REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

HELD AT JOHANNESBURG, GAUTENG

CASE NO: IT 45997

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

SIGNATURE — **29 December 2022** DATE

In the matter between:

TAXPAYER S Applicant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

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J U D G M E N T

STRIJDOM AJ

[1] This is an interlocutory application to a tax appeal in which the applicant sought an order that an additional income-tax assessment issued for the 2016 tax year ("the additional assessment") be referred back to the respondent on the grounds that:

[1.1] The applicant was entitled to include certain items of expenditure disregarded by the respondent in the calculation of an allowance claimed by the applicant in terms of section 24C of the Income Tax Act 58 of 1962 ("ITA"), for the 2016 year of assessment ("the 24C allowance");

[1.2] there was no substantial understatement and therefore no basis to impose understatement penalties ("USPs") in terms of sections 221 and 223 of the Tax Administration Act 28 of 2011 ("the TAA"); and

[1.3] there was no basis to levy interest in terms of section 89 quat of the ITA, ("the tax appeal").

[2] The applicant sought, separately to the relief set out in paragraph 1 above and before the adjudication thereof an upfront determination that the new grounds of assessment be struck out from the respondent's rule 31 statement. In this regard the applicant sought an order that the second sentence of paragraph 45 and the entire contents of paragraph 46 of the rule 31 statement be struck out on the basis that it introduces an impermissible new ground of assessment in the appeal.

[3] The parties have agreed that it is convenient and in the interest of justice for the Objection *in Limine* to be dealt with as a separated issue in advance of the hearing of the merits of the tax appeal.

[4] The respondent opposed this application on the basis, *inter alia* that:

[4.1] Rule 31(2) does not place a preclusion on the respondent as alleged by the applicant;

[4.2] The portions of the rule 31 statement that the applicant wishes to strike out do not constitute a novation of the whole of the factual or legal basis of the disputed assessment, as alleged by the applicant;

[4.3] The portions of the rule 31 statement that the applicant wishes to strike out do no require the issue of a revised assessment, as is suggested by the applicant in its rule 32 statement.

[5] The portions of the rule 31 statement ("impugned portions") that the applicant objects to are the second sentence of paragraph 45 and the entire paragraph 46 thereof. Paragraph 45 states:

> "The items listed above totalling R413 090 233.00 do not constitute expenditure to be incurred in the performance of obligations in terms of the contract. The items comprise general administrative expenses that the Appellant would incur unrelated to future contractual obligations that the Appellant has received income in advance for".

[6] Paragraph 46 states:

> "The items listed further do not comprise future expenditure to be incurred in the fulfilment of the Appellant's contractual obligations, but instead constitute expenses already incurred before the conclusion of the 2016 tax year."

[7] The applicant has at all relevant times hereto been registered for Income Tax, and submitted an ITR 14 Income Tax Return for the 2016 tax year to the respondent on 30 June 2017.

[8] The applicant claimed an allowance in terms of section 24C ("24C allowance") of the Income Tax Act ("ITA") in the amount of R988 539 291.00 for the 2016 tax year in the return.

[9] The respondent issued an original assessment for the 2016 tax year upon the receipt of the ITR 14 on 30 June 2017, based on the applicant's declaration in the return.

[10] On 12 August 2019, the respondent notified the applicant that it would be conducting an audit into the applicant's income tax declarations for the 2016 tax year, with the audit scope centred on the applicant's claim for an allowance in relation to future contract expenditure sought in terms of section 24C of the ITA.

[11] The correspondents above informed the applicant that the audit would focus on the claim for an allowance for future expenditure in terms of section 24C. A detailed calculation in respect of the allowance claimed for future expenditure on contracts was requested.

[12] The applicant submitted a response referring to expenditure from the 2016 tax year which the applicant utilised in its calculation of the 24C allowance it sought to deduct in the same 2016 tax year.

[13] The applicant was asked by the respondent in a letter dated 5 November 2019[1] to provide a detailed explanation as to why the following expense items qualify to be included in the calculation of the Section 24C allowance:

BU Head Office salary to site
Site office expense
Telephone / postages / fax
Financial charges
Legal fees
Professional fees
Rent Housing
Training & education
Travel & accommodation
Cost accruals
Management fee
Director / Manager O/H
Salaries

[14] The applicant elected not to provide any material response to this request, save to state that the amounts were already incurred in relation to a contract. The applicant stated:

"All expenses incurred was (sic) in respect of that contract."[2]

[15] On 20 May 2020, subsequent to engagements between the parties in the course of the audit, the respondent issued to the applicant a finalisation of audit letter[3] and an additional assessment[4] for the 2016 tax year, in accordance with sections 42 and 92 of the TAA.

[16] The finalisation of audit and additional assessment ("the assessment") set out the following adjustments to the applicant's Income Tax Assessment for the 2016 tax year:

[16.1] The allowance in terms of Section 24C of the ITA permitted to the applicant was reduced due to the exclusion of the particular items of expenditure listed above which the applicant had submitted should be included as part of the calculation of the allowance claimed in items of Section 24C ("excluded expense items");

1 Bundle Pg 727 E 728.
2 Bundle Pg 730.
3 Bundle Pg 1 to 6.
4 Bundle Pg 22.

[16.2] The imposition of an understatement penalty ('USP') of 10% on the adjustment above; and

16.3] The imposition of interest in relation to the underpayment of provisional tax by the applicant in terms of section 89*quat*(2) of the ITA.

[17] The applicant objected to the assessment, with such objection[5] thereafter being disallowed by the respondent[6]. The matter proceeded through the appeal phase of the dispute resolution process, with ADR unsuccessfully attempted. The matter was referred to the Tax Court at the instance of the applicant.

[18] The respondent delivered its rule 31 statement within the agreed period. The applicant subsequently delivered a rule 32 statement wherein its grounds of appeal are set out, and wherein it took issue with certain portions being included in the rule 31 statement. The applicant contended that the respondent for the first time:

[18.1] In the second sentence of para 45 of the rule 31 statement that the excluded expense items comprise general administrative expenses that the applicant would incur unrelated to future contractual obligations that the applicant has received income in advance for;

[18.2] At para 46 of the rule 31 statement, that the excluded expense items do not comprise future expenditure to be incurred in the fulfilment of the applicant's contractual obligations, but instead constitute expenses already incurred before the conclusion of the 2016 tax year.

[19] The applicant alleged in the rule 32 statement that the inclusion of the impugned portions in the rule 31 statement contravened both rule 31(2) and rule 31(3), and contended that the impugned portions are to be struck out on this basis.

[20] It was submitted by counsel for the applicant that the reference in rule 31(2) to the grounds of assessment must be read and be taken to mean the actual grounds that existed and were relied upon by the respondent at the time the additional assessment was issued. This follows from the use of the words "disputed assessment" in rule 31(2)(*a*) which can only be a reference to an actual assessment based on grounds of assessment, issued by the respondent in respect of which the taxpayer lodged an objection at which only point the assessment, based on those grounds, becomes "disputed". If the respondent were to be able to include new grounds that were not initially relied upon when the assessment was issued, those grounds will not have been "disputed" in the sense envisaged by rule 31(2) to the extent

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5 Bundle Pg 7.
6 Bundle Pg 31.

that the taxpayer will not have addressed them in an objection or notice of appeal. The taxpayer would be significantly prejudiced and face continuous uncertainty as to the ambit of the dispute if the respondent is not held to its initial grounds of assessment.

[21] It was further submitted by the applicant that the reference in rule 31(3)(*c*) to "the material facts and legal grounds relied upon by the respondent in opposing the appeal" can only relate to those facts and grounds directed at the taxpayers, grounds of appeal against an assessment as set out in the objection and notice of appeal. This is confirmed having regard to the provisions of section 107 of the TAA.

[22] The applicant contended that not only has the respondent failed to comply with rule 31(2) but the inclusion of the new grounds constitutes a novation of the legal basis of the disputed assessment and/or require the issue of a revised assessment.

[23] Rule 31(2) states as follows:

> "31. **Statement of grounds of assessment and opposing appeal—**(2) The statement of the grounds of opposing the appeal must set out a clear and concise statement of—
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> (*a*) the consolidated grounds of the disputed assessment;
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> (*b*) which of the facts or the legal grounds in the notice of appeal under rule 10 are admitted and which of those facts or legal grounds are opposed; and
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> (*c*) the material facts and legal grounds upon which SARS relies in opposing the appeal."

[24] The subrule places no preclusion on the respondent and deals only what must be present in the statement. The preclusions are dealt with in rule 31(3).

[25] In the matter of *Lion Match v C SARS*,[7] Moodly J stated at para 36:

> "Subrule (2) sets out three categories of grounds that SARS must include in the Rule 31 statement. Subrule (3) stipulates that SARS is precluded from including in the statement:
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> "(a) a ground that constitutes a novation of the whole of the factual or legal basis of the disputed assessment; or
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> (b) a ground which required the issue of a revised assessment."

[7] *Lion Match Company (Pty) Ltd v Commissioner for The South African Revenue Services* [2017] JOL 37365 (KZD).

[26] Rule 31(2)(*a*) relates to the grounds of the assessment under dispute that had been appealed against and directs the respondent to include the grounds of that assessment in the rule 31 statement. The respondent has complied with this subrule.

[27] Rule 31(2)(*b*) relates to the respondent's response to the appellants' grounds of appeal in the Notice of Appeal under rule 10. The respondent is required to admit or oppose the appellant's grounds as part of the rule 31 statement. The respondent has done so in the rule 31 statement.

[28] Rule 31(2)(*c*) directs that the statement must include "material facts and legal grounds upon which the respondent relies in opposing the appeal". It was submitted by counsel for the respondent that these grounds may be different from those upon which the disputed assessment was based is clear, as for it to be otherwise would create an illogical duplication between rules 31(2)(*a*) and 31(2)(c).

[29] It was further submitted that an obvious reason for the distinction is that the grounds of a disputed assessment would have been formulated before an appeal had been lodged and before any challenge to the assessment had been put forward. It is not possible for the respondent to cater for all grounds of opposition to an appeal before it has had sight of an appeal or even an objection. Such is applicable to this case, where the applicant only provided the contracts relevant to the 24C allowance claim and full schedules of the excluded expense items with its appeal[8] and not with its objection.[9] It would also not be possible for all grounds of opposition to an appeal to be formulated at the time of disallowance of an objection, as rule 10(3) allows for a taxpayer to introduce new grounds of appeal after the disallowance of an objection. I agree with this submission.

[30] In my view rule 31(2)(*c*) places no obligation on the respondent to limit the grounds opposing the appeal to the formulation of any preceding correspondence, document or process that it issued. The grounds to be put forward under this subrule are therefore the respondent's grounds contemporaneous to the preparation of the statement in response to the taxpayer's appeal, for the purpose of opposing the Tax Court Appeal.

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8 Bundle Pg 56 to 591 E 592 to 611.

9 Bundle Pg 7 to 30.

[31] The Tax Court in *Lion Match* supra recognised an equivalence between the previous rule 10 and the current rule 31 and stated:

> "Rules 10 to 12 of the previous Tax Court Rules issued under the ITA are the equivalent of Rules 31 to 33 of the new rules issued under the TAA. Rule 10(3) provided that the statement of the grounds of assessment had to:
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> (a) set(ting) out a clear and concise statement of the grounds upon which the taxpayer's objection is disallowed; and
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> (b) stating the material facts and legal grounds upon which the Commissioner relies for such disallowance."

[32] The old rule 10(3)(*b*) is thus compatible with the current rule 31(2)(*c*), but for the distinction with reference to "disallowance" rather than opposition to appeal.

[33] The applicability of the Court's interpretation of the old rule 10 in ITC 1843 to the current Rule regime was confirmed in *Lion Match*, wherein it was stated:

> "The conclusion of Claasen J in ITC 1843 that Rules 10 to 12 of the old rules entitled the Commissioner and the taxpayer to depart from their respective previously stated positions, particularly because the relevant grounds are expressed in the present tense and not with reference to earlier documents, may be equally applicable to the new Rule 31 to 34."

[34] Rule 31(2)(*c*) obligates the respondent to set out the material facts and legal grounds it relies on presently in the Tax Court Appeal and not those relied on in formulating the assessment. Any limitation on this is not found in rule 31(2) but rather in rule 31(3).

[35] The applicant has alleged at para 49 of the rule 32 statement that the respondent is precluded from introducing new grounds, in the rule 31 statement which did not form the basis relied upon when the assessment was issued.

[36] Rule 31(3) states:

> "(3) SARS may not include in the 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."

[37] It is clear from the wording of rule 31(3) that the grounds may not be new, but rather that they may not constitute a novation of the whole of the factual basis of the disputed assessment or required the issue of revised assessment.

[38] It was stated by Keightley J in the Tax Court ITC 1912[10] at para 30:

> "This places the taxpayer in an equivalent position to SARS which, under TCR 31(3), can include a new ground in its statement, provided it does not amount to a novation of the assessment, or is such that it requires a new assessment."

[39] The applicant bears the burden of proving that such new grounds "amount to a novation of the assessment or is such that it requires a new assessment".

[40] It was submitted by the respondent that no revised assessment is needed as no alteration to the tax liability will take place, and no other aspect of the assessment will be required to be revised. In my view the applicant has presented no case in this regard.

[41] The respondent's legal basis for the disputed assessment was consistently communicated to the applicant and is discernible from all communication and all applicable legislation. It is therefore incorrect for the applicant to allege that it was not aware of what case it had to answer or to allege that it had to guess what requirements of section 24C it had to meet.

[42] The applicant assumed the burden of meeting all requirements of Section 24C upon submitting a claim for the allowance. The SCA in *Africa Cash & Carry*[11] has confirmed that the Tax Court has a duty to re-evaluate all of the appellants' conduct evidence and declarations to establish if the legal requirements for valid deduction have been met.

[43] The applicant must prove that the impugned portions are novations which substitute the legislated requirements for a valid allowance with an entirely new set of obligations that the applicant must meet. The applicant would still bear the burden of proving that every requirement of section 24C is met to discharge the onus upon it.

[44] In my view the applicant has failed to prove that the impugned portions of the rule 31 statement are grounds that constitute a novation of the whole of the legal basis of the disputed assessment.

[45] The applicant has also alleged that the impugned portions of the rule 31 statement constitute a novation of the whole of the factual basis of the disputed assessment.

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[10] Income Tax Case No 1912 80 SATC 417.

[11] *Africa Cash and Carry (Pty) Ltd v Commissioner for The South African Revenue Service* [2020] 1 ALL SA 1 (SCA).

[46] Rule 31(2)(*c*) does not require that the factual grounds in opposing the appeal set out in the respondent's rule 31 statement accord fully with the wording and content of the FOA, the disallowance of objection, or any disallowance of objection, or any other preceding correspondence.

[47] The second sentence of para 45 of the rule 31 statement accords with the content of the two letters referred into, in that:

[47.1] Both letters inform the applicant that in order for a section 24C allowance to be claimed the expenditure/items of expenditure to be claimed must be incurred in the performance obligation in terms of the contract.

[47.2] Both letters communicate the respondent's assertion that the excluded expense items relate purely to administrative matters and would not quality under section 24C of the ITA.

[47.3] The letters inform the applicant that section 102 of the TAA places the burden on the applicant to prove that the amount is deductible or claimable.

[48] The second sentence of para 45 of the rule 31 statement conveys the same with reference to the statutory requirement that the expenses must relate to contractual obligations that the applicant has received income in advance for. The second sentence of para 45 is neither a new ground, nor is it novation of the whole of the factual basis of the assessment.

[49] The applicant states that the respondent never previously alleged in the aforementioned documents that the excluded expense items had already been incurred in the 2016 year of assessment and that this is a contravention of rule 31.

[50] In this matter the applicant has provided schedules which illustrate that all the excluded expense items were incurred before the end of the 2016 tax.[12] It is therefore the applicant's own version that the excluded expense items were already incurred before the conclusion of the 2016 tax year. The applicant has also admitted in the rule 32 statement that the expenditure in question was incurred in the 2016 year.[13] The documents provided with the appeal and as annexures to the rule 32 statement confirm that the excluded expense items are past expenditure.

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12 Bundle Pg 592 to 611.

13 Bundle Pg 636 – rule 32 statement para 4.

[51] The grounds raised in para 46 of the rule 31 statement is not new to the dispute. The inclusion of a new ground in a rule 31 statement is also not impermissible and is acceptable with relation to factual grounds.

[52] I contended that the inclusion of the impugned portions does not constitute a novation of the whole of the factual basis of the assessment.

[53] In the result:

The Application is dismissed with costs.

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Strijdom JJ
Acting Judge of The High Court of South Africa
Gauteng Division
Johannesburg

Heard on: 14 October 2022

Judgment: 29 December 2022