the proceeds from the sale of the property for capital gains tax purposes in the income tax return for the 2017 year of assessment yet the net and calculated profit of **R14 420 024** in the VAT reconciliation in respect of the disposal of **Erf [....] Brackenfell** was declared by the [taxpayer] in the income tax reconciliation schedule for IT15SD purposes.

103. The [taxpayer] further declared total gross sales of **R25 176 200** in the VAT reconciliation schedule for IT14SD purposes. The gross sales are inclusive of the proceeds from the disposal of **Erf [....] Brackenfell**. The [taxpayer] has thus acknowledged the sale of **Erf [....]** (sic) **Brackenfell**.

104. In the VAT 201 for the 10/2016 VAT period, the [taxpayer] also declared standard rated supplies of **R25 316 449** thereby acknowledging the proceeds of **R25 200 000** (VAT incl) from the disposal of **Erf [....]** (sic) **Brackenfell.**

105. Reasonableness required the [taxpayer] to have known that the sale of the property on 26 September 2016 and the subsequent registration on 27 October 2016 is a disposal event that triggers proceeds which accrued to the [taxpayer] during the 2017 year of assessment.

106. The [taxpayer's] failures to make such declarations are actions that fall below the standard of a reasonable person in similar circumstances.

107. SARS submits that the understatement penalties were correctly imposed at 25%."

THE TAXPAYER'S RULE 32 STATEMENT

20. After setting out the facts and conclusions of law upon which it relied, the taxpayer alleged that no understatement existed. Given that this is no longer an issue between the parties, it is not necessary to discuss the question further.

21. The nub of the taxpayer's case for the purposes of this appeal appears from the following allegations it its Rule 32 Statement.

"*Reasonableness of the [taxpayer's] actions*

12. For those reasons set out in paragraphs 16 to 20 below, the [taxpayer] contends that it had not acted unreasonably in adopting the tax position it had; a contention with which [SARS] appears to agree.[5]

*Understatement not connected with return completion process*

13. The above notwithstanding, it is the [taxpayer's] contention that any 'understatement' did not arise from its return completion process and therefore that the imposition of an understatement penalty on the basis of 'reasonable care not taken in completing return' is inappropriate. Rather if an 'understatement' is present, it arose from the tax position taken by the [taxpayer].

14. An understatement in the present matter cannot be said to be causally connected to the process followed by the taxpayer when completing its income tax return. [SARS] therefore identified the incorrect behaviour against which it applied the understatement penalty."

22. After setting out its allegations of fact and legal conclusions which it contended justified the "tax position"[6] it had adopted, the taxpayer concluded as follows –

"17… The taxpayer's calculation of its tax liability cannot be described as being unreasonable solely due thereto that it had interpreted the time of disposal and time of accrual rules in a manner different to [SARS].

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[5] The taxpayer references the contents of paragraphs 18 and 19 of its Rule 32 Statement by way of a footnote.

[6] In s221 of the TAA, '*tax position*' is defined as '*an assumption underlying one or more aspects of a tax return, including whether or not –*

*(a) an amount, transaction, event or item is taxable;*

*(b) an amount or item is deductible or may be set-off;*

*(c) a lower rate of tax than the maximum applicable to that class of taxpayer, transaction, event or item applies; or*

*(d) an amount qualifies as a reduction of tax payable…"*

18. The reasonableness of the [taxpayer's] provisional tax calculation is further borne out by the fact that [SARS] elected not to penalize the [taxpayer] for any 'understatement' on the basis of 'no reasonable grounds for 'tax position' taken. Had [SARS] truly considered the [taxpayer] to have no reasonable grounds for the 'tax position' adopted, it would have been obliged to levy a 50% penalty as opposed to a 25% penalty. It is for this reason that the table in section 223 of the [TAA] provides for behaviour of 'No reasonable grounds for 'tax position' taken', and which behaviour attracts penalties in a 'standard case' at 50%.

19. The failure to levy an understatement penalty at rates higher than 25% confirms that [SARS] was in fact satisfied that the underestimation of the 2017 provisional tax liability was not negligently or deliberately underestimated. Rather [SARS'] actions betray [its] views that the 'tax position' of the taxpayer in the current matter was not unreasonable, but that reasonable grounds for that position had existed.

20. Finally, it is notable that the [taxpayer's] position has been confirmed by independent expert opinion, further support therefor that it's 'tax position' adopted was in fact reasonable."

23. As already observed, SARS did not file a Rule 33 reply to the taxpayer's allegations, particularly those made in para's 12 and 18 to 20 of its Rule 32 statement. In accordance with the practice in the High Court, the failure by a party to reply to an allegation in a plea is deemed to be a denial of such allegations by the other side.[7] This approach appears to be incorporated in the Tax Court Rules.

"**34 Issues in appeal**

The issues in an appeal to the tax court will be those contained in the statement of the grounds of assessment and opposing the appeal read with the statement of the grounds of appeal and, if any, the reply to the grounds of appeal."

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[7] See Rule 25(2); Moghambaram v Travagaimmal 1963 (3) SA 61 (D&CLD) at 62F

PRE-TRIAL CONFERENCE

24. On 29 January 2021 the parties held a virtual pre-trial meeting as contemplated in Rule 38 of the tax court rules. In the minute of that meeting the parties recorded, inter alia, that –

"1.2 The following facts are in dispute:

1.2.1 Whether the understatement arose from:

1.2.1.1 behaviour on the part of the taxpayer which may appropriately be described as 'reasonable care not being taken in completing a return';

1.2.1.2 unreasonable actions on the part of the taxpayer; and

1.2.1.3 a *bona fide* and inadvertent error on the part of the taxpayer; and

1.2.2 Paragraphs 63 to 65 of [SARS'] Rule 31 Statement."

25. The fact that SARS made no issue in the pre-trial procedures of any allegation regarding the alleged unreasonableness of the tax position adopted by the taxpayer serves to confirm that it was only interested in establishing conduct by the taxpayer in conflict with item (ii) as justification of the penalty imposed. Notwithstanding the fact that the taxpayer had pointed out to SARS in its Rule 32 Statement that, at best for SARS, its conduct resorted under item (iii), SARS exhibited no apparent interest in advancing a case for a penalty under that item.

EVIDENCE ADDUCED BEFORE THE TAX COURT

26. In the Tax Court SARS relied on the *viva voce* evidence of Ms. Marothodi, a risk profiler in its Specialist Audit Division, who was tasked with investigating the taxpayer's 2017 tax return after it was referred to her by an operational manager at SARS.

27. In her evidence-in-chief Ms. Marothodi was asked by counsel to explain her decision in assessing the understatement penalty.

> "Ms. Tsoai:
>
> Now can you please explain to the Court how did you choose - or how did you come to the conclusion that reasonable care was not taken in completing a return was the most appropriate behavior or category that should be imposed on the taxpayer or the appellant?"

Her reply was as follows.

> "When raising the assessment I went to the TAA for the imposition of USP, since there was an understatement. The taxpayer omitted some amounts, as explained. So in choosing the behaviour I selected the reasonable care not being taken in completing a return because firstly the taxpayer declared output for the same transaction… And the sale agreement was concluded, as well as the transfer was done. The system issued a letter after the case was picked up for verification, affording the taxpayer to submit (sic) if there is an error on the return. It was not done. I started with the audit and issued the letter again for the taxpayer to explain."

28. When pressed under cross-examination by Dr. Marais, the witness fell about but eventually accepted that she had chosen the wrong behavioural category in assessing the understatement penalty. She vacillated between contending that the behaviour of the taxpayer was unreasonable in failing to include the CGT figure in the 2017 tax return to unreasonable in relation to the basis for the tax position it claimed to have taken.

29. Eventually, Ms. Marothodi conceded that SARS had erred in imposing a 25% penalty on the basis of the item (ii) behaviour it had relied on and accepted that the position contended for by the taxpayer (a reasonable assumption in relation to the tax position it had taken) was viable, eventually stating rather opportunistically –

> "Okay, looking at the facts, I must say that SARS lost the opportunity using that 50%."

30. The witness then rather brazenly went on to suggest to counsel for the taxpayer that his client should be happy with the lesser penalty because its conduct had been unreasonable either way. The evidence clearly demonstrates that the witness manifestly did not understand the difference between the behaviour categorised in items (ii) and (iii). In light of the damaging concession made by SARS' only witness, the taxpayer astutely closed its case without calling any witnesses.

THE FINDINGS OF THE TAX COURT

31. The Tax Court accepted that SARS had unequivocally sought to levy the penalty on the basis of the taxpayer's failure to take reasonable care in the completion of its tax return and that it was bound by that determination.

> "[45] The question which then arises is whether SARS correctly categorized the understatement as being the result of '*reasonable care not taken in completing a return'.* Although during argument SARS advanced various reasons why it was correctly categorized as such, it is bound by the concession of its own witness Ms. Marothodi that this was, in hindsight, incorrect and that the penalty should rather have been based on '*no reasonable grounds "for tax position" taken'* which would have attracted a penalty of 50%.
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> [46] Put differently, SARS pinned its colors firmly to the mast of failing to take reasonable care in the tax return completion process as pleaded in its rule 31 statement, which is the case the appellant was called upon to meet. However the evidence established that the cause of understatement was, in SARS' view, a tax position based on unreasonable grounds, although we refrain from making any finding thereon since we were not required to adjudicate upon this. However we are nonetheless bound to conclude, in the circumstances, that on its own version SARS erred in imposing the

understatement penalty in item (ii) as opposed to item (iii) of 50% in the understatement penalty percentage table contained in s 223(1) of the TAA."

32. After the conclusion of argument, the Tax Court had invited the parties to make written submissions on the question as to whether it was entitled to increase the penalty to 50 %. Relying on the decision of the Supreme Court of Appeal ("SCA") in Purlish[8], the Tax Court held that it was precluded from making such an increase. However, said the Tax Court, the very passage relied upon entitled it to hold the taxpayer to the imposed penalty.

> "[49] On our interpretation of the above quoted passage this does not mean that the appellant then escapes liability for the penalty imposed by SARS, but simply that it nonetheless remains liable for the reduced to 25% penalty."

The issue before this Court is therefore whether this conclusion arrived at by the Tax Court was correct. It requires, firstly, consideration of paragraph 25 of Purlish.

33. The facts in Purlish were that the taxpayer had paid provisional income tax and applied for a refund in excess of R13m, alleging that the company had not yet commenced trading. After conducting an audit, SARS established that the taxpayer was indeed trading, had accrued substantial income and had, furthermore, charged VAT for its services rendered to clients without rendering VAT returns to SARS. Its tax returns thus contained allegations which were tantamount to fraud. After determining the income tax payable by the taxpayer, SARS proceeded to impose understatement penalties at the rate of 100% on the basis of item (iv) – "Gross negligence"

34. The taxpayer then successfully objected to the imposition of the understatement penalties and SARS reduced these to 25% in respect of income tax and 50% in respect of VAT. The matter eventually proceeded to the Tax Court where it was found that the taxpayer had been grossly negligent and that the imposition of

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[8] Purlish Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service [2019] ZASCA 04 (26 February 2019) at [25]

the 100% penalties on both taxes was warranted. The Tax Court then proceeded to increase the penalties.

35. The matter served before the SCA with the leave of the Tax Court where the SCA held as follows:

> "[25] The next question is whether the Tax Court was entitled to increase the understatement penalties levied by SARS. Section 129(3) of the TAA empowers the Tax Court to increase an understatement penalty. **But, that only arises if the issue has been properly raised for adjudication before that court.** This is determined by Rule 34, which provides:
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> '*The issues in an appeal to the tax court will be those contained in the statement of the grounds of assessment and opposing the appeal read with the statement of the grounds of appeal and, if any, the reply to the grounds of appeal*.'

It was fairly conceded by counsel for SARS, that SARS had never raised the issue of the increase of the reduced penalties for adjudication before the Tax Court. In its Rule 31 statement, SARS only sought to justify the reduced penalties. It follows that it was incompetent for the Tax Court to have increased the reduced penalties. To that extent the appeal against the decision of the Tax Court must succeed. It follows that the understatement penalties of 100 per cent imposed by the Tax Court in respect of both income tax and VAT for the relevant periods must be set aside and SARS' understatement penalty of 25 per cent in respect of income tax and 50 per cent in respect of VAT reinstated. Accordingly paragraphs 2 to 5 of the order of the Tax Court falls to be set aside." (Emphasis added)

36. In my respectful view the Tax Court misread Purlish. There is no debate that the Tax Court has the power to increase an understatement penalty – s129 (3) of the TAA expressly provides so.

> "**129. Decision by tax court**

(3) In the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the tax court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or increase the understatement penalty."

37. But that power to increase is contingent upon, firstly, SARS having made the allegation in its Rule 31 Statement, and, secondly, having discharged the burden of proof. That is the basis upon which the SCA decided Purlish as the highlighted passage above makes clear.

38. The position under the TAA and the tax court rules is in accordance with the accepted purpose of pleading. The position was summarized thus in Trope[9] -

"It is, of course, a basic principle that particulars of claim should be so phrased that a defendant may reasonably and fairly be required to plead thereto. This must be seen against the background requirement that the object of pleadings is to enable each side to come to trial prepared to meet the case of the other and not be taken by surprise."

39. In Molusi[10] the Constitutional Court summarized the position further as follows.

"[28] The purpose of pleadings is to define the issues for the other party and the court. And it is for the court to adjudicate upon the disputes and those disputes alone. Of course there are instances where the court may of its own accord (mero motu) raise a question of law that emerges from the evidence and is necessary for the decision of the case as long as its consideration on appeal involved no unfairness to the other party against whom it is directed. In Slabbert [11] the Supreme Court of Appeal held:

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[9] Trope v South African Reserve Bank and another 1992 (3) SA 208 (T) at 210G-H

[10] Molusi v Voges 2016 (3) SA 370 (CC) at

[11] Minister of Safety and Security v Slabbert [2010] 2 All SA 474 (SCA) at [11]

> *'A party has a duty to allege in the pleadings the material facts upon which it relies. It is impermissible for a plaintiff to plead a particular case and seek to establish a different case at the trial. It is equally not permissible for the trial court to have recourse to issues falling outside the pleadings when deciding the case.'"* (Internal references otherwise omitted).

40. In a matter such as this, SARS is further restricted by the provisions of Rule 31(3) to which reference has already been made. Having opted in its tax assessment to impose an understatement penalty under item (ii), it was not open to SARS to seek to advance a different factual basis for its assessment in its Rule 31 Statement, e.g. under item (iii), without issuing a revised assessment. The reason for this is obviously to fairly afford a taxpayer the opportunity to reconsider its position before embarking on a tax appeal process.

41. As I have demonstrated above, the case SARS sought to advance throughout was that the imposition of the understatement on the taxpayer was justified because of the taxpayer's alleged behaviour under item (ii) - that it had not taken reasonable care in completing its tax return. It never deviated from that approach and did not seek to amend its case (in circumstances where that may have been permissible) at any stage until its witness changed tack under cross-examination.

42. As the SCA directed in Purlish, the issues in this case were determined by the provisions of Rule 34 of the tax court rules. And, as demonstrated above, the parties confirmed in para 1.2.1.1 of their pre-trial minute that the issue was the behaviour categorized in item (ii) – no more, no less.

43. Accordingly, if SARS elected to impose a 25% understatement penalty under item (ii), it was required to prove the factual basis therefor when its determination was challenged by the taxpayer in the Tax Court. It is common cause that SARS did not do so, and in the circumstances there is no basis, either in fact or law, for it to recover that penalty from the taxpayer. It follows that the Tax Court was wrong in confirming the understatement penalty of 25%.

44. Before us, Mr. Mokgatle argued that, as SARS had established an understatement by the taxpayer, it was entitled to impose a penalty without more. The argument almost seems to suggest a measure of strict liability. I do not agree. SARS' prerogative to impose an understatement penalty is closely circumscribed by the provisions of s222 and 223 of the TAA. Importantly, it must be borne in mind that that prerogative only comes into consideration if it has been established by SARS that the understatement was not occasioned by a bona fide error on the part of the taxpayer.

45. The non-applicability of the bona fide error proviso in s222 (1) of the TAA was not in dispute in this case. But that did not entitle SARS to then impose any penalty it considered applicable. S222 (2) carefully circumscribes the powers of SARS.

> "222(2) The understatement penalty is the amount resulting from applying the highest applicable understatement penalty percentage in accordance with the table in section 223 to each shortfall determined under subsections (3) and (4)[12] in relation to each understatement in a return."

It follows that if, for example, SARS finds that there has been an understatement based on the taxpayer's failure to take reasonable care in completing its return, it must impose the 25% penalty: it does not have any discretion to lower the percentage. Similarly, if the behaviour category relied on by SARS is the absence of reasonable grounds for the tax position taken, it must impose a 50% penalty. There is thus no statutory basis to impose a 25% penalty in respect of behaviour falling within the ambit of item (iii).

46. What happened in this matter is that the Tax Court found that SARS was bound by the concession made by its witness under cross-examination and that it had thus failed to establish the factual basis for imposing the item (ii) penalty of 25%. The Tax Court went further and found that there was no basis for it to consider

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[12] These subsections provide the method of calculation of the shortfall in a taxpayer's return to which the understatement is to be applied.

whether the item (iii) penalty of 50% had been established because this was not the case pleaded by SARS.

> "(W) e refrain from making any finding thereon since we were not required to adjudicate upon this."

That notwithstanding, it sustained the claim by SARS for a 25% penalty.

47. In my respectful view, there is no statutory basis for such a finding. Once SARS had failed in its bid to discharge the onus of proving the item (ii) penalty for which it had contended and which buttressed the case the taxpayer came to meet, that was the end the case. SARS was not entitled to ask for "the money and the box", as it were. In finding that SARS was entitled to retain the penalty which it had failed to prove, the Tax Court effectively deprived the taxpayer of answering a case it was not called upon to meet. Aside from the manifest unfairness of such an approach, the Tax Court (a creature of statute bound by the limits of its jurisdiction) was not permitted to make such an order under s129(3) where the confirmation of an understatement penalty is dependent on SARS discharging its burden of proof.

48. In the result, I propose that it must be concluded that the Tax Court erred in confirming the understatement penalty and that the taxpayer's appeal to this Court should be upheld.

COSTS

49. Counsel were ad idem that in the event of the appeal succeeding, the costs on appeal should follow the result. Mr. Mokgatle also agreed with the terms of the order that Mr. Bothma proposed save for the issue of costs in the Tax Court, where Mr. Mokgatle suggested that it be ordered that each party pay its own costs.

50. The question of costs before a tax court is governed by s130 of the TAA and Mr. Bothma submitted that s130 (1)(a) was applicable.

> "**130.Order for costs by tax court**

(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."

51. In my view, the approach adopted by SARS in assessing the understatement penalty was indeed unreasonable in the circumstances. Throughout the taxpayer played open cards with SARS and as early as 16 May 2018, set out its case in seeking to justify the adoption of its tax position. That stance was repeated in detail in its Rule 32 Statement. SARS did not seek to adequately engage with the taxpayer as to the reasonableness of the tax position adopted, nor consider revising its assessment to levy a 50% penalty thereon. Rather, it steadfastly persisted with its claim that the taxpayer had not taken reasonable care in submitting the 2017 tax return.

52. To meet SARS' case, which it now readily admits was based on the wrong statutory provision, the taxpayer was required to spend time and valuable resources, including legal expenses and procuring expert advice from a tax practitioner. Those resources were wasted when SARS abandoned its initial position half way through the proceedings and opportunistically attempted to justify something which was manifestly legally untenable.

53. In the circumstances I am satisfied that the taxpayer has established that SARS' decision to fix and impose an understatement penalty of 25% under item (ii) was unreasonable in the circumstances and that it would be just and equitable to order it to pay the taxpayer's costs in the Tax Court. In terms of s130 (2), such costs are taxable on the High Court scale.

54. In the circumstances I would propose the following order:

A. The appeal is upheld with costs.

B. The order of the Tax Court dated 18 June 2021 is set aside and replaced with the following –

1. The appeal is upheld.

2. The respondent is directed to alter the 2017 additional assessment issued for the appellant to exclude the understatement penalty imposed.

3. The respondent is ordered to pay the appellant's costs of suit, such costs to be taxed on the High Court scale.

**GAMBLE, J**

I agree and it is so ordered.

**GOLIATH, AJP**

I agree.

**KUSEVITSKY, J**

Appearances:

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|---|---|
| For the appellant: | Mr. P-S Bothma |
| Instructed by | Marais Pacitti Attorneys |
| | Cape Town. |

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| For the respondent: | Mr O Mogatle (with him Ms T Tsoai) |
| Instructed by | The Commissioner for the<br>South African Revenue Service<br>Pretoria. |