REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT MEGAWATT PARK, GAUTENG)

Case No.: **IT 46591**

(1) REPORTABLE: YES / **NO**

(2) OF INTEREST TO OTHER JUDGES: YES / **NO**

(3) REVISED.

31 July 2024
DATE SIGNATURE

In the matter between:

HCS **Appellant**

and

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

J U D G M E N T

MANOIM, J

[1] This is an application for default judgment. The applicant, HCS has appealed against an assessment, additional assessment, and additional penalties, imposed by the respondent, the Commissioner of South African Revenue Services (SARS), in respect of the 2017 and 2018 tax years.

[2] Because SARS is in default of compliance with the rules of this court, HCS seeks the relief set out in its appeal; namely that the appeal be upheld, and the amounts assessed be set aside.

[3] It is common cause that SARS is in breach of the rules because it did not file the necessary pleading – its rule 31 statement - in time. It has done so by now. For this reason, it seeks condonation for the late filing. It opposes the application for default judgment relying on a defence of good cause shown.

Background

[4] In September 2020 SARS advised HCS of its intention to conduct an audit in respect of the 2017 and 2018 tax years, specifically reviewing cross border transactions. There were various interactions between the parties thereafter largely relating to SARS requests for further information about HCS's operations in Germany. A crucial letter in this regard was one emanating from HCS on 27 October 2021 in which the provisions of section 6*quat* of the Income Tax Act, 58 of 1962, (ITA) were relied on which deals with foreign tax credits.

[5] In 2022 SARS concluded an audit on SARS. It issued a letter of audit findings on 10 April 2022. In this letter SARS indicated an intention to issue additional assessments for the 2017 and 2018 tax years in respect of foreign tax credits that had been overclaimed in terms of section 6*quat* and in respect of 2018, two amounts for undeclared income. HCS was given an opportunity to respond. It was also warned of the possibility that understatement penalties might be levied.

[6] HCS responded in May 2022 to dispute these conclusions, but to no avail. SARS on 15 June 2022 issued a letter of assessment. The assessment amounts followed those set out in the April letter but this time, in addition, contained understatement penalties as well on all the adjusted amounts. There followed a notice of objection by HCS in July 2022 and in response, a notice of disallowance by SARS in September 2022.

[7] HCS then noted an appeal on 28 November 2022 and hence the matter came before this court. HCS also stated that the matter was not appropriate for alternative dispute resolution.

[8] SARS was required to deliver a statement in terms of rule 31 of the Tax Administration Act, 28 of 2011, (TAA) rules, within 45 days of the delivery of the Notice of Appeal. That meant the last date for delivering the rule 31 statement was 28 February 2023. But by that date SARS had not done so. On 10 March 2023 HCS issued a notice in terms of rule 56(1)(*a*). In terms of this rule the defaulting party – in this case SARS - is called upon to remedy its default within 15 days of delivery of the notice, failing which the party issuing the notice indicates it will apply for a final order. The prescribed period had lapsed by 3 April 2023, but by this stage SARS had still not filed the rule 31 statement.

[9] HCS then brought the present application for default judgment on 5 May 2023. At the time of this filing SARS had still not filed the rule 31 statement nor an application for condonation. The rule 31 statement was eventually delivered on 6 June 2023 at the same time as the filing of SARS's answering affidavit and application for condonation. This means that the rule 31 statement was delivered just over 3 months late.

[10] There is no dispute that SARS has not filed the rule 31 statement on due date, and that thereafter it did not remedy its default within the requisite time period. It is also not in dispute that the SARS has done so now and that it has applied for condonation. With this background the issues to be decided in this case are:

a. Whether SARS has shown good cause for its default.

b. Whether the following factors militate in favour of default judgment or condonation:

    i. prospects of success; and

    ii. Balance of prejudice.

[11] The requirement of 'good cause shown' emanates from rule 56(2) of the tax court rules. This rule states:

> "56(2) The tax court may, on hearing the application—
>
> (*a*) in the absence of good cause shown by the defaulting party for the default in issue make an order under section 129(2); or
>
> (*b*) make an order compelling the defaulting party to comply with the relevant requirement within such time as the court considers appropriate and, if the defaulting party fails to abide by the court's order by the due date, make an order under section 129(2) without further notice to the defaulting party."

[12] In *Competition Commission of South Africa v Pickfords Removals SA (Pty) Ltd*, the Constitutional Court after noting that good cause shown is a well-known term in our law set out the relevant factors to consider:[1]

> "Courts are afforded a wide discretion in evaluating what constitutes 'good causes so as to ensure that justice is done. Ultimately, the overriding consideration is the interests of justice, which must be considered on the facts of each case. Factors germane to this enquiry may include the extent and cause of the delay; the effect of the delay on the administration of justice and other litigants; the reasonableness of the explanation for the delay; the issue(s) to be raised in the matter; and the prospects of success."

[13] The extent of the delay has been set out earlier. I now look at the cause of the delay and the reasonableness of the explanation for the delay. There are three periods in which an explanation is proffered by SARS. That which took place after the appeal had been delivered, the second after the notice of default and the third thereafter until the rule 31 statement was filed.

[14] In this case the HCS file was pushed between two internal departments. Initially the work that led to the assessment which is the subject of this appeal was conducted by a department responsible for audits. Once the appeal came in the matter was sent to another department in SARS known as the Tax Appeal Allocation Committee or TAAC. The appeal was sent by the audit person to the TAAC in December. There it remained due to the December shut down period and was not looked at until January. The TAAC met in late January and decided that the matter given its nature should proceed directly to the Tax Court. In late January 2023, a SARS official notified HCS's attorneys that Mr Daniel had been allocated the matter. At the same time internally in SARS the matter was then sent to Mr Daniel who said he was allocated it given its high value and complexity.

[15] However, Mr Daniel was non-responsive to this email. I use this curious turn of phrase because Mr Daniel had initially stated he had never received it but later he admits it was received but it was overlooked by him. The upshot is that the matter received no attention. The next milestone was at the end of March 2023. Every month SARS officials receive a list of the matters that are allocated to them. It was then that Mr Daniel says he became aware that he was the responsible person for the matter. Of course, by now the 28 February deadline for the filing of the rule 31 statement had passed. Since Mr Daniel had no knowledge of the matter he requested the file from the audit person. By now it was already April. He only received the file from the audit person on 12 April. But by then the default period had also now expired – it lapsed on the 3 April.

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[1] 2021 (3) SA 1 (CC) at paragraph 54.

[16] Mr Daniel says he was unaware that HCS had issued the default notice. Oblivious, he had pended the file while he had to work on other urgent matters. What became of the rule 56 notice which had been sent to SARS, inter alia, on 10 March 2023. It seems that this notice had also not been attended to although it had been sent. It was not however copied to Mr Daniel but addressed to the email of the general litigation unit and the email of a Mr Souns, who is a staff member of the litigation unit. Mr Souns in an affidavit says he never received the notice. He cannot explain why this is the case although there is read receipt which shows that it was opened.

[17] In a replying affidavit Mr Daniel takes a different stance. Here he attributes no blame to the SARS system but to human error. But his bottom line is that neither he nor Mr Souns were aware of the relevant emails sent to them.

[18] So, when did this matter come to Mr Daniel's attention? He says only on 5 May when Mr Souns phoned him to say that the default judgment application had been served. But even then, there was a degree of delay. External counsel was briefed who had to be consulted. It took till 6 June 2023 before the rule 31 was filed.

[19] SARS explanation for the delay is an account of a litany of errors and neglect. The case fell between the cracks of the various personnel involved. It points to a system not well geared to deal with litigation and with no back up system to prevent error. SARS attempts to cast some blame on the applicant. It says that after HCS was advised in January that Mr Daniel was responsible for the matter all further correspondence and hence the rule 56 notice should have been directed to him – it was not - but instead to Mr Souns. Second Mr Daniel says he has regular and cordial dealings with HCS's deponent and assumed that she would be someone amenable to an extension.

[20] In all three of the periods I have identified, SARS explanation for the delay is unsatisfactory. When the appeal was delivered there was a lengthy delay in allocating the matter and then negligence by Mr Daniel who did not become aware of the email to him. Once the rule 56 notice was delivered the oversight was that of Mr Souns. Again, the failure to read the email is not adequately explained. Finally, even when SARS was now out of time to respond to the rule 56 notice and Mr Daniel was aware that SARS was in default, he failed to act with sufficient expedition to get consent from HCS for a late filing or to file the rule 31 statement.

[21] SARS has on this conspectus not made out an acceptable explanation for the delay. I accept this is mitigated to some extent by the following factors. HCS did not direct the default notice to Mr Daniel despite having been informed that he was the relevant person. If HCS had a collegial relationship with Mr Daniel from previous experience there may well have been a reasonable expectation that HCS would appreciate the pressures that SARS internal litigation staff work under, and a phone call or email to him might have elicited a swifter response.

[22] But despite this the delay is lengthy and not satisfactorily explained. This of course does not finally decide the issue of good cause. I turn now to whether SARS has prospects of success.

Prospects of success

[23] HCS has subsidiary companies that operate in Germany. It is an elaborate structure of companies that sit under a parent company known as the HCS K Partnership which has three German subsidiaries. According to HCS each subsidiary is a taxpayer is terms of German tax law.

[24] In terms of section 6*quat* of the ITA, HCS can claim a foreign tax credit in respect of the amounts claimed it had paid in tax in terms of German law. SARS says HCS claimed more in foreign tax credits than it paid in German taxes.

[25] But says HCS certain accounting adjustments were made in accordance with German tax law. This meant, without going into detail, that on HCS's version it had not over claimed on tax credits in South Africa.

[26] But says SARS in its rule 31 statement:

> "SARS duly requested the appellant to provide it with an explanation as to the difference between the income from business operations declared in its income tax return submitted in Germany and the income from its foreign partnership declared in the income tax return submitted in South Africa for the 2018 tax period."

[27] And SARS went on to state:

> "The appellant failed to provide an acceptable explanation for the difference. The appellant contended *inter alia* that from a South African perspective, the only income that accrued to the appellant concerned the actual profit transferred from the German companies to HCS K under the so-called PALTA agreements and not the total gross income of the German companies, in respect of which HCS is the ultimate holding company."

[28] But argues HCS, SARS has misconstrued the relationship between HCS K and the German subsidiaries in terms of an agreement known as PALTA which is the acronym for a profit-sharing arrangement.

[29] As HCS states in its replying affidavit:

> "The only amounts that were received by or accrued to the HCS K partnership from the German subsidiaries are the PALTA amounts. Because the underlying items of income and expenditure that make up the accounting profit of the German subsidiaries (to which the adjustments relate) did not accrue to nor were they incurred by the HCS K partnership, they are not deemed by section 24H to have accrued to or incurred by SCHI."

[30] Thus far this is a technical argument between HCS and SARS of the interface between the German tax treatment and how SARS would view the relationship. But HCS also argues that SARS has failed to discharge its obligations in terms of section 92 of the TAA. This section states:

> "**92 Additional assessments.**—If at any time SARS is satisfied that an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the fiscus, SARS must make an additional assessment to correct the prejudice."

[31] HCS argues that SARS has not satisfied itself. Instead on its reading of the assessment correspondence what SARS has done is to require the taxpayer to satisfy it. This argues SARS is impermissible because it places the onus of proof on the taxpayer.

[32] But HCS raises a further legal argument to indicate that SARS has no prospects of success on the foreign tax credit issue. SARS had also stated in the rule 31 statement that:

> "In the event that any portion of the income from business operations ought not to have been declared in South Africa, it is contended that the appellant would then had to apportion the tax credit as the appellant would only have been entitled to a section 6*quat* credit, proportionate to the portion of the 'income from business operations' declared in South Africa. However, the appellant contends that it is entitled to the full tax credit to the extent proven to be paid in Germany."

[33] HCS argued that SARS had in this paragraph pleaded a new alternative assessment which was not permissible in terms of rule 31(3) as this would require a revised assessment.

[34] Rule 31(3) states:

> "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."

[35] SARS denies it has done so and argues that HCS has misconstrued its assessment letters in terms of the section 92 issues.

[36] I have paraphrased much of this debate. What I seek to illustrate is that it is by no means straightforward. On the technical arguments of the accounting standards my difficulty is that since I am not sitting with assessors nor has SARS had the benefit of expert evidence or fuller discovery taking a view on the prospects of this issue in a default judgment application would be inappropriate.

[37] Second the two legal points raised by HCS and not conceded by SARS are at least arguable and require a more in depth reading of the assessment letters.

[38] Finally, even if I am wrong on this, the issue of the USP does raise a triable issue because even on HCS's case it had made errors which it has conceded and sought to correct. Whether this justifies a USP and one in the amount sought, is another matter but it is certainly a triable issue. Given that this is not an exception it is not open to me to carve out the triable issue from the one which might not be a triable issue. Therefore, I conclude that SARS at least on the issue of USP has reasonable prospects of success.

Prejudice

[39] Finaly, I turn to the issue of prejudice. The only issue of prejudice raised on the papers by HCS was that if the matter was not decided now a key employee who is familiar with the issue in this case is leaving them by the end of 2023. HCS says it would be prejudiced in the preparation and presentation of its case if she was no longer in their employ when the appeal is heard as this is likely to be only set down after her departure. I do not consider this convincing. There is no reason why the employee would not still be available or could not be subpoenaed if necessary. This is frequently a situation that arises in commercial litigation.

[40] In contrast SARS would be prejudiced if HCS is liable for understatement of a penalty. Large amounts are involved in this matter if SARS prevails, even if only on some of the issues. Thus, on the balance of prejudice SARS makes out a stronger case.

Conclusion

[41] On balance therefore having considered the issues I find that condonation should be granted and that in terms of rule 56, SARS has shown good cause.
As far as costs are concerned SARS should pay the costs of the proceedings as its delay justified HCS in bringing these proceedings even if it has not been successful in obtaining default judgment. On costs I consider only the costs of one counsel was justified.

ORDER

1. SARS application for condonation is granted.

2. The rule 31 statement is deemed to have been filed on the date of this order.

3. HCS's application for default judgment is dismissed.

4. Costs of the applications for default judgment and opposing condonation are awarded to HCS including the costs of one counsel on scale C.

Manoim, J
President of the Court