REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT CAPE TOWN)

Case No.: **IT 46080**

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

5 December 2024 ....

DATE SIGNATURE

In the matter between:

PEAR (PROPIERTY) LIMITED Appellant

and

THE COMMISSIONER FOR THE

SOUTH AFRICAN REVENUE SERVICE Respondent

J U D G M E N T

JANISCH AJ:

Introduction

[1] The Appellant, a citrus farming company, appeals against an additional income tax assessment made by the Respondent ("SARS") in respect of the Appellant's 2017 year of assessment.

[2] In the additional assessment, SARS adjusted the Appellant's taxable income in two respects:

2.1 First, it disallowed the deduction of an amount of R9,600,000 that the Appellant had claimed under section 11(*a*) of the Income Tax Act 58 of 1962 ("the ITA") as an insurance premium. The actual amount claimed was R10,000,000, but SARS conceded the deduction of R400,000 thereof as an "underwriting fee"; and

2.2 Second, it included an amount of R1,197.52 as "notional interest" accruing to the Appellant on an "experience account" in that year under the insurance policy.

[3] SARS also imposed an understatement penalty of 10% for a "substantial understatement" in terms of Chapter 16 of the Tax Administration Act 28 of 2011 ("the TAA"), and interest in terms of section 89*quat*(2) of the ITA in respect of the period from the provisional tax effective payment date to the date of the additional assessment.

[4] Save for the 89*quat*(2) interest, which SARS later agreed to remit, all these issues remained in dispute in the appeal.

[5] A preliminary point which arises is whether SARS was empowered to make the additional assessment in the light of section 99(1)(*a*) of the TAA. This provision, which is subject to various exceptions, provides statutory immunity from additional income tax assessments once three years have expired from the date of the original assessment. It is commonly referred to as a "*prescription*" provision. If it applies, the additional assessment must be set aside irrespective of its correctness on the merits.

[6] Before dealing with these issues, I set out the relevant facts.

The facts

[7] The Appellant led the evidence of two witnesses. They were Ms MM, a director and the *de facto* chief executive officer of the Appellant, and Mr XY, a partner at Moore Incorporated, the Appellant's accountants ("*Moore*"). These witnesses dealt both with the

genesis and implementation of the insurance contract which is central to the dispute, and with procedural aspects involving the Appellant's communications with SARS and the circumstances leading up to the issue of the additional assessment.

The farming activities and risks

[8] The Appellant's farming activities are focused on the production of oranges, lemons and mandarins. These are primarily destined for export markets, including the European Union.

[9] Ms MM testified about the risks inherent in the Appellant's citrus farming activities, which could lead to a loss of product and income. Apart from issues such as drought, frost and wind, she highlighted two particular risks: a cosmetic fungal disease that appears on the outside of fruit called Citrus Black Spot ("*CBS*"), and a pest called False Codling Moth ("*FCM*") which lays its eggs in citrus. Certain orchards are more likely to be exposed to FCM than others, depending for example on their proximity to riverine vegetation. The presence of CBS or FCM can lead to the rejection of entire consignments of citrus by the receiving markets, with a corresponding loss of income.

[10] Ms MM stated that prior to June 2017, the Appellant used its reserves to absorb such losses. I understood her to mean that the Appellant did not insure externally against such risks but relied on its accumulated funds to cover any losses.

Introduction to the insurance product

[11] The Appellant's tax year ends on 30 June each year. In April or May 2017, Ms MM met with Mr XY to prepare for the year end. Mr XY testified that he had prepared a provisional tax calculation and that the Appellant was "looking for expenses to be brought into the books to be paid". Essentially it seems that tax planning was being done with a view to reducing the 2017 tax liability, by incurring expenditure early on items needed for the farming operations in the following year. Ms MM said that in the course of their discussion Mr XY mentioned that he was aware of a "*structured self-insurance product*" which he would recommend as a good crop insurance. He had recently learned about this product from a roadshow conducted by a broker for a particular short-term insurer. Mr XY confirmed that the broker had met with him and his fellow directors at Moore and had explained the policy. He had also indicated that the insurance premium would be deductible for income tax purposes.

[12] Mr XY gave Ms MM the broker's details. She made contact with him and he explained the nature of the policy. Ultimately the Appellant agreed to take cover for a period of 7 months for a premium of R10 million plus VAT (i.e. R11,400,000), which would provide insurance cover of R12 million plus VAT (i.e. R13,680,000).

[13] Ms MM testified that she thought this was worthwhile expenditure, given the risks that the Appellant was faced with, and that it would be a wise thing to do at the time. Later she testified that it was a "well-considered" expense and that it was attractive to receive cover of more than the amount the Appellant would put into the policy. She also said that it was not sustainable to keep using the company's own reserves to cover these risks. At the same time, she acknowledged that the tax deductibility of the premium was an attractive feature.

The policy

[14] Having indicated the Appellant's willingness to enter into the policy, Ms MM received certain documents from the insurer for signature.

[15] The first document is a pre-populated "application form". In a block titled "Policy details & other information", it is recorded that the period of insurance is from 1 June 2017 to 31 December 2017. The premium is stated to be R10 million plus VAT. Below that is the following information:

"Underwriting charge	4%
Risk transfer limit	20%
Policy indemnity limit	R12,000,000.00
	(Premium plus Risk Transfer Limit)"

[16] The application form also contains a debit order authority for payment.

[17] The second document is entitled "summary of overview: insured details". It contains a tick next to "crop insurance" as the class of insurance cover required. It declares that no losses have been suffered in the past 3 years.

[18] Part of this second document is a schedule (under a heading "risk category 17: crop") setting out the crops covered by the policy. In a table, the premium of R10 million and the risk cover amount of R12 million are broken down and allocated to specific fields or orchards identified by number and the type of citrus product. This suggests that some form of risk assessment was done by the insurer to identify the different orchards which required cover, and the amounts of cover sought for each, although Ms MM did not specifically testify about this.

[19] On the first page of the second document, above the signature, there is a declaration. A portion reads as follows:

> "I/we agree that this declaration and the details given shall the basis of the contract between myself/ourselves and [the insurer]. I/we further agree to accept a policy subject to the usual conditions prescribed by the Company and endorsed on their policy, and to pay premium

> thereunder. I/we further declare that the items under which this insurance is issued by the Company has been fully explained to me, in particular that the aggregate of all claims under this insurance may never exceed the policy indemnity limit as defined by the Company."

[20] Ms MM signed these documents on 22 June 2017 and returned them to the insurer. Copies were given to Mr XY to place on file. The Appellant duly paid the premium of R10 million plus VAT.

[21] On 29 June 2017 the insurer sent the Appellant the policy contract. The Appellant did not have to sign this. The policy summary reflects the following:

21.1 The policy holder can claim against the policy in respect of risks in insured categories. Claims are limited to the policy indemnity limit.

21.2 The insurer pays claims from the balance in the "experience account" up to the maximum of the policy indemnity limit, but if the total claim exceeds the balance of the experience account, the maximum claim is limited to the policy indemnity limit.

21.3 The policy can be cancelled on 30 days' notice at any time. If the experience account is positive, the balance thereof will be paid to the insured.

21.4 An initial underwriting fee is levied.

21.5 The policy is administered by way of the "experience account" in respect of which monthly statements are provided. The value of the premium is credited to the experience account, and is reduced by the amount of the underwriting fee and any claims. Amounts of "notional interest" are added from time to time on the balance of the experience account. More details as to how the notional interest is calculated are set out in a "general exceptions conditions and provisions" document which was also provided by the insurer.

21.6 The policy can be "pledged as surety".

[22] The insurer also provided a "policy schedule" which contained limited information, such as the details of the parties and the duration of the insurance period, and had an annexure showing the premium and the extent of risk cover.

[23] It is common cause that in the short period between the inception of the policy and the end of the Appellant's year of assessment, the insurer had credited the experience account with an amount of R1,197.52 which was reflected in a statement provided by the insurer for the 2017 calendar year as "notional interest at 5.75% (effective)".

[24] The same statement shows that on 1 January 2018, there was a "policy cancellation" where the account balance was returned to the Appellant but immediately thereafter credited back to the account as a "policy renewal". Ms MM confirmed that the policy had been renewed for another year (as also occurred in later years).

[25] There was no evidence of any claims ever having been made on the policy.

[26] To complete the chronology in relation to the policy, on 23 June 2021 the Appellant gave a notice of cancellation. The reason given was that the Appellant "is experiencing an unexpectedly smaller crop and lower prices due to the exchange rate, and needs the funds". The credit in the experience account at that time was R11,304,932.01 which was duly paid to it on 9 July 2021. This amount was incorporated in the Appellant's taxable income in the 2022 year of assessment, but because the Appellant was in a tax loss position in that year, no tax was paid on it.

<u>The 2017 income tax return</u>

[27] Ms MM's evidence was that she relied upon Mr XY in relation to the construction of the Appellant's financial statements and the contents of its tax returns.

[28] In relation to the Appellant's income tax return, filed by Moore on its behalf on 18 December 2017, the following aspects are relevant:

28.1 In the section entitled "expense items," under the heading "insurance (excluding s 37A payments)", there is an amount of R10,268,796. The evidence was that this constituted the R10 million premium paid under the insurance policy, as well as premiums under other insurance unrelated to the appeal.

28.2 In the section entitled "income items", under the heading "interest - financial institutions", there is an amount of R359,946. The evidence was that this did not include the R1,197 in respect of "notional interest" on the policy. That amount also was not included in other potential lines for interest received in the return.

[29] Mr XY testified that he was not aware of the "*notional interest*" feature of the policy, and therefore did not include any such item in the return for 2017. The same was true of the returns for 2018 and 2019, where the "notional interest" was considerably higher. The Appellant has accepted, in relation to those years, that it was liable for tax on those amounts. The issue remains live for 2017, given the Appellant's reliance on prescription which did not apply in the later years.

[30] The Appellant's taxable income for the 2017 year of assessment, after claiming the R10 million deduction, was R3,585,747, which resulted in a tax liability of R1,004,009.

<u>The original assessment and the SARS verification</u>

[31] In keeping with the SARS practice of "face value assessment," an original assessment for the 2017 year was issued on 18 December 2018 in accordance with the contents of the tax return.

[32] Some four months later, on 5 April 2018, the Appellant received from SARS a letter on a letterhead reflecting "Compliance Audit / Request Outstanding Information."

[33] The letter referred to the Appellant's 2017 tax return and stated that SARS required additional information "in order to proceed with the case". One of the three categories of information requested was formulated as follows:

> "Insurance expenses have increased from R220,527 in 2016 tax year to R10,268,796. Please explain, why there is a huge increase in insurance expenses? And submit a schedule and supporting documents."

[34] It is therefore apparent that the substantial increase in insurance expenses from one year to the next had been "flagged" within SARS, and that a SARS official in "Compliance Audit" either decided, or had been instructed, to obtain an explanation for this and to submit "a schedule and supporting documents".

[35] Mr XY responded to the SARS query on behalf of the Appellant on 19 April 2018.

[36] In relation to the query specified above, Mr XY stated as follows:

> "The insurance expenses increased because of a self-insurance taken out from [the insurer] to the value of R10 000 000.00 in addition to the R268 796 for the year, and was deducted in full in terms of section 32(*h*) (*sic* – this should have been section 23H). Refer to the [Insurer] Contract Attachment B.
>
> Start date: 01/06/2017
>
> End date: 31/12/2017."

[37] Attached to the letter were the two documents described in paragraphs [15] to [19] above, both signed by Ms MM on behalf of the Appellant. Mr XY's evidence was that they were only documents which he had on file in relation to this deduction of R10 million.

[38] On 20 April 2018, the Appellant received from SARS a letter entitled "finalisation of verification of income tax return". SARS stated that it had finalised the verification of the income tax return for the 2017 tax period, and that "no adjustments have been made in respect of your ITR14 income tax return for the 2017 tax period". SARS reserved the right to conduct a further verification or audit in future if required, in respect of that or any other tax period.

The audit and its outcome

[39] Nothing further happened in relation to the assessment of the 2017 tax year until 28 December 2020, when the Appellant received from SARS a "notification of a corporate income tax audit". This was ten days after the expiry of a three-year period from the date of the original assessment for 2017.

[40] SARS advised that it would conduct an audit in terms of the TAA "based on a risk assessment". Although the letterhead reflects the relevant tax period as 2019, the scope of the audit was stated to cover 2017 to 2019. A number of aspects were identified as falling within the audit, including, in respect of each such year, "Insurance (excluding section s 37A payments)" and "Interest – Financial Institutions".

[41] The Appellant was required to provide the following in relation to the insurance aspects:

> "Detailed breakdown of insurance expenses for the 2017-2019 financial years. Also provide copies of the relevant agreements/contracts as well copies (*sic*) of the 'Experience Accounts' where applicable."

[42] In response to this request, Mr XY furnished various documents to SARS. These included the policy summary, schedule and standard form contracts referred to above, as well as the insurer's annual statements of activity on the experience account.

[43] On 28 May 2021, SARS issued a letter of audit findings. In respect of the 2017 year of assessment, it proposed to disallow the R10 million premium deduction (resulting in an adjustment of R2,800,000), and to subject the notional interest component to tax (resulting in an adjustment of R335.31). It proposed to impose an understatement penalty.

[44] SARS referred to the former amount as "non-deductible insurance premiums" with regard to section 11(*a*) of the ITA read with section 99(1)(*a*) and 99(2)(*a*)(ii) of the TAA. It recognized that the assessment had prescribed, but intended to re-open it "as the failure to assess the full amount of tax chargeable is due to a misrepresentation by the taxpayer e.g. failure to declare the notional interest in the 2017 tax return".

[45] As regards the notional interest, SARS contended that this was “capitalized / accumulated income managed on behalf of or for the benefit of the taxpayer” and not previously subjected to tax. SARS gave the same reason for reopening this part of the prescribed assessment as it did for the premium.

[46] On 28 June 2021, the Appellant responded to the SARS letter of audit findings. It made certain representations as to why it was entitled to the deduction of the premium (with a focus on the incurral of expenditure) and why the notional interest should not be included.

[47] As regards the understatement penalty, the Appellant contended that even there was an understatement, it resulted from a *bona fide* inadvertent error as envisaged in section 222 of the TAA, and the penalty could therefore not be imposed. The Appellant also sought the remittal of section 89*quat* interest on the basis that it acted on advice and that the shortfall in provisional tax payments was beyond its control.

[48] The Appellant’s representations did not bear fruit. On 19 July 2021, SARS issued a finalisation of audit letter, together with additional assessments in terms of section 92 of the TAA in respect of the 2017 to 2019 years of assessment.

[49] In the letter, SARS set out in detail (in seven paragraphs) why the premium does not constitute “expenditure” for purposes of section 11(*a*). It made no reference to the other requirements for deductibility under section 11(*a*) (i.e. that the expenditure is not in the production of income or was of a capital nature) or any other provision of the ITA. It reiterated that it could re-open a prescribed assessment because the failure to assess the full amount was due to the Appellant’s failure to declare the notional interest in the 2017 return.

[50] In relation to the understatement penalty, SARS confirmed that it had imposed a 10% penalty for “substantial understatement”. It did not address the Appellant’s averment that there was a *bona fide* inadvertent error.

<u>The objection</u>

[51] The Appellant, through Mr XY, filed a notice of objection to the additional assessment. It was supported by a covering letter dated 7 September 2021. The Appellant again took the point that the 2017 assessment had prescribed and denied that section 99(2) applied. It stated that there should be no adjustment for the insurance premium because “it is *bona fide* insurance taken out for crop insurance against the black spot” and “an ordinary expense in the course of business and valid deduction according to section 11(*a*)”.

[52] The letter of 28 June 2021 sent in response to the letter of audit findings was also attached to the objection.

[53] SARS's decision on the objection was dated 5 October 2021. It persisted in disallowing the deduction of the premium. Its argument in this regard was again focused exclusively on the Appellant not having incurred "expenditure." It also persisted with the inclusion of the amounts of notional interest, and with the imposition of the 10% understatement penalty on the basis that the amount of tax in issue exceeded R1 million.

[54] As regards prescription, SARS stated the following:

> "In terms of section 99(2)(*a*)(ii) of the TA Act, prescription of assessments has not been applied because SARS was not able to assess the full amount of tax chargeable due to misrepresentation of innocently claiming premiums paid to insurer as deductible, consequently resulting to incorrect taxable income."

[55] The only success achieved by the Appellant pertained to section 89*quat* interest, which SARS waived on the basis that the errors were out of the Appellant's control (it having relied on external auditors and accountants).

The issues in the appeal

[56] The Appellant appealed to this court.

[57] The parties proceeded to file their "pleadings" in terms of the dispute resolution rules published under the TAA. These comprised SARS's rule 31 statement of grounds of assessment and opposing the appeal, the Appellant's rule 32 statement of the grounds of appeal, and SARS's rule 33 statement of reply.

[58] Rule 34 provides that "the issues in an appeal to this 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".

[59] The four issues listed by SARS as being in dispute in relation to 2017 and requiring adjudication were as follows:

59.1 Whether prescription applies to the additional assessment raised for the 2017 tax year;

59.2 Whether the Appellant is entitled to claim the full amount of R10 million as alleged insurance policy premiums paid to the insurer in the 2017 tax year as a deduction in terms of section 11(*a*) of the ITA;

59.3 Whether notional interest earned in respect of the experience accounts related to the alleged insurance policy is to be deemed to have accrued to the Appellant in the 2017 tax year and included in the Appellant's gross income for each of these periods; and

59.4 Whether SARS was correct in imposing an understatement penalty of 10% on the Appellant for the 2017 tax year.

[60] The parties' statements go on to deal in more detail with these issues. To the extent necessary, I shall outline aspects of the pleaded case where I address the issues below.

Section 99 of the TAA: statutory immunity / "prescription"

[61] SARS's power to issue the additional assessments for 2017, more than three years after the original assessment for that year was issued, is logically the first question to be decided. If the statutory immunity provided by section 99(1) applies, the additional assessment cannot stand, irrespective of the merits.

<u>Legal principles</u>

[62] In terms of section 92 of the TAA, "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".

[63] Section 92 is subject to section 99(1), which provides that an assessment may not be made in terms of "this chapter" (i.e. Chapter 8, of which section 92 is a part) three years after the date of assessment of an original assessment by SARS. As stated, the original assessment for 2017 in this case was made on 18 December 2017, and the additional assessment was made on 19 July 2021.

[64] Section 99(1) is in turn subject to section 99(2), which provides *inter alia* that subsection (1) does not apply to the extent that:

> "(*a*) in the case of assessment by SARS, the fact that the full amount of tax chargeable was not assessed, was due to—
>
> (i) fraud;
>
> (ii) misrepresentation; or
>
> (iii) non-disclosure of material facts."

[65] Section 99(2) is similarly worded to its predecessor, section 79 of the ITA.

[66] It was authoritatively held, in relation to section 79, that to overcome the statutory immunity or prescription of assessments, SARS must establish two aspects:

66.1 The existence of <u>conduct</u> in the form of fraud, misrepresentation or non-disclosure of material facts; and

66.2 A <u>causal connection</u> between that conduct and the fact that the full amount of tax was not assessed.

[67] The leading authority in this regard is *Secretary for Inland Revenue v Trow* 1981 (4) SA 821 (A). The relevant *dicta* are at 825A-C. The requirement to establish a causal connection between the conduct and the non-assessment by SARS was the result of the words “was due to” in section 79. The same words are used in section 99(2) of the ITA.

[68] A difference between the language of section 79, as addressed in *Trow*’s case, and section 99(2) is that in the former case, the Commissioner only had to show that he was “satisfied” with both the existence of the conduct and the causal link. This could be fairly lightly established. Section 99(2) however does not contain the language of “satisfaction” on the part of SARS. Thus it is not enough for SARS merely to say that it has formed the view that the requirements for section 99(2) are present; they must actually be shown to exist.

[69] An issue arises as to the point at which the causal link between a misrepresentation or non-disclosure and the non-assessment of the full amount must be tested. Given the SARS practice of “face value” assessments, every original assessment is the product of what is contained in the tax return (see *Commissioner for Inland Revenue v Mutual Unit Trust Management Company Ltd* 1990 (4) SA 529 (A) at 542C-F.) By definition, every error which is later identified in the return is therefore linked to the <u>original</u> non-assessment of the correct amount of tax. If that were enough to trigger section 99(2), it would mean that every taxpayer that objectively “*got it wrong*” in its return would be precluded from relying on prescription. Section 99(1), which aims to create finality in tax assessments, would be stripped of operative effect.

[70] That is clearly not what the provision intends. The thinking behind the three-year period in section 99(1) (and its equivalent five-year period in the case of original assessments that are self-assessments) is that SARS will issue an original assessment and then have a sufficient period to conduct any audits or verifications and to issue additional assessments. Once that period expires, the taxpayer will in the ordinary course be entitled to assume that the original assessment for that year has become unassailable.

[71] The exception to this general rule, as provided for in section 99(2), thus pertains to the non-assessment within the three-year period, rather than merely in the original assessment. As stated by the SCA in *Commissioner for the South African Revenue Service v Spur Group (Pty) Ltd* [2021] ZASCA 145 in paragraph [53]:

> "It is trite that SARS bears the onus to show that <u>the non-assessment within the requisite three-year period</u> was the result of the aforesaid misrepresentation and non-disclosure referred to earlier."

[72] Section 99(2) thus involves a factual enquiry which must be decided on a balance of probabilities. SARS must show that the conduct complained of in fact caused the non-assessment; or put differently, that had it not been for the conduct complained of, the very assessment that is now is dispute would on the probabilities have been made in the three-year period. Since SARS bears the onus in this regard, if at the end of the evidence the court is unable to conclude that that this is more probable than not, SARS will fail in its reliance on section 99(2).

[73] In *Spur Group (supra)*, SARS relied on section 99(2)(*a*) and contended that the non-assessment of the taxpayer within the three-year period after the original assessment was the result of certain misrepresentations made in the tax return. More particularly, the taxpayer had incorrectly answered "*no*" to various questions which had a direct bearing on the claimed deduction. It argued that SARS had failed to establish the requisite causal nexus between these incorrect answers and the non-assessment.

[74] Having recorded SARS's onus in respect of the causal connection, the court said this (in paragraph [53]):

> "In addressing this issue, it is apposite to consider SARS's relevant internal processes in the years in question pertaining to the making of original and additional assessments."

[75] The court held that the integrity of the SARS assessment process depended largely on the correctness of the information provided in the return, and on SARS's ability to conduct audits of returns in the ensuing three-year period to ensure a proper tax treatment.

[76] There was detailed evidence by a senior SARS representative as to how the tax return was structured to include so-called "triggers" which activated risk assessments. Should a trigger arise when a particular code was activated, further steps would be taken. The matter could either be resolved at that stage or could proceed to an audit. The questions were included for purposes of identifying specific risks relative to the questions asked. SARS testified that the answers to the questions, if they had been different, would have triggered a risk alert for SARS, while the wrong answer would not have.

[77] It was concluded that "SARS was thus not alerted to the existence of the [transactions in issue] and particularly the [amount in question]. This persisted until the true position was picked up in the course of an audit" which gave rise to the additional assessment.

[78] The court went on to state the following (paragraph [62]):

> "Spur accepted that false statements were contained in the returns. Against that, it contended that scrutiny of the financial statements and a more alert auditing process would and should have ensured a proper assessment within the prescribed period. It overlooked the face value assessment process understandably undertaken by SARS. Audits are implemented because of triggers caused by specific answers in tax returns. If the questions that would give rise to the triggers are wrongly answered, as happened in this case, the matter may not come before an auditor within the three year period and the clarification of questions will therefore never be asked."

[79] It was held, on the facts, that the misrepresentations and non-disclosures in the tax returns precluded a "trigger alert" that would have caused the return to come before an auditor. Essentially the SCA accepted, on the strength of the SARS evidence, that if the correct answers had been given, an audit would have been triggered and the assessment would have been made within the three-year period. SARS was held to have established the facts needed for section 99(2) to apply, and prescription was therefore overcome.

[80] As regards the first enquiry into the taxpayer's conduct, the misrepresentation or non-disclosure of material facts need not be the result of fault on the part of the taxpayer. This is apparent from the juxtaposition of sub-paragraphs (*a*) and (*b*) of section 99(2). Sub-paragraph (*b*), which pertains to self-assessment, expressly provides that the reason for the full tax not being assessed should be fraud or "intentional or negligent" misrepresentation or non-disclosure of material facts. The highlighted words are not included in sub-paragraph (*a*) relating to assessments by SARS. This indicates that in that context, intentional or negligent behaviour is not required to be established. It was in any event the conventional understanding of section 79 of the ITA, before its repeal by the TAA, that even innocent conduct would suffice (see e.g. *Natal Estates Ltd v SIR* 1975 (4) SA 177 (A) at 208F-G, *ITC 1425* 49 SATC 157 at 162-163 and *ITC 1518* 54 SATC 113 at 137).

[81] Against that background, I turn to consider the facts of the present appeal.

<u>The pleadings on prescription</u>

[82] I begin with the pleadings as they pertain to prescription. Since SARS bears the onus in this regard, it is of importance how it formulates its case for reliance on section 99(2).

[83] In the rule 31 statement, SARS pleads in overview that it invoked section 99(2) "to indicate that prescription does not apply, due to misrepresentation on the part of the Appellant in relation to the characterisation of the premium as a deductible expense, and due to non-disclosure of material facts in the Appellant's failure to declare the notional interest earned as income in the relevant period".

[84] The SARS case is more fully set out later in the rule 31 statement.

[85] SARS makes the general proposition that the Appellant "has committed misrepresentation and non-disclosure of material facts <u>with regard to its tax return and declaration to SARS</u> for the tax period in question".

[86] SARS thus locates the misrepresentation and non-disclosure on which it relies in the Appellant's ITR14 income tax return. Elsewhere it pleads that non-disclosure also occurred in the IT14 SD supplementary declaration submitted to SARS for the 2017 year. However, this document was not put up in evidence and did not feature in argument. The focus is therefore on the 2017 tax return.

[87] SARS goes on to contend that the misrepresentation occurred in relation to the Appellant's "characterization of the payment of the amount of R10 million to [the insurer] as a deductible expense in terms of section 11(*a*) of the ITA". SARS says that this characterization "misrepresents the nature of the payment" in that it is "apparent from the Appellant's contract with [the insurer] that the full amount paid to [the insurer] was not expended, but rather held for the Appellant's benefit by [the insurer], in an account wherein interest would accrue to the Appellant, and from which the Appellant is entitled to withdraw the amount at any time upon request to [the insurer]."

[88] In contending that there was a "misrepresented characterisation of the policy" in the tax return, SARS is therefore saying that the Appellant claimed a deduction in its tax return to which it was not entitled on the merits because the requirements of section 11(*a*) were not met.

[89] As regards the notional interest amount, SARS says that it was "earned" and should therefore have been declared in the tax return. It states that the failure to declare the accrued income and to provide a complete statement in respect of such income constitutes a non-

disclosure of material facts relating to the Appellant's financial affairs at the time of submission of the return.

[90] In both respects, SARS pleads – without further elaboration – that the misrepresentation and non-disclosure resulted in the full amount taxable not being assessed.

[91] I should point out here that the rule 31 statement is the first time that SARS contended that there was a misrepresentation in relation to the premium that was claimed as a deduction. In all prior correspondence it had relied only on the non-inclusion of the notional interest to enable it to overcome prescription.

[92] The Appellant responds in its rule 32 statement by denying, for various reasons, that the circumstances for applying section 99(2) were present. I shall deal with certain of these contentions below. In overview, it denies that there has been a misrepresentation or non-disclosure. It also specifically pleads that SARS had "failed to demonstrate why the alleged misrepresentation caused the incorrect amount of tax to be levied".

[93] In its rule 33 statement, SARS contends that the Appellant admitted to not declaring the notional interest income, and admitted that it is taxable. On that basis it pleads that the Appellant has admitted to having committed a misrepresentation that caused the full amount of tax chargeable for the 2017 tax year to not be assessed.

<u>Section 99(2) operates on a "per item" basis</u>

[94] Before evaluating the parties' respective arguments, I must address a contention made in oral argument on behalf of SARS. This is to the effect that as long as it can be shown that there was a misrepresentation or material non-disclosure that caused the full amount of tax not to be assessed in respect of one item, prescription in respect of the entire assessment is automatically overcome, and SARS is then permitted to revisit any aspect of the assessment.

[95] I am not aware of any authority directly on point. However, in my view the sensible, businesslike and purposive interpretation of section 99(2) (the aim of which is to achieve finality of assessments – *Commissioner, SARS v Brummeria Renaissance (Pty) Limited* 2007 (6) SA 601 (SCA) in paragraph [26]) is that the causal link between the conduct complained of and the non-assessment of the "full amount of tax chargeable" must be determined on a "per item" basis. In other words, for SARS to be able to make a new determination through an additional assessment, it must show a causal link between the conduct and the non-assessment of a particular item or amount. It is of course possible for SARS to establish that one instance of misrepresentation or non-disclosure has led to the non-assessment of more than one item, but that does not mean that the establishment of one such causal link is automatically an "*open sesame*" to reconsider the entire assessment.

[96] I therefore deal separately with the application of section 99(2) to the R10 million deduction claimed and the R1,197 notional interest amount.

A misrepresentation?

[97] For the following reasons, I am of the view that it cannot be said that the 2017 income tax return contained a "misrepresentation" in relation to the R10 million premium which was claimed as a deduction.

[98] The full amount of the premium was included under "insurance (excluding s37A payments)" in the Appellant's ITR14 income tax return. The Appellant thereby indicated that it had paid such an amount and was claiming it as a deduction.

[99] Counsel for SARS confirmed in oral argument that it was not SARS's case that the insurance contract was a sham or simulation, i.e. that one was not in fact dealing with an insurance contract or an insurance premium, but in reality with some other type of transaction. The SARS argument was that the premium paid was unusual or unconventional for an insurance contract, and that having regard to certain characteristics of the contract, it did not meet the requirements of section 11(*a*).

[100] While commercially an insurance premium that gives rise to a risk benefit over a short period in an amount of 120% of the premium may be unusual, the insurance contract in fact entitles the Appellant to payment of the full risk benefits in exchange for the premium. Thus if, on the day after the policy was taken out, the Appellant had in a storm lost fruit in the insured orchards with a value equal to or higher than R12 million, it would have been entitled to claim insurance cover payments of R12 million. Thus there was an insurance premium that was paid.

[101] A cornerstone of SARS's argument as to the unusual nature of the premium is that if the Appellant had cancelled the contract, it would have become entitled to the full amount standing to the credit of the experience account. While that is so, this does not in my view mean that the R10 million was not paid as an insurance premium. The fact that the Appellant may have cancelled the insurance contract and recovered an amount approximating the premium does not mean that, while the contract is in force, it does not entitle the Appellant to the benefits of insurance cover in the event of a peril eventuating as a *quid pro quo* for the premium paid.

[102] I therefore do not think that the Appellant made a misrepresentation of fact in claiming the amount as an expense item under "insurance".

[103] SARS's pleaded case is however that the misrepresentation took the form of the Appellant <u>(mis)characterizing the payment as a deductible expense</u>. In other words, the misrepresentation relied upon is the Appellant's inclusion of the amount as a deduction when on SARS's approach it is not deductible as a matter of law.

[104] What section 99(2) envisages by a misrepresentation is one <u>of fact</u>, as opposed to one of law. This is apparent from the immediate context of the section which refers also to a non-disclosure of <u>material facts</u>. Whether an amount factually paid is deductible under the ITA is a question of law; it is the product of the interpretation and application of the ITA. To say that an amount incurred is deductible under section 11(*a*) is in fact to express a legal opinion.

[105] Thus if the Appellant had claimed the insurance payment as a deduction under the heading "lease payments" or "maintenance", there would be no difficulty in concluding that there was a misrepresentation of fact. The same cannot be said of a factually correct disclosure, such as this was, even if SARS is ultimately correct that the insurance payment is not deductible in law.

<u>A non-disclosure of material facts?</u>

[106] On the other hand, on the assumption that the amount of R1,197 in respect of notional interest was an amount to which the Applicant factually became entitled, the failure to include that amount in the return does constitute a non-disclosure of that fact.

[107] However, given the extremely small quantum of the amount, I do not consider that this can be treated as a non-disclosure of a <u>material</u> fact.

[108] In *ABC (Pty) Ltd (in liquidation) v Commissioner for the South African Revenue Service* (Case No. IT12951), in relation to an enquiry into prescription in the context of section 79 of the ITA, the taxpayer had overstated its expenditure in two years of assessment by 0.606% and 0.010% respectively. The Court held (in paragraph [32]) that "based on the relative amounts in dispute, [SARS] is unable satisfy the requirement of it being a material non-disclosure."

[109] The question of materiality of non-disclosure of an amount received or accrued, for purposes of justifying the significant step of overcoming prescription, must in my view have regard to the relative amount involved. In accordance with the maxim *de minimis non curat lex*, an amount may be so small as to be legally insignificant. In the present case, the amount of notional interest is equal to 0.02% of the gross profit of the Appellant before tax in the 2017 year. I have little doubt that, if this were the only item in issue between the parties, there is no prospect that SARS would have attempted to re-open the 2017 year for that amount, and that

this court would have regarded this as a matter not warranting the application of judicial resources.

[110] In keeping with the approach in *ABC* (*supra*), I do not think that the non-disclosure of the minuscule amount of notional interest in the 2017 year can be treated as a non-disclosure of a material fact.

<u>Causation?</u>

[111] Even if I am wrong in concluding that the present facts do not reveal a misrepresentation or non-disclosure of material facts, I consider that SARS has not discharged the onus of demonstrating that any misrepresentation or non-disclosure caused the non-assessment of the full amount of tax in the three-year period.

[112] Most fundamentally, SARS saw fit to close its case without calling any witness to provide evidence in support of the operation of section 99(2). The SCA in the *Spur Group* case (*supra*) showed that for these purposes it was necessary to consider the processes of SARS in relation to making original and additional assessments. A witness was called to explain the system of "triggers" in the tax return, and the likely consequences that would have flowed from the taxpayer providing the right answers to the questions. However, in the present case no evidence was led to assist the Court in determining that the Appellant's conduct in completing its income tax return on the probabilities caused the non-assessment of the two disputed amounts in the three-year period.

[113] The issue of prescription, and particularly the existence of the necessary causal link, was in issue on the pleadings and SARS therefore had to discharge its onus.

[114] SARS argued that it follows from the very fact that the additional assessment was issued in the present case, following an audit that commenced after the three-year period, that if it had not been for the conduct complained of, there would have been an earlier assessment. I cannot accept this argument in the absence of a factual basis for it. Every case where prescription is sought to be overcome involves a decision by SARS to assess outside the three-year period. A court cannot without more conclude that the mere fact that SARS was ultimately persuaded to assess means that the conduct complained of caused a non-assessment in the three years.

[115] Not only was there no evidence from SARS in support of the causal link, but there are objective facts which point to a contrary conclusion. The Appellant's decision to claim a R10 million deduction in relation to insurance expenses in the 2017 return in fact triggered an enquiry from SARS. A SARS official assigned to examine the Appellant's return noticed (whether *mero motu* or with the assistance of a computer algorithm) the substantial increase

in insurance costs from 2016 to 2017, and pertinently asked for an explanation and supporting documents.

[116] In response to this request, the Appellant (through Mr XY) stated that the amount was paid under a "self-insurance taken out … to the value of R10 000 000" (my underlining). It pointed out that the contract was for a limited period of six months. The supporting documents that were attached (the signed application form and the signed proposal) reflected certain material terms of the policy, namely that a premium of R10 million was payable, giving rise to insurance cover of R12 million, with a 4% underwriting fee. The declaration also referred to the policy being subject to "the usual conditions prescribed by [the insurer]".

[117] The response to SARS thus contained very clear indications (i.e. the description as "self-insurance", the short insurance period and the high premium compared to the amount of cover) that one was not dealing with a conventional insurance policy. Despite this, SARS very shortly thereafter concluded its verification exercise without any further enquiries or a referral to audit. One would assume – I the absence of evidence to the contrary – that the explanation was considered and that SARS was satisfied with the deduction of the premium, at least to the extent that it did not request any further documents. Nothing more was heard until after the three-year period had expired.

[118] The above facts support the inference that what caused the non-assessment in the three-year period was not the claiming of the deduction in the return, or the non-inclusion of a small amount of notional interest, but a decision by a duly authorized SARS official, responsible for enquiring into the nature of the unusual deduction claimed, not to pursue the matter further.

[119] It may be, of course, that there are facts known to SARS, pertaining to the above process, that would assist in refuting the above inference. SARS was free to lead evidence in this regard. It decided not to do so.

[120] Over and above this, a few days after the expiry of the three-year period, the Appellant learned that the matter had been referred to audit on the basis of a "risk assessment". There was no indication (whether in the letter or in evidence) of the nature of the risk assessment, who was responsible for it, and what facts or circumstances gave rise to it. In other words, it was not apparent whether it was anything contained in or excluded from the Appellant's tax return that caused SARS to seek to revisit the Appellant's 2017 year. What is however clear from the correspondence is that at the time of the letter SARS was familiar with the concept of an "experience account". It did not find out about that from the Appellant itself. Precisely how and when it had come upon this information, and whether there was any link to the Appellant's tax return or the non-assessment of the Appellant, is unclear. It is not stated

whether the audit decision is a result of a change of approach within SARS as to how to deal with insurance policies of this nature.

[121] This reinforces my view that on the present facts, to discharge the onus SARS had to produce evidence establishing the necessary causal link between the tax return and the earlier non-assessment. It had done so, and discharged its onus, in the *Spur Group* case. It did not do so here.

[122] I should also say that to the extent that SARS wished to make a case for the non-disclosure of the <u>notional interest</u> causing the non-assessment of an amount equal to the <u>premium deduction</u>, it had to establish that particular causal link. I have doubts as to whether it could easily have done so when a trigger raised by the premium deduction itself did not lead to its disallowance within the relevant time, but the point is that no evidence to this effect was led at all.

[123] In the circumstances, the court is, at the very least, left uncertain as to whether the reason for non-assessment of the amounts in the three-year period was the Appellant's disclosure or non-disclosure in its tax returns. In terms of the rules of onus, if at the end of the case the court is not certain as to whether a fact has been established or not, the party that bears the onus loses. The absence of evidence to establish the causal link is by itself fatal to SARS's attempt to invoke section 99(2)(*a*).

[124] Finally, I should deal briefly with certain other arguments made by SARS in relation to the issue of prescription.

[125] Emphasis was placed on the nature of the Appellant's response to the SARS verification request, where it is contended that the Appellant "continued to portray the policy as conventional insurance" and thereby "compounded" its initial misrepresentation that the policy is a conventional insurance product.

[126] I do not consider these submissions persuasive. In the first instance, the misrepresentation relied upon in the pleadings was in the tax return, not the verification response. But in any event, the verification response specifically identified the product as "self-insurance." This is not the same as calling it a "conventional insurance product".

[127] SARS argued that the position was similar to the Spur Group case. The difference, however, was that in that case there was evidence that the wrong answers in the returns caused particular triggers not to be set off, and that if they had been, an assessment would have followed. Here, a trigger was in fact set off by the return, and there was still no assessment. There was no evidence to support the conclusion that different conduct would have led to a different result.

[128] Finally in relation to the alleged non-disclosure of the notional interest, SARS relied on the *dictum* of Howie J in *ITC 1459* 51 SATC 142 to the following effect:

> "It is no answer to say, as was argued on behalf of appellant, that the Commissioner should have been alerted by what he saw, or was able to see, in the return and accompanying documents. The question is whether he had all the material facts when he issued all the original assessments. If not, whatever the reason, then *cadit quaestio.* It does not matter if his ignorance was partly due to a failure to make enquiries before issuing the assessments. Having regard to the information furnished subsequent to the Commissioner's enquiries regarding the present transaction and comparing that information with the paucity of detail in the returns read with their supporting documents, it is manifest that the Commissioner or his officer did not have all the material facts. Clearly it was the absence of those facts which led to the issue of the original assessments."

[129] The above dictum arose in relation to an argument based on the now repealed section 3(2) of the ITA which provided for the withdrawal by a SARS officer of a decision, but not where "all the material facts were known to the said officer when he made his decision". It does not pertain to the prescription test in the erstwhile section 79 of the ITA, which is the predecessor of section 99. It is also difficult to apply by implication to a section that is premised upon a "face value" original assessment process. The requirements of section 99, and their practical application, are more reliably obtained from the approach in *Spur Group* as discussed above.

[130] In the circumstances, the appeal must succeed on the ground that the additional assessment was out of time, and that section 99(2) does not overcome the statutory immunity granted by section 99(1).

The Merits

[131] Despite the conclusion that section 99 of the TAA precluded SARS, on these facts, from issuing the additional assessment for the 2017 year, it is appropriate nonetheless to address the merits of the matter. A court of appeal may conceivably be called upon to consider both the question of prescription and the merits of the appeal.

<u>The notional interest</u>

[132] In relation to the notional interest of R1,197, SARS relied on section 7(1) of the ITA which states as follows:

> "Income shall be deemed to have accrued to a person notwithstanding that such income has been invested, accumulated or otherwise capitalized by him or that such income has not been actually paid over to him but remains due and payable to him or has been credited in account or reinvested or accumulated or capitalized or otherwise dealt with in his name or on his behalf,

> and a complete statement of all such income shall be included by any person in the returns rendered by him under this Act."

[133] On that basis, SARS contended that monthly notional income was allocated to the experience account and accrued to the Appellant on the basis that it was unconditionally entitled to it, whether or not claims were made.

[134] It seems correct that the amount of R1,197 accrued to the Appellant in the 2017 year of assessment. The Appellant would always have received that amount from the insurer, either in the form of an insurance claim or as part of the payment owing on expiry or cancellation of the policy. That suffices to treat it as an amount forming part of gross income.

The premium deduction

[135] With regard to the section 11(*a*) deduction (which remained in dispute to the tune of R9,600,000), SARS averred in the rule 31 statement that "the full payment does not constitute a deductible expense having actually been incurred on the basis, inter alia, that the payment does not result in diminution of the Appellant's assets and the amount is held for the benefit of the Appellant while generating interest for the Appellant". It went on to aver that the Appellant bears the burden of proving that it is entitled to the full deduction in terms of section 11(*a*).

[136] It is apparent from the case as pleaded by SARS that its only substantive reason for denying the applicability of section 11(*a*) was that the amount had not actually been incurred. It stated that it had disallowed the claim "on the basis, *inter alia*, that the Appellant has failed to meet the burden upon it to prove that the alleged expense in question was actually incurred".

[137] Although SARS uses the term "*inter alia*", if one has regard to the letter of audit findings and the partial allowance of the objection, the only reason ever given for disallowing the deduction under section 11(*a*) was the contention that the amount had not been actually incurred. At no stage did SARS indicate that the amount was not incurred in the production of income or was of a capital nature.

[138] SARS went on to submit that "particular traits of the contingency policy confirm that the full amount paid to (*sic*) does not constitute expenditure actually incurred and is accordingly not a permissible deduction under s 11(*a*) of the ITA". Those traits were identified. In essence, they involved the existence of the experience account, the fact that the funds in that account are returned to the Appellant at the termination or cancellation of the policy without penalty, the earning of notional interest on the balance in the experience account, and the fact that it is stated in the policy that it can be pledged as security for a loan or a performance guarantee.

[139] On that basis, SARS submitted that the full amount paid to the insurer in respect of the policy was not actually expended.

[140] SARS went on to plead reliance on section 23L(2) of the ITA. This provision, if applicable, disqualifies the deduction of an insurance premium in certain circumstances. It provides as follows:

> "No deduction is allowed in respect of any premium incurred by a person in terms of a policy to the extent that the premium is not taken into account as an expense for the purposes of financial reporting pursuant to IFRS in either the current year of assessment or a future year of assessment."

[141] SARS averred that the IFRS definition of an expense was not met, and therefore that section 23L(2) warrants the disallowance of the deduction.

[142] Finally, SARS relied upon section 23(*e*) of the ITA. This states as follows:

> "No deductions shall in any case be made in respect of the following matters, namely—
>
> (*e*) income carried to any reserve fund or capitalized in any way."

[143] SARS contended that the experience account constituted a reserve fund as contemplated in section 23(*e*).

[144] Under the heading "Conclusion Regarding Section 11(*a*) Deduction Claimed in Respect of R10mil Payment to [the insurer] For The 2017 Tax Year", SARS submitted that the Appellant was not entitled to the full amount as a deduction "for the following reasons":

144.1 The full amount of R10 million was not expenditure actually incurred. It was instead transferred to the interest-bearing experience account where it is held for the Appellant's benefit as an asset that may be pledged as surety and is available at all times to the Appellant for withdrawal upon termination, or as cover. The requirements of section 11(*a*) are thus not met;

144.2 Section 23L(2) has application and no deduction may be allowed; and

144.3 The deduction is not allowed because section 23(*e*) applies, in that it is a payment which has been carried to the experience account in reserve as cover for unforeseen eventualities.

[145] In the rule 32 statement, in addressing the premium deduction, the Appellant dealt with the question as to whether the expenditure had been incurred. It stated as follows:

> "The Appellant notes that whether the 'expenditure was actually incurred' is the tip of the spear raised by the Respondent in disallowing the deduction. <u>It is the only basis whereupon the Respondent relies for section 11(*a*) of the ITA not applying</u>."

[146] The Appellant pleaded that an amount had in fact been incurred for purposes of section 11(*a*), essentially on the basis that the amount was paid to the insurer pursuant to an unconditional legal obligation to have expended those amounts.

[147] The Appellant also addressed SARS's reliance on section 23L of the ITA. It contended that the Conceptual Framework for Financial Reporting ("CFFR") that forms part of IFRS would apply to determining whether the amount constituted an expense for purposes of IFRS. It contended that the classification of the deduction as an "expense" rather than an "asset" was correct in terms of those standards.

[148] The Appellant did not plead a specific case in relation to section 23(*e*), but denied SARS's averments.

[149] The only significant aspect of the rule 33 statement, for present purposes, is that SARS did not expressly deny the Appellant's statement that the only grounds upon which it had relied for purposes of disqualifying section 11(*a*) was that the expenditure had not been incurred.

[150] Based on the above analysis, I am of the view that SARS limited its attack on the deductibility of the premium amount to non-incurral of expenditure, section 23L and section 23(*e*). Rule 34 provides that "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". On a fair reading of those pleadings, the issue of whether the amount was of a capital or revenue nature was not identified as part of SARS's case, and therefore does not appear to be an issue in the appeal.

[151] It is however not necessary to make a final decision on this aspect. My views on the deductibility of the premium (assuming that prescription is disregarded) are not affected by whether the amount, if incurred, was of a capital nature.

<u>The *Boerdery* case</u>

[152] On 20 March 2024, this court sitting in Johannesburg handed down judgment in *Taxpayer Boerdery v Commissioner for the South African Revenue Service* (IT 45979) ("the *Boerdery* case").

[153] The *Boerdery* case involved a very similar deduction by the taxpayer, namely insurance premiums paid under a “multi-peril contingency policy contract” in relation to farming. The premiums were allocated to a “special experience account” and the bulk of the amount would be repaid to the taxpayer in the absence of any claim during the 12-month policy term.

[154] Two parts of the section 11(*a*) test were placed in issue:

154.1 whether the insurance premium constituted “expenditure actually incurred”; and

154.2 if expenditure was incurred, whether this was of a capital or revenue nature.

[155] As regards the question of expenditure actually incurred, this Court had regard to the insurance contracts in their entirety, including the existence of the experience account, the earning of notional interest on that account, the debit of reinsurance premiums and claims paid under the policy from time to time, the deduction of an “insurer’s margin” and an “investment management fee”, and the clause which provides for the payment of a premium refund of the positive balance reflected in the experience account on the termination or cancellation or the renewal of the policy, as the case may be.

[156] The Court referred to *Commissioner for the South African Revenue Service v Labat Africa Limited* 74 SATC 1 (SCA). On that authority it held that expenditure means “the action of expenditure, disbursement or consumption – hence money spent. Therefore, to constitute expenditure, money must have been permanently outlaid in exchange for something else other than money – purchase of goods or services; or an asset must have been permanently outlaid in exchange for a different type of an asset or service – in a barter transaction”.

[157] In *Labat*, it had been held that the term “expenditure” must bear its ordinary meaning, which “refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent”. The SCA stated as follows (in paragraph [12]):

> “Expenditure, accordingly, requires a diminution (even if only temporary) or at the very least movement of assets of the person who expends. This does not mean that the taxpayer will, at the end of the day, be poorer because the value of the counter-performance may be the same or even more than the value expended.”

[158] Against that background, the Court in the *Boerdery* case (in paragraph [39]) concluded that the taxpayer expended the “annual premium” to acquire the rights in terms of the insurance policy. These included the rights acquired in respect of the experience account and the related features. Since there was a movement in the taxpayer’s assets, cash having been exchanged for the rights in terms of the insurance policy, the taxpayer was held to have

incurred expenditure equal to the annual premium despite there being no diminution in its overall assets.

[159] I am in respectful agreement with the approach to this issue adopted in the *Boerdery* case. The Appellant's payment was of an amount owing under the policy. Even though there was an entitlement, immediately upon payment of the premium, to cancel the contract and to recover the amounts in question (save for the underwriting fee component of R400,000), so that the Appellant would always be able to recover an amount close to the amount of the premium paid, this does not mean that the amount was not actually expended. There was a shift in assets. The money ceased to belong to the Appellant and vested in the insurer, subject to the rights under the contract.

[160] The present transaction is different from the deposit of an amount in a bank account. It is trite that such a payment is not deductible for income tax purposes. What is not so clear is whether this is because it does not constitute "expenditure actually incurred", or is of a capital nature, or is disqualified for some other reason. Viewed from the perspective of income, the Appellate Division in *CIR v Genn & Co (Pty) Ltd* 1955 (3) SA 293 (A) at 301B-G held that money borrowed does not form part of gross income. It is certainly not every obtaining of physical control over money or money's worth that constitutes a receipt for purposes of those provisions. That was the case with a borrower, since what is borrowed does not become his "except in the sense, irrelevant for present purposes, that if what is borrowed is consumable there is in law a change of ownership in the actual things borrowed".

[161] The present facts are different. There is, as was found in the *Boerdery* case, an actual parting with money in exchange for different contractual rights. Only one of those rights is the potential return of sums expended, and then only if there has not been a claim on the insurance policy. I do not see that the premium payment is equivalent to a deposit in an accessible bank account.

[162] SARS argued that the facts of the present case can be differentiated from the *Boerdery* case in relation to the question of expenditure actually incurred in other respects too. It said that in the *Boerdery* case, the money had to be permanently outlaid in exchange for something else other than money, while the features of the present insurance product were inconsistent with finding that the amounts were permanently expended. SARS pointed to the "*pledge facility*" in the policy, which recognized that the policy could be pledged as security to a third party. That did not feature in the evidence in the *Boerdery* case.

[163] I do not agree that the facts of the present case are materially different in the above respects from those in the *Boerdery* case. In that case, as in this, there was a single payment of a premium, a portion of which was reflected as an underwriting fee or risk fee, but the entire

premium was in fact exchanged for rights and obligations that were based upon insurance-related events occurring. The fact that there is no mention in the *Boerdery* case of the potential to pledge the policy does not mean that that was not a feature of that case, but it is in any event irrelevant. If anything, the fact that the Appellant acquired contractual rights to a greater payment (in the form of an insurance policy) than the amount expended differentiates the policy from a temporary housing of the amount, as is the case with a bank deposit.

[164] Finally, with regard to SARS's focus on the permanent outlay of money, in *Labat* (*supra*) in paragraph [13] it was held that expenditure required a diminution in assets "even if only temporary". It was not, in my view, a requirement that there should be some entirely irreversible expenditure. The fact that the contract contemplated the potential return of similar amounts in certain circumstances, including on termination, would therefore not by itself result in the amount not being treated as expenditure incurred.

[165] Despite that finding, the Court in the *Boerdery* case held that the amount was not deductible, on the basis that it constituted expenditure "of a capital nature".

[166] The Court discussed the difference between capital and revenue expenditure as summarized in *BP Southern Africa (Pty) Ltd v Commissioner for the South African Revenue Service* 69 SATC 79 (SCA) in paragraphs [7] and [8], namely that the purpose of expenditure is important and often decisive in assessing whether it is of a capital or revenue nature; and that expenditure incurred for purposes of acquiring a capital asset of the business is capital expenditure, whereas expenditure which is part of the cost incidental to the performance of the income producing operations as distinct from the equipment of the income producing machinery is revenue in nature. *BP* also highlighted that the "true nature of each transaction" must be examined to decide whether the expenditure is capital or revenue (*New State Areas Ltd v Commissioner for Inland Revenue* 1946 AD 610 at 627) and that every case turns on its own facts (*CIR v African Oxygen Limited* 1963 (1) SA 681 (A) at 691A-B).

[167] On that basis, the Court held that in exchange for payment of the annual premium, the taxpayer "obtained the right to a credit of the same amount which stood for its benefit in the experience account. The balance of the experience account was refundable at the end of the contract period and generated income in the form of interest. Irrespective of what the yield was called, [the] taxpayer's right to the experience account was an income producing concern and therefore a capital asset".

[168] I cannot regard the premium on the present facts as being expenditure of a capital nature for the same reasons. In my view, the proper approach is to identify the role and purpose of the expenditure in the context of <u>the Appellant's concern or business as a whole</u>. I reiterate that SARS's case was not that the expenditure was in truth no insurance premium,

but only that it was unconventional insurance. Viewed from that perspective, the insurance aimed to protect the Appellant against losses in fruit sales as a result of the insured events occurring. Its purpose therefore was to fill a hole in the Appellant's income earning stream as a result of one of the protected risks eventuating, and not to compensate it for the loss of a capital asset (*cf*. *ITC 1850* 73 SATC 228 in paragraph [16]). The fact that the policy terms envisage the accrual of notional interest on the experience account does not, in my view, render the payment one that acquires an independent income-producing concern.

[169] Thus if the issue as to whether the expenditure is capital or revenue in nature has properly been placed before this Court, I would conclude that the expenditure, on the present facts, is not of a capital nature.

<u>Section 23L</u>

[170] Even if the Appellant demonstrates that the expenditure meets the requirements of section 11(*a*), the deduction will be disallowed if section 23L(2) applies. On the assumption that the amount constituted a premium incurred by the Appellant in terms of a policy of insurance other than a long-term policy, section 23L(2) prohibits the deduction of that premium:

> "to the extent that the premium is not taken into account as an expense for the purposes of financial reporting pursuant to IFRS in either the current year of assessment or a future year of assessment."

[171] As stated, SARS specifically pleaded that the amount of the premium would not be regarded as an expense for purposes of IFRS financial reporting. That was therefore an issue in the appeal (assuming no prescription). In terms of section 102(1)(*b*) of the TAA, the Appellant bore the overall onus of establishing that the amount was deductible. This includes proving that the amount was an expense for IFRS purposes.

[172] Section 23L(2) is of one of a number of provisions in ITA which specifically assign tax consequences in accordance with the application of accounting standards (IFRS in particular). Other examples include section 11(*j*) (deduction of doubtful debts) and section 22(3A) (determination of the cost price of trading stock).

[173] In my view, where the ITA assigns tax consequences based on accounting standards, it envisages the correct application of those standards. In other words, it is irrelevant how the taxpayer in fact accounted for the item in its financial statements. What matters is the correct accounting treatment.

[174] The question as to whether an amount constitutes an expense for IFRS financial reporting purposes is therefore one of fact, capable of objective determination. In this sense it is akin to statutory provisions which assign consequences based on the treatment applied by foreign law (e.g. the definition of "foreign dividend" in section 1(1) of the ITA which depends on how the payment is treated for purposes of the income tax law in a foreign country).

[175] The content of foreign law is treated as a question of fact which is proved by way of expert evidence. See Schlesinger v Commissioner for Inland Revenue 1964 (3) SA 389 (A) at 396G and *The Asphalt Venture Windrush Intercontinental SA and Another v Uacc Bergshav Tankers* 2017 (3) SA 1 (SCA) in paragraph [31]. In the same way, the correct accounting treatment is a question of objective fact which would be proved by evidence from expert accountants. Such persons could testify both as to which particular standard within the IFRS cluster of standards would be applicable to the taxpayer, and as to how the amount in question would properly be classified in accordance with the applicable standard.

[176] It is so that in the context of proving foreign law, a court is not necessarily entirely dependent on experts. It was held in *MV Pasquale Della Gatta; MV Filippo Lembo; Imperial Marine Company v Deiulemar Compagnia di Navigazione SPA* 2012 (1) SA 58 (SCA) in paragraph [27] that:

> "Foreign law is treated as a fact requiring to be proved by tendering the evidence of a witness who can speak to the contents of that law. However, such evidence is unnecessary where the law in question can be ascertained readily and with sufficient certainty without recourse to the evidence of an expert, because the court is then entitled to take judicial notice of such law."

[177] Even though this court is constituted with a member who is an accountant, all three members of the court make decisions as to questions of fact. In my view we are not, as a court, equipped to determine the proper application of IFRS to the item in question in the absence of expert evidence. Even if there is a similar exception to that reflected in MV Pasquale Della Gatta (supra) where one is dealing with proof of correct accounting treatment, it will surely very seldom be possible for this court to conclude "readily and with sufficient certainty" what the correct accounting treatment is.

[178] In the present case, the parties made conflicting submissions based on their interpretation of the standards (in particular the CFFR). The Appellant contended that the premium was not an "*asset*" for IFRS purposes (defined as a "present economic resource controlled by an entity as a result of past events") because even though there may be an "economic resource", the Appellant does not control that resource. On the other hand, SARS argued that it was not an "expense" as defined (in essence "decreases in assets, increases in liabilities, that result in decreases in equity") because there was no decrease in the Appellant's assets.

[179] With respect to the submissions of counsel, I do not believe that this court is in a position, without expert assistance, to draw conclusions “readily and with sufficient certainty” as to the correct accounting treatment of this admittedly unconventional insurance policy.

[180] The fact that neither party put up expert evidence as to how the premiums should be classified for IFRS purposes means that we are unable, at the end of the evidence, to determine whether the facts envisaged in section 23L(2) are or are not present. Applying the law as to the onus of proof, it is the Appellant, which bears the overall onus, that would fail.

[181] Accordingly, if the conclusion had been that SARS could rely on section 99(2), the Appellant’s appeal would in my view have failed on the ground of its not having demonstrated that section 23L(2) does not apply.

[182] That being so, it is not necessary to consider the other SARS argument based on section 23(*e*). My *prima facie* view is however that because one is dealing with an insurance premium, albeit an unusual one, that accrues to the insurer’s estate and gives rise to countervailing insurance obligations for the duration of the policy, as opposed to a deposit fund, this does not appear to bear the hallmarks of “income carried to any reserve fund or capitalized in any way”.

Understatement Penalties

[183] Since I have concluded that the additional assessment cannot stand, the understatement penalty imposed likewise falls away.

[184] Again, however, if I am wrong in relation to the primary conclusion, and if my view that the Appellant would otherwise have failed on the merits were to stand, then the question would nonetheless arise whether there are grounds not to impose the USP.

[185] Although in its original response to the SARS letter of audit findings the Appellant stated that if it was wrong in claiming the deduction, this was attributable to a *bona fide* inadvertent error on the part of the Appellant, for reasons not explained the Appellant chose not to raise this issue in its pleadings. Its only contention was that if it is successful in being allowed the section 11(*a*) deduction, the USP will be remitted entirely.

[186] Applying rule 34 as set out above, I am of the view that the existence of a bona fide inadvertent error was not an issue placed before this Court.

[187] SARS established that the amount of tax in dispute exceeded R1 million. It is common case that this was more than 5% of the amount of tax properly chargeable in the 2017 year of assessment. Accordingly, the threshold of a "substantial understatement" was overcome. The USP would therefore have been legitimately imposed had it not been for section 99(1).

Costs

[188] In Tax Court proceedings, it is not the norm to award the successful party its costs or to make a costs order against the unsuccessful parties. In terms of section 130(1)(*a*) and (*b*), this court may only grant an order for costs in favour of the Appellant if the SARS grounds of assessment are held to be unreasonable, or in favour of SARS if the Appellant's grounds of appeal are held to be unreasonable.

[189] In the present case, I cannot say that the grounds upon which SARS relied were unreasonable. Even though I have held that the requirements to overcome prescription have not been met, the point was not so obvious as to mean that SARS's decision to pursue the matter was unreasonable.

[190] In the circumstances, I see no reason to depart from the ordinary approach towards costs in this court.

Order

[191] In the circumstances, I make the following order:

191.1 The appeal is upheld.

191.2 SARS is directed to alter the additional assessment for the 2017 year of assessment by allowing the full deduction of the insurance premium claimed and excluding the notional interest component.

191.3 There is no order as to costs.

M W Janisch

Acting Judge of the High Court

South Africa

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I concur.

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Ms L Groener

Commercial Member

I concur.

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Ms S Louw

Accounting Member

Instructed by:

Jean-Roux van Huyssteen

TRM Tax Attorneys