REPUBLIC OF SOUTH AFRICA
IN THE HIGH COURT OF SOUTH AFRICA
GAUTENG DIVISION, PRETORIA

CASE NO: A201/2021
REPORT ABLE: NO
OF INTEREST TO OTHER JUDGES: NO.
REVISED: NO

In the matter between:

SIYANDISA TRADING (PTY) LTD APPELLANT

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICES RESPONDENT

JUDGMENT

Van der Schyff J

Introduction

[1] This is an appeal against the judgment of the Tax Court dated 14 May 2021. The appellant (Siyandisa) appeals against the respondent's (SARS or the Commissioner) income tax assessment issued against it for the 2011 and 2012 years of assessment.

[2] There are three issues in dispute in this appeal:

i. The disallowance of a depreciation claim on tools and equipment;
ii. The disallowance of a deduction of finance charges; and
iii. The imposition of an understatement penalty.

[3] The Tax Court confirmed SARS's assessment, and the aggrieved appellant approached this court on appeal. It is contended by the appellant, and conceded by SARS that the Tax Court erroneously relied on s 12C of the Income Tax Act 58 of 1962 (ITA) in coming to its findings regarding the disallowance of the depreciation claim. The provision applicable to the disputed depreciation claim is s 11(e) of ITA. This section grants a discretion to the Commissioner to determine the amount of the depreciation allowance. Although ss 11(e) and 12C both provide for wear and tear, or depreciation allowances, it is a misdirection to base a finding on incorrect statutory provisions. This court is thus entitled to interfere with the Tax Court's judgment. Due to the order relating to the depreciation allowance being based on an incorrect legislative provision, the issue stands to be reconsidered. It is, however, not necessary to remit the issue to the Tax Court as this court is in as good a position as the Tax Court to adjudicate the appeal that was before the Tax Court. If it is found that the Tax Court and this court share the same view regarding the disallowance of the depreciation claim, albeit that this court considered the provisions of s 11(e) of ITA, and the Tax Court erreounesly relied on s 12C, the appeal will stand to be dismissed.

[4] As for the appeal regarding the disallowance of finance charges and the imposition of an understatement penalty, this court will only interfere if it is evident that the Tax Court misdirected itself. Before the legal questions (i.e., the issue of the depreciation claim and the question as to whether this court should interfere with the Tax Court's findings regarding the disallowance of finance charges and the imposition of an understatement penalty) can be

addressed, it is important to have regard to the factual context underpinning the litigation.

Factual background

i. Depreciation

[5] The appellant conducted the business of the supply of aircraft services which includes the repair and overhaul, airframe maintenance, and rental of aircraft and components. The appellant rendered these services through its sole director Mr. Olmsted, and six full-time employees. Mr. Olmsted became the director of the appellant in 2007, but at that time the company was dormant and remained dormant until 2010.

[6] Mr. Olmsted is also the founder of the Talon Investment Trust (Talon), a trust created for the benefit of his family. He is also a director of Xcel Aviation (Pty) Ltd, (Xcel). On 12 April 2010, all the shares of the appellant and Xcel were held by Talon.

[7] On 13 April 2010, the appellant and Xcel entered into a sale of business agreement whereby the appellant acquired certain aircrafts, aircraft parts, furniture, computer equipment, tools, and equipment. In terms of clause 2.1 of the aforesaid sale agreement, the purchase price for the sale of the business was the aggregate of the ongoing liabilities in respect of leased and financed assets and R 36 211 367.00, which amount was attributed to the sale assets as -

> The fixed assets - the tax value thereof at the effective date;
> The stock-the value thereof as determined in clause 3, i.e., the sellers' current book value'.

[8] The sale of the assets was in exchange for the sale of 200 ordinary shares by the appellant to Xcel. The assets were thus sold for shareholding.

As reflected in the financial statement, the share premium was R34 376 192.00. There was, therefore a difference of R1 835 175.00 between the value of the assets and the share premium of the 200 ordinary shares. The appellant explained to the respondent that the difference was an ongoing liability on the assets that the purchaser would assume.

[9] In its 2011 financial statements, Xcel reflected the costs of the tools, equipment, and furniture at R25 143 639.00, to wit the price at which Xcel acquired such assets from Executive Helicopters, a company of which Mr. Olmstead was a director and Talon was a shareholder, in 2007. At that stage, Executive Helicopters held all the shares of Xcel. The appellant avers that the respondent allowed Xcel's claim for depreciation based on the price at which the aforesaid assets were acquired from Executive Helicopters. As indicated hereinafter, this averment is disputed by the respondent. The appellant avers that when the sale of business agreement was concluded between Xcel and the appellant, the depreciated book value of the tools and equipment amounted to R 11 666 667. The appellant contends that this amount represents the market value of the assets, and the price that persons dealing at arm's length would have paid.

[10] The appellant reflected the costs of the tools and equipment in its 2011 financial statements under 'plant and machinery' at R11 666 667.00, and its claim for depreciation was based on this value.

[11] The appellant claimed depreciation in respect of the tools and equipment at a rate of 20% per annum as a deduction from income that amounted to R2 045 662.00 and R2 333 333.00 in the 2011 and 2012 years of assessment, respectively.

[12] In its rule 31 statement, the respondent explained that a tax enquiry was held in terms of s 50 of the TAA. The respondent investigated the tax affairs of the appellant and its connected entities and raised a query

regarding the values of the tools and equipment involved in the sale transaction. The respondent held the view that Xcel initially acquired the tools and equipment from Executive Helicopters, and a query was raised in relation to the transaction and acquisition of these tools and equipment. The query remained unresolved, and as a result, the subsequent acquisition of the tools and equipment by the appellant from Xcel remains entangled in an unresolved controversy. It is the respondent's case that the values of the tools and equipment on which depreciation was claimed, were inflated. The unresolved query relates, amongst others, to the values attached to the tools and equipment. The list of the tools and equipment provided by the appellant to the respondent during the audit did not indicate the value of each asset on the list. It is thus unclear how their value and the depreciation thereon were determined. Because the transaction was concluded between two connected entities, the question arose whether this was an arm's length transaction. As a result, the respondent rejected the deduction and disallowed the depreciation claim.

[13] The appellant submitted that it does not have any knowledge of any unresolved issue between Xcel and Executive Helicopters in respect of the tools and equipment. The appellant attached a list of the tools and equipment that forms the subject matter of the objection to its objection against the additional income tax assessments, and referred to the list as 'the list of equipment which clearly indicates that the tools and equipment do not form part of the tools and equipment that relate to the unresolved query between Executive Helicopters and Xcel.' It is not evident from the list in itself on what basis it 'clearly indicates' that the tools and equipment sold by Xcel to the appellant, do not relate to the tools and equipment bought by Xcel from Executive Helicopters. The list also did not reflect any value attributed to any of the items listed.

[14] In its statement of grounds of appeal in terms of rule 32, the appellant explained that the prices of the individual items listed as tools and equipment

were initially not incorporated in the list provided to the respondent because the tools and equipment were acquired in one composite transaction in terms of the sale of business agreement at the depreciated tax value in the hands of Xcel. In the subsequently completed list, the appellant prepared a complete list wherein it reflected the value of the individual items on the basis that the items were new as second-hand prices could not be obtained.

[15] The appellant avers that its claim for deprecation is based on the provisions of s 11(e) of the TAA and nots 12C as alleged in the rule 31 statement.

[16] It is necessary, at this juncture, to pause and have regard to the methodology used by the appellant to establish values for the tools and equipment in light of the respondent's view and the evidence led during the proceedings before the Tax Court. Volume 6 of the appeal record contains '[s]upporting documents of methodology to establish new values of tools.' A list was also provided ti led 'The value of new plant and machinery expressed, in USO and SA Rand as of March 2020.' Mr. Olmsted, who testified on behalf of the appellant, explained that a valuation was done of the tools and equipment eight years after its acquisition because SARS did not allow the depreciation on the basis proposed by the appellant, and reassessed it. The tools and equipment are not readily available in a used, serviceable condition on the local or international market, and therefore the appellant was of the view that the only way to determine its value was to go to the manufacturers and obtain current prices where possible, and use current new prices at the exchange rate at the time. The evidence shows, however, that the manufacturers were not approached save for visiting some websites where pricing information was sourced from.

[17] During the hearing before the Tax Court, the appellant called an expert witness, Mr. Guldenpfennig. Mr. Guldenpfennig testified that he was a technical expert and not a financial expert or, as he put it, 'an expert on

monetary evaluation.' He repeated this reservation several times during his evidence. Notwithstanding this clarification, counsel for the appellant attempted to elicit evidence regarding the value that can be attached to certain tools or equipment that needs to be calibrated before it is functional, from Mr. Guldenpfennig. He put the following to Mr. Guldenpfennig:

> 'If I give an example ... Assuming I buy a specific piece of equipment or tool, brand new or second hand ... Brand new and the one is calibrated and the other one is not calibrated, is it correct then that if you have to put a value on it ... I know you cannot put a value on it, but the logic is to deduct the cost of calibration to determine replacement value. Or would you not want to comment on that?'

Mr. Guldenphennig answered:

> 'Correct. The action you have to take to make a tool without a calibration certificate to use on making measurement, is the cost of having it calibrated. So that does not mean that the tool without the calibration certificate is of no value.'

[18] Mr. Guldenpfennig indicated that he was testifying to rebut the evidence of the respondent's expert witness, who had not testified at that time. The respondent ultimately decided not to call their expert witness. Mr. Guldenpfennig was referred to the respondent's expert witness's summary wherein it was stated that the items listed in Annexure JM1 are scrap. As far as the content of Annexure JM1 was concerned, Mr. Guldenpfennig said that the list is generally speaking the list of tools and equipment but that he cannot say that every piece of equipment specifically is in use.

[19] Mr. Guldenpennig testified that he was of the view that the respondent's expert witness's *curriculum vitae* does not support a finding that he has the knowledge and experience to make a judgment on the regulatory

compliance of the equipment. Mr. Guldenpfennig's evidence was that tools and equipment on the list were used, although he could not confirm that everything was in use. He also confirmed that measuring tools and equipment that needed to be calibrated before they could be used were not without value for the mere fact that it was not calibrated because one can buy uncalibrated new items and have them calibrated before putting them to use. The uncalibrated equipment can, however, not be used until they are calibrated. Mr. Guldenpfennig did not know whether the tools and equipment were calibrated in 2010, 2011, or 2012. He confirmed that a tool with a calibration certificate is more valuable than one without. The witness also confirmed that the values of items reflected in the list titled *"Value of new plant machinery expressed in US and SA rands as on March 2020"* would not necessarily be the amounts and values of the tools and equipment in the 2011 and 2012 years of assessment.

[20] The appellant also called Mr. Olmsted to testify. He testified, amongst others, that at the time of the conclusion of the sale of business agreement between Xcel and the appellant, Xcel had an aircraft operating license and an AMO certificate for doing maintenance on aircraft and on customers' aircraft components, which the appellant did, and do, not have. He stated that the decision was taken to acquire the tools and equipment at the taxable book value because it was the most tax-efficient way due to Xcel and the appellant being related parties. He was asked whether it would not have been more accurate to consult with manufacturers and dealers in the industry to determine the market value of the items. He answered that due to his experience in the industry, he had a good idea of the value of the tools and equipment and reiterated that the tools and equipment are not readily available on the local and international markets. Mr. Olmsted also testified that Xcel initially acquired the tools and equipment from Executive Helicopters in 2007 and that Executive Helicopters acquired the tools and equipment over the company's life span from 1983 to 2007. Mr. Olmsted confirmed during cross-examination that the appellant did not provide the respondent

with a 'detailed cost per item' list when requested to do so since the tools were provided as a 'consignment', and the tools and equipment were purchased in a single transaction with all the items valued together for the purpose of the sale. He repeatedly explained that the parties took the tax value of the items as reflected in Xcel's books as the market-related value for the sale of the package, or consignment, of tools and equipment, and confirmed that no valuation was provided to SARS. Mr. Olmsted also confirmed that Annexure JM1, the list of tools and equipment that reflects the value attributed to the respective items listed, was only provided to the Tax Court and was not made available to the SARS auditor. The evidence of the person or persons who compiled the list with values was not led.

[21] Counsel for the appellant submitted since the tools and equipment were acquired by the appellant from a connected person, the appellant was entitled to claim depreciation allowances based on the market value of the tools and equipment regardless the price allocated in terms of the sale of the business agreement and the actual amount paid. He submitted that the issue to be decided in respect of the depreciation allowances is whether the appellant proved on a balance of probabilities that the market value of the tools and equipment was at least R11.6 million at the time of the conclusion of the sale of business agreement. The appellant contends that because the 2020 replacement value exceeds the 2011 depreciated book value of the tools and equipment, the court must find that the appellant proved on a balance of probabilities that the market value of the tools and equipment exceeded R11.6 million in 2011.

[22] The respondent then led the evidence of its auditor. She confirmed that the appellant was informed that the depreciation claim was not allowed in relation to the tools and equipment that formed part of the unresolved query relating to the transaction concluded between Executive Helicopters and Xcel. She said:

'The tools and equipment that we are referring about, it actually originated from Executive Helicopters, which actually sold it to Excel Aviation. And then during the audit on Excel Aviation, SARS actually requested additional information substantiating information regarding the tools and equipment that the taxpayer acquired. So the taxpayer failed to prove to SARS how the tools and equipment was acquired. No documentary proof was provided. And then, as a result on the audit of Excel Aviation, the wear and tear was disallowed. So the same wear - the same tools and equipment was sold to Siyandisa Trading. So Siyandisa Trading, Excel Aviation and Executive Helicopters, they are related entities. Mr. Olmsted was a director of the three companies.'

[23] She confirmed that she was provided with a list of tools and equipment. Since no values were reflected on the list, the list was of no value. She testified that the depreciated value of the tools and equipment was not accepted by SARS when it was in Xcel's hands, and can thus not be accepted while it is in the appellant's hands. When referred to the original assessment issued relating to Xcel where the depreciation was seemingly accepted, she testified that an additional assessment was later done where Xcel's depreciation claim was not accepted. No documentary proof was provided regarding the later assessment, but the respondent's witness testified that she did the audit under Xcel and know that the deduction of wear and tear on tools and equipment was not allowed. Because she testified that the respondent accepted the sale of business agreement and did not challenge it in accordance with the anti-avoidance provisions provided for in legislation, counsel for the appellant said that the respondent was obliged to grant the s 11(e) allowances.

[24] An aspect canvassed during cross-examination with Mr. Olmsted, was the value of the appellant's shares minutes before the transaction with Xcel was concluded. Mr. Olmsted explained that the appellant had 1000 ordinary issued shares and the value thereof was R1 000. He was asked to explain how 200 ordinary shares could be used to pay R34 000 000, and counsel for

the respondent put it to him that if the 200 shares were used as payment the 200 shares had to be worth R34 million before the transaction was actually concluded. On this basis, the value of 1000 shares would be R170 million. Counsel for the appellant objected to the line of questioning. Counsel submitted to the court that SARS should have applied the anti-avoidance provisions and given notice to the taxpayer that it intends to disregard the transaction. A different process would have ensued. The assessments were, however, not done on this basis, and SARS is not now entitled to follow this route. Counsel for the respondent conceded that the assessment was not done in terms of the anti-avoidance provisions. He submitted that the court is entitled to consider the anti-avoidance provisions *mero motu*. Such an approach would, however, militate against the sacred *audi et alteram* principle, and the court is bound to the case made out by the parties on paper.

Discussion

[25] In considering the question whether the appellant is entitled to claim depreciation in respect of tools and equipment in terms of s 11 (e), the first question to answer is whether the appellant succeeded in proving that the market value of the tools and equipment in question was 'at least' R 11 666 667 when the agreement was concluded. The appellant's case is simply that it determined the price of the tools and equipment in the sale of business agreement, as the value thereof in Xcel's books. Because SARS allowed the tools and equipment in Xcel's hands to depreciate to R11 666 667.00, SARS is bound to accept that this is the fair market value of the items. It was thus not necessary to value each individual item for the depreciation claim on the tools and equipment as a category, to be calculated. The crux of the respondent's argument is that it cannot be accepted that the value of the tools and equipment in Xcel's books are correct because the tools and equipment are tools and equipment bought by Xcel from Executive Helicopters and it forms part of an unresolved query. Until the query regarding the transaction between Executive Helicopters and Xcel is resolved, the value of R 11 666

667.00 cannot be taken as the market value of the tools and equipment, since the respondent is of the view that the values attached to the tools and equipment were inflated when the transaction between Executive Helicopter and Xcel was concluded.

[26] The appellant's emphasis on the respondent's failure to utilise the anti-avoidance provisions of the ITA and the respondent's emphasis on the fact that some of the measuring tools or equipment were not calibrated, could thus not be used and were rendered valueless, are of no consequence in determining whether the appellant should be allowed to succeed in its depreciation claim. What is relevant, is that the respondent indicated from the onset that the tools and equipment in question are the same tools and equipment that form the subject matter of an unresolved query in a transaction concluded between Executive Helicopters and Xcel. Although the appellant's counsel put it to the respondent's auditor that the appellant disputes that the tools and equipment in question are the same tools and equipment that were obtained from Executive Helicopters, Mr. Olmsted's evidence confirms that the tools and equipment were acquired by Xcel from Executive Helicopters. The appellant's counsel took the respondent's auditor to task because the amended assessment wherein Xcel's depreciation claim was rejected was not discovered and did not form part of the documentary proof. It was, however, not put to the respondent's witness during cross-examination that such an additional assessment was not done by SARS. Counsel just stated - 'It is one of those things, it might be true, it may not be true, but there's no supporting documents. I will not press this further.'

[27] There is no reason why the evidence of the respondent's auditor, that she audited Xcel's assessment and that SARS did not allow a depreciation claim for wear and tear under Xcel after the original assessment was issued, should not be accepted. I agree with the respondent's submission that the book value attributed to the tools and equipment could in these circumstances, not form the basis of a depreciation

claim in the appellant's books. Nothing prevents parties, *inter partes,* from agreeing that tools and equipment are sold as a consignment or package, without an individual value being attributed to individual items. Where the purchaser, particularly where a transaction was concluded between related parties, however, wants to utilise the tax benefits provided for ins 11(e) of the ITA, the purchaser must ensure that its house is in order in that it is able to prove that the items were purchased at market value.

[28] Through, amongst others, s 11(e) of the ITA the legislature recognised that taxpayers should be entitled to relief for normal tax purposes for certain capital expenditures, for example, for assets that diminish in value as they are used in the taxpayer's trade.[1] Legwaila *et al,*[2] explain that although s 11(e) refers to an amount by which the 'value' of a qualifying asset has been diminished, in most circumstances, the allowance is based on the costs of the asset. The costs are deemed to be the costs which, in the opinion of the Commissioner, a person would, if the qualifying asset was acquired in a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of the asset was in fact concluded, have incurred in respect of the direct costs of the asset. The costs of an item include its purchase price, or its fair value as at the date

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[1] The relevant portions of s 11 (e) of the ITA read as follows: **'11. General deductions allowed in determination of taxable income.-For** the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived- ... (e) save as provided in paragraph 12 (2) of the First Schedule, such sum as the Commissioner may think just and reasonable as representing the amount by which the value of any machinery, plant, implements, utensils and articles (other than machinery, plant, implements, utensils and articles in respect of which a deduction may be granted under section 128, 12C, 12DA, 12E (1), 12U or 378) owned by the taxpayer or acquired by the taxpayer as purchaser in terms of an agreement contemplated in paragraph (a) of the definition of "instalment credit agreement" in section 1 of the Value-Added Tax Act and used by the taxpayer for the purpose of his or her trade has been diminished by reason of wear and tear or depreciation during the year of assessment: Provided that- ... (vii) where the value of any such machinery, implements, utensils and articles acquired by the taxpayer on or after 15 March 1984 is for the purposes of this paragraph to be determined having regard to the cost of such machinery, implements, utensils and articles, such cost shall be deemed to be the cost which a person would, if he had acquired such machinery, implements, utensils and articles under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of such machinery, implements, utensils and articles was in fact concluded, have incurred in respect of the direct cost of the acquisition of such machinery, implements, utensils and articles, including the direct cost of the installation or erection thereof;'.

[2] Legwaila T *et al.* Tax Law An Introduction. 2nd ed. JUTA 243.

of the transaction and other costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended. Costs incurred to calibrate a measuring tool or equipment would typically be added to the purchase price in order to determine the costs of the item. Hence the mere fact that a measuring tool or equipment was not calibrated does not, in itself, disqualify the application of s 11(e).

[29] SARS issued Binding General Ruling (Income Tax) 7 (Issue 4) on 9 February 2021 (BGR). Paragraph 4.2.4 deals with determining the value of a qualifying asset for purposes of s 11(e) where the qualifying asset was acquired by 'donation, inheritance, distribution *in specie* or at a non-arm's length price from a connected person.' In these circumstances, the allowance is based on the asset's market value, and the market value is determined under paragraph (vii) of the proviso to s 11(e). As a result, it is prescribed in the BGR that taxpayers must ensure that they have the necessary information or documentation readily available when requested by SARS to substantiate the arm's length price of an asset and the inclusion of any amount in the determination of the value of an asset.

[30] The term 'arm's length price' denotes the price at which a willing buyer and a willing unrelated seller would freely agree to transact, and where the parties will strive to get the utmost possible advantage out of the transaction for themselves.[3] In casu, sight cannot be lost of the fact that the appellant and Xcel are connected and related entities. There is a noticeable difference between an item's market value and its book value. The depreciation on book value is written off to zero in five years, and book value is thus not a good indication of market value. The best evidence of the second-hand value of the items on the list would have been the evidence of the manufacturers or dealers in the industry. The appellant attempted to indicate that the book value of the consignment of tools and equipment correlated significantly with the value attributed to the items almost eight years after the sale of business

[3] *Hicklin v SIR* 1980 (1) SA 481 (A).

agreement was concluded. Second-hand or used value cannot, without more, be determined with reference to current prices allegedly obtained from websites, particularly not if regard is had to the fact that the tools and equipment were initially acquired by Executive Helicopters between 1983 and 2007 and the evidence indicates that due to the differing nature of the tools and equipment, and their differing useful life, their respective market values would have depreciated differently over time.

[31] I have to agree with the Tax Court's finding that the methodology belatedly applied in order to place a value on the tools and equipment was not authenticated or corroborated. The evidence of the unidentified, unnamed, engineer who obtained prices of equipment that was only sourced internationally was not led. In addition, no evidence was led regarding the impact of inflation and the exchange rate on the calculation of the 2011 value of the items. As already stated, the evidence led does not support an inference that the respondent accepted the value of the tools and equipment as it relates to the preceding Executive Helicopter - Xcel transaction. In these circumstances, the appellant failed to prove on a balance of probabilities that the market value of the tools and equipment acquired by the appellant from Xcel equaled or surpassed R11 666 667.00.

[32] The appeal against the respondent's dismissal of the depreciation claim thus stands to be dismissed.

ii. Finance Charges

[33] The appellant avers that it incurred finance charges in the amount of R253716.00 that it claimed as a deduction from its income in respect of its 2011 year of assessment. The finance charges relate to interest paid to ABSA Bank (ABSA) in terms of a loan agreement that Xcel concluded with ABSA in 2008 to finance the purchase of an aircraft for which the appellant assumed liability in terms of the sale of business agreement concluded

between the appellant and Xcel. The respondent disallowed the aforesaid claim as the ABSA loan agreement was not signed by ABSA, and no proof of payment to either Xcel or ABSA was provided by the appellant.

[34] The appellant submitted that it has subsequently retrieved a letter from ABSA dated 14 August 2013 together with a statement of account reflecting interest paid and confirming that the aforesaid loan was repaid in full on 1 August 2013. The letter received from Absa dated 14 August 2013 relates to account number 77196230. The purported loan agreement, which agreement is not signed by ABSA, however, relates to account number [....].

[35] During the Tax Court proceedings Mr. Olmsted explained that the appellant did not make any payment to Xcel or ABSA in connection with the finance agreement concluded between Xcel and ABSA. He said that payments were made to ABSA by Xcel and the amounts were set off between Xcel and the appellant through journal entries.

[36] The respondent's auditor testified that the finance charges were disallowed since the amounts that were reflected in the financial statements were not reflected in the general ledger account. The amount was thus disallowed because it could not be traced to its source.

[37] Counsel for the appellant submitted that the only issue in respect of the appellant's claim for finance charges under s 11(a) of the ITA, is whether it was incurred. In accordance with s 29 of the Tax Administration Act 28 of 2011 (TAA), taxpayers must ensure that they have the necessary information or documentation on hand to support any debtor's allowance claimed. *In casu,* the taxpayer failed to prove the extent of finance charges incurred.

[38] In circumstances where the loan agreement provided by the appellant was not signed by both the parties to the agreement, and the loan account and alleged settlement letter contained different account numbers, the Tax

Court's view that the appellant did not discharge the burden of proof that it was entitled to a deduction in terms of s 11(a) of the Act cannot be faulted and the appeal on this issue stands to be dismissed.

iii. Understatement penalty

[39] The appellant submits that it did not make an understatement as defined in s 221 of the TAA, and therefore no understatement penalty is payable. In the alternative, the appellant avers that if there was an understatement, the appropriate percentage that should be applied is 50%.

[40] The respondent avers that the appellant's tax returns for the 2011 and 2012 years of assessment reflected a net loss which resulted in an assessed loss. As a result of the respondent's disallowance of the deductions, the appellant's assessed loss was reduced a d the difference for the two years of assessment, were, respectively R2 772 330.00 and R3 005 175.00. This difference was the result of understatement by the applicant in its 2011 and 2012 tax returns. The respondent determined that the understatement was due to the appellant's 'gross negligence, standard care' and imposed a 100% penalty in terms of the understatement penalty percentage table in s 223 of the TAA.

[41] In order to encourage tax compliance and deter non-tax-compliant behaviour, SARS is empowered to impose sanctions where non-tax compliance is established. The sanctions provided, include, amongst others, understatement penalties. Understatement penalties are regulated by sections 221 to 223 of the TAA. Section 222 of the Tax Administration Act1 ("the TAA") provides that in the event of an understatement by a taxpayer, the taxpayer must pay, in addition to tax payable, the understatement penalty unless understatement results from a bona fide inadvertent error. Section 223(1) contains a percentage table in respect of understatement penalties. Our courts have held that the imposition of a penalty is by definition

punishment although it may also be compensatory in effect. The levying of a penalty depends on the level of blameworthiness attributed to the conduct of the taxpayer.

[42] An 'understatement' triggering 'understatement penalty' is defined in section 221 of the TAA as any prejudice to SARS or the fiscus as a result of: a) failure to submit a return required by a tax Act or by the Commissioner; b) an omission from a return; c) an incorrect statement in a return; d) if no return is required, the failure to pay the correct amount of tax; ore) an impermissible avoidance arrangement.

[43] SARS levied the understatement penalties on the basis that the appellant provided incorrect declarations in the relevant tax returns. The incorrect declaration was the deduction of depreciation on the tools and equipment and the deduction of finance charges. SARS determined that the appellant's behaviour fell within the 'gross negligence' category based on the fact that expenses were claimed without supporting documentation.

[44] The Tax Court stated in this regard -

> 'The respondent imposed 100% on the basis of gross negligence ona standard case. In my view, the appellant's conduct of not correcting the statements made on the returns, despite being afforded an opportunity to do so, constitutes negligence. The respondent is found to have appropriately imposed the penalty.'

[45] If regard is had to the table contained in s 223 of the TAA, the legislature differentiated between, amongst others, 'no reasonable ground for tax position taken'; 'impermissible avoidance arrangement,' and 'gross negligence.' SARS argued that the court should consider the conclusion of the sale of business as an impermissible avoidance arrangement. This was, however, never the respondent's case, in fact the evidence presented by

SARS is clear that SARS deliberately steered away from investigating in terms of s BOA and from considering whether the business sale agreement constitutes an impermissible avoidance agreement.

[46] It is evident that by failing to provide SARS with the necessary documentary proof to substantiate its depreciation - and deduction of finance charge claims, the appellant's conduct fell short of the standard of a reasonable man, and it was negligent. The next question is whether this conduct can be classified as grossly negligent and involved a conscious risk-taking or a total failure to take care.

[47] Gross negligence was defined by Scott JA, in *MV Stella Tingas: Transnet Limited t/a Portnet v Owners of the MV Stella Tingas and Another 24* as follows:[4]

> 'It follows I think, that to qualify as gross negligence the conduct in question, although falling short of dolus eventualis must involve a departure from the standard of the reasonable person to such an extent that it may be categorized as extreme; it must demonstrate where there is found to be a conscious risk taking, a complete obtuseness of mind, or, where there is no conscious risk taking, a total failure to take care. If something less were required, the distinction between ordinary and gross negligence would lose its validity.'

[48] It is trite that to classify conduct as grossly negligent is to classify it on a scale of blameworthiness. After having proved the conduct in question, SARS must classify it for the purposes of Chapter 16 of the TAA, selecting the appropriate description of the behaviour from the options provided in s 223 of the TAA.

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[4] 2003 (2) SA 473 (SCA) at par [7].

[49] Negligence can resort under both the categories' no reasonable grounds for tax position taken', and 'gross negligence'. The Tax Court did not explain why it regarded the appellant's behaviour as gross negligence. Negligence does not summarily equate to 'gross negligence'. *In casu,* the appellant was not in possession of any documentation regarding the depreciation claim that it deliberately withheld or failed to produce. The appellant's case was that it acquired the tools and equipment as a package deal and did not have documentation pertaining to each of the listed items. SARS contended however that despite it adjusting the understatement penalty after the objection was raised, there was no 'change in behaviour.'

[50] In considering whether the appellant's conduct stands to be classified as 'grossly negligent' or 'no reasonable grounds for tax position taken', I have to consider that the respondent's reason for disallowing the depreciation claim was stated from the onset. The respondent's position was that the acquisition of the tools and equipment, and the value attributed to it, remained entangled in an unresolved controversy. The appellant, however, denied that the tools and equipment form part of the unresolved query that relates to the transaction between Xcel and Executive Helicopters. Mr. Olmstedt, when testifying, however confirmed that the tools and equipment were acquired by Xcel from Executive Helicopters. This still leaves the question whether the appellant was grossly negligent in promoting the view that the book value of the tools and equipment in Xcel's hands equates the market value thereof. Mr. Olmsted's evidence actually substantiated the notion that the book value of an asset does not equate to the asset's market value. His recorded evidence relating to the money received from the insurance company reads as follows:

> 'We bought it for R4.8 and the market value ... being the book value plus finance, and ... BUT the market value was actually R 12 364 000.'

[51] In these circumstances, where the appellant and Xcel are connected entities, and the appellant persistently failed to substantiate the

market value of the tools and equipment and to provide the necessary proof underpinning the claim regarding the finance charges, it cannot be said that SARS misdirected itself in holding that the appellant was grossly negligent in persisting in its position. The Tax Court was correct not to interfere with the understatement penalty.

ORDER

In the result, the following order is granted:

1. **The appeal against the judgment and order of the Tax Court dated 14 May 2021 regarding the confirmation of the 2011 and 2012 tax assessments, and the imposition of a 100% understatement penalty is dismissed;**

2. **The appellant is to pay the costs of the appeal.**

E van der Schyff
Judge of the High Court

I agree

M Mbongwe
Judge of the High Court

I agree

M Leso
Acting Judge of the High Court

Delivered: This judgement is handed down electronically by uploading it to the electronic file of this matter on Caselines. As a courtesy gesture, it will be sent to

the parties/their legal representatives by email.

For the appellant:	Adv. J Truter
Instructed by:	Couzyn, Hertzog & Horak
For the respondent:	Adv. M Tijana
Instructed by:	The State Attorney
Date of the hearing:	2 November 2022
Date of judgment:	17 February 2023