Republic of South Africa

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT THE WESTERN CAPE DIVISION: CAPE TOWN)

Case No: IT 45842

F TAXPAYER Applicant

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE Respondent

Court: Justice J I Cloete
Heard: 27 January 2022
Delivered electronically: 25 February 2022

JUDGMENT

CLOETE J:

Introduction

[1] This matter involves two interrelated applications. The first is that of the applicant ("taxpayer") for a final order against the respondent ("SARS") due to the latter's failure to deliver its rule 31 statement timeously. The second is SARS' counter-application for condonation and the determination of a further period for delivery of that statement. Both applications are opposed.

[2] Where reference is made in this judgment to a "rule(s)" it is to those promulgated under s 103 of the Tax Administration Act ("TAA"),[1] and I will also refer only to those portions of any particular rule that are relevant for present purposes. To this it must be added that *'day'* means a *'business day'* in terms of rule 1 as read with s 1 of the TAA.

[3] The first issue to be determined is whether SARS' delay is so egregious that it should not be countenanced. The second is whether the taxpayer is entitled to the substantive relief which it seeks, namely the upholding of its appeal in relation to its 2016 to 2018 years of assessment.

Delay and condonation

[4] Following an audit conducted by SARS additional assessments were raised on 17 March 2020 in respect of the taxpayer's 2016 to 2018 years of assessment.

[5] In terms of rule 6 a taxpayer aggrieved by an assessment may, prior to the lodging of an objection, request SARS to provide reasons, which request must be delivered within 30 days from date thereof. The taxpayer duly requested reasons within the 30 day period on 2 April 2020.

[6] SARS was required to provide its reasons within 45 days of delivery of the request in accordance with rule 6(5), i.e. by 10 June 2020,[2] but failed to do so. In terms of rule 6(6) this initial 45 day period may be extended by SARS if its

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1 Act 28 of 2011.
2 The taxpayer's reference to 24 June 2020 at para 10 of the founding affidavit is a patent error.

official(s) is satisfied that more time is required to provide reasons due to *'exceptional circumstances, the complexity of the matter or the principle or the amount involved'.*

[7] However rule 6(7) stipulates that (a) the notice of such an extension must be delivered to the taxpayer prior to expiry of the initial 45 day period (and this is thus a peremptory requirement), and (b) the extension may not exceed a further 45 days. SARS only notified the taxpayer of the extension it required on 3 July 2020, some 16 days after expiry of the initial 45 day period. It finally delivered its reasons on the very last day of the extension which it unilaterally imposed, on 7 September 2020. This was despite the fact that it had raised the additional assessments as a result of its own audit almost 6 months earlier.

[8] Upon receipt of the reasons the taxpayer delivered its notice of objection within 30 days thereafter (on 20 October 2020) in accordance with rule 7(1)(a). In turn rule 9(1)(a) requires SARS to deliver a decision on an objection within 60 days which, in the context of this matter, was by 12 February 2021. Again SARS failed to meet this deadline, and it was only after the taxpayer put it to terms by delivery of a rule 56(1)(a) notice[3] that SARS transmitted its decision, which was a partial disallowance of the objection, on 22 February 2021.

[3] Rule 56(1)(a) stipulates that if a party has failed to comply with a period or obligation prescribed under the rules, the other may deliver a notice informing the defaulting party of the intention to apply to the tax court for a final order under s 129(2) of the TAA in the event that the defaulting party fails to remedy the default within 15 days of delivery of the notice.

[9] The taxpayer's notice(s) of appeal had to be delivered within 30 days thereafter in accordance with rule 10(1)(a), i.e. by 6 April 2021. The notice(s) of appeal was delivered on 31 March 2021.

[10] SARS was required to deliver its rule 31 statement within 45 days thereafter in terms of rule 31(1)(d), i.e. by 7 June 2021. Annexures "AA1" and "AA2" to the taxpayer's answering affidavit in the SARS condonation application confirm that SARS was also notified on 31 March 2021 that alternative dispute resolution had not been selected by the taxpayer.

[11] The rule 31 statement was not delivered within the prescribed time limit. One day after it expired and on 8 June 2021, SARS notified the taxpayer that the appeal in respect of the years of assessment 2016 to 2018 had been referred to the Tax Court Litigation Unit (Ms Mukwevho) for litigation in the Tax Court.[4] No request was made therein for condonation for the late filing of the rule 31 statement, and, as had been the case previously, nor was any explanation given for the delay.

[12] On 11 June 2021 the taxpayer delivered its rule 56(1)(a) notice putting SARS to terms to remedy its default within the prescribed 15-day period, failing which it intended to apply for a final order under s 129(2) of the TAA. However the notice only refers to the taxpayer's notice of appeal submitted in respect of its 2018 year of assessment.[5] Be that as it may, the parties have approached the matter as if the condonation sought and the substantive relief which the taxpayer seeks apply to all three years, since the issues are identical.

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4 Annexure "PVM1" to the taxpayer's founding affidavit.
5 Annexure "PVM2.2" to the taxpayer's founding affidavit.

[13] On 17 June 2021 Mukwevho by letter advised the taxpayer that only the 2018 appeal had been allocated to her. She acknowledged that the time period to deliver the rule 31 statement lapsed prior to the matter being allocated to her, and stated *'…due to backlog as a result of Covid-19, lack of capacity and no filling of vacancies across SARS, therefore we failed to deliver the rule 31 statement timeously'.* She went on to state:

> *'7. I have unfortunately, not completed all reviews and investigations on the appeal in order to enable a decision thereon. The matter has further not been presented and adjudicated at the required internal governance structures and it will not be possible to have these processes finalised in time, precisely 10 days from today.*
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> *8. It has now become evident that I will not be able to finalise the Rule 31 statement within the requisite period as per the notice in terms of Rule 56(1)(a), dated 10 June 2021.*
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> *9. You are therefore requested to indicate whether the appellant would be amenable to providing us with an extension of the time period within which to file the Rule 31 statement. The extension requested is until Friday 20 August 2021.'*

[14] On 21 June 2021 the taxpayer advised it was willing to grant an extension of one month, which Mukwevho erroneously interpreted to be 30 July 2021. The taxpayer yet again tried to accommodate SARS by agreeing to an extension until 30 July 2021 provided that the rule 31 statement covering all three tax years would be provided on that day.[6] However the rule 31 statement was not delivered

[6] Annexure "PVM4.1" to the taxpayer's founding affidavit read with annexure "TMS 3" to SARS' answering affidavit.

by 30 July 2021, which was a Friday. At 17:25 that day (thus after business hours) SARS notified the taxpayer that the matter had been re-allocated to another official (Mr Sehloho) in the same unit. Sehloho (incorrectly) recorded that the extension previously granted expired on 31 July 2021. The taxpayer was also advised that SARS had *'recently briefed counsel in this matter to assist us with finalising our Rule 31 Statement. We therefore request a further indulgence of 21 business days to file…'*[7] which expired on 31 August 2021.

[15] On Monday 2 August 2021, i.e. on the first business day following 30 July 2021, the taxpayer, which had finally had enough, refused the request and informed SARS that it would have to bring an application for condonation in terms of rule 52(6). The taxpayer's representative placed on record *inter alia* that no proper reasons for the further delay had been provided (nor for any of the prior delays). The taxpayer then launched its application for a final order on 10 August 2021. SARS ultimately only served its rule 31 statement on 21 September 2021, which was 36 days after the agreed extended deadline (i.e. 30 July 2021) and 15 days after the expiration of the deadline which it itself had thereafter requested (i.e. 31 August 2021).

[16] The notification to the taxpayer that SARS had *'recently briefed counsel'* was untrue. From the SARS affidavit filed in opposition to the taxpayer's application and in support of its own application for condonation the following is evident. Mukwevho requested that the appeals for the 2016 and 2017 years be assigned to her on 21 June 2021. She *'proceeded to assess the merits of the matter and*

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7 Annexure "PVM5" to the taxpayer's founding affidavit.

due to its complexity and the novel issue raised, she requested her manager to assign the matter to another experienced personnel in the Tax Court Litigation Unit.'. However in the following paragraph of the affidavit a different reason was given for the handover to Sehloho:

> *'40. Given the limited time within which Mrs Mukwevho had to assess the merits of all… 3 (three) appeals for years of assessment in dispute (2016, 2017 and 2018), on the 24th June 2021, she requested that the appeals be reallocated to a more experienced colleague.'* (my emphasis)

[17] The matter was then assigned to Sehloho on 28 June 2021. What happened thereafter, according to Sehloho, was the following:

> *'43. On assessing the merits of the matter I also identified the novel issues raised and began the search for suitable counsel to be briefed in line with both the policies of the SARS and State Attorney and began to draft the memorandum to brief counsel to be approved by our Chief Litigation Officer.*
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> *44. The memo to brief was approved on the 22nd July 2021 by the Chief Litigation Officer and then an instruction was prepared and sent to the office of the State Attorney on 26 July 2021 to appoint the suitable counsel identified in the memo to brief, in line with their policy of procurement of legal services…*
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> *45. On the 30th July 2021, I contacted Dr Marais and informed him that we have appointed counsel to assist us with finalising our Rule 31 Statement. I requested a further indulgence of 21 business days…*
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> *46. The undertaking [sic] was based on the belief that counsel would be speedily appointed by the State Attorney…'* (my emphasis)

[18] Accordingly, on SARS' own version, all that had happened by 30 July 2021 was that Sehloho had instructed the State Attorney to appoint suitable counsel, and not that counsel had recently been briefed to finalised the rule 31 statement, which is what he had conveyed to the taxpayer.

[19] As it turned out, due to internal requirements at the State Attorney, counsel was in fact only briefed and given instructions on 12 August 2021.[8] Six days later, on 18 August 2021, the state attorney was instructed to address a letter to the taxpayer requesting yet a further indulgence to file the rule 31 statement by no later than 31 August 2021.

[20] The taxpayer's representative responded on the same date. For present purposes what is relevant is that SARS was given until 7 September 2021 to launch its condonation application. The latter application was then delivered on the final day, i.e. 7 September 2021.

[21] To sum up, SARS has displayed a persistent disregard for the time limits prescribed in the rules. Of particular significance is its failure to seek the extension it required to provide reasons to the taxpayer before the period for furnishing reasons expired; its failure to request an extension to file its rule 31 statement before the prescribed time limit expired; its failure to provide any explanation whatsoever to the taxpayer for these delays; and its woefully inadequate, generalised explanation furnished 10 days later that the matter had only been allocated to Mukwehvo after expiry of the prescribed time limit for the

[8] Para 56 of the SARS' affidavit.

filing of the rule 31 statement *'due to backlog as a result of Covid-19, lack of capacity and no filling of vacancies across SARS'.*

[22] Also significant is SARS' misleading of the taxpayer that Mukwehvo had been allocated the appeal for all three additional assessments when according to her she had only been allocated one of them; its misrepresentation to the taxpayer of the date of the extension to which the latter had agreed; and its misrepresentations to the taxpayer of the reason why the appeal had been re-allocated to Sehloho and that counsel had *'recently'* been briefed.

[23] Further, and although SARS sought to submit otherwise, it cannot reasonably be gainsaid that much, if not all, of the information required to prepare the rule 31 statement should have been available to SARS long before expiry of the period in which it was obliged to file that statement. First, the additional assessments had been raised in March 2020 as a result of SARS' own audit. Second, SARS provided reasons for the additional assessments after having specifically required an extension for this purpose, which could only have been because of *'exceptional circumstances, the complexity of the matter or the principle or the amount involved'*. Third, SARS partially disallowed the taxpayer's objection. Presumably therefore at each of these stages the SARS official(s) concerned would, or should, have properly applied their minds to all of the information, along with their knowledge and understanding of the relevant statutory provisions.

[24] During argument counsel for SARS appeared to suggest that the officials concerned were duty bound to consider the matter afresh at each stage, but there is nothing in its papers to support this assertion, and it was certainly not

conveyed to the unwitting taxpayer. Indeed, as submitted by counsel for the taxpayer, no explanation was given by SARS in its papers why the considerations that applied in February 2021 (when the objection(s) was partially disallowed) did not apply later. But in any event, even if that is the case, counsel who SARS briefed to draft the rule 31 statement is not a SARS official fulfilling an administrative function, and he was only briefed on 12 August 2021, over two months after SARS notified the taxpayer that the appeal(s) had been referred to its litigation unit.

[25] I was urged by counsel for SARS to ignore the delays prior to 30 July 2021 on the basis that these were not in issue for purposes of determination of the condonation application. However to my mind this would be adopting a blinkered approach because, as submitted by counsel for the taxpayer, the most recent series of delays were simply the perpetuation of a pattern of disregard for the rules and what is required of administrative functionaries such as the SARS officials in the present matter.

[26] It is settled law that the standard to be applied in determining an application for condonation is the interests of justice. This is wide and elastic concept and includes a consideration of:

> *'…the nature of the relief sought; the extent and cause of the delay; the effect of the delay on the administration of justice and other litigants; the reasonableness of the explanation for the delay; the importance of the issue to be raised…; and the prospects of success. It is crucial to reiterate that both* Brummer *and* Van Wyk *emphasise that the ultimate determination of what is in the interests of justice must reflect due regard to all the relevant factors but it is not necessarily*

limited to those mentioned above. The particular circumstances of each case will determine which of these factors are relevant."[9]

[27] Section 195 of the Constitution deals with basic values and principles governing public administration and reads in relevant part as follows:

'195(1) Public administration must be governed by the democratic values and principles enshrined in the Constitution, including the following principles:

(a) A high standard of professional ethics must be promoted and maintained.

(b) Efficient, economic and effective use of resources must be promoted…

(d) Services must be provided impartially, fairly, equitably and without bias…

(f) Public administration must be accountable.

(g) Transparency must be fostered by providing the public with timely, accessible and accurate information…'

[28] In terms of s 195(2) thereof these principles apply *inter alia* to administration in every sphere of government as well as organs of State. One of the purposes of the TAA is to ensure the effective and efficient collection of tax by prescribing the powers and duties of persons engaged in the administration of a tax Act[10] such as the TAA.

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[9] *Grootboom v National Prosecuting Authority* 2014 (2) SA 68 (CC) at para [22], referring to *Brummer v Gorfil Brothers Investments (Pty) Ltd and Others* 2000 (2) SA 837 (CC) at para [3] and *Van Wyk v Unitas Hospital and Another (Open Democratic Advice Centre as Amicus Curiae)* 2008 (2) SA 472 (CC) at para [20].

[10] Section 2(c) of the TAA.

[29] In *Buffalo City Metropolitan Municipality v Asla Construction (Pty) Ltd*[11] the Constitutional Court, albeit in the context of considering delay in a legality self-review, held that if the delay is unreasonable and no satisfactory explanation has been provided, it is necessary to consider whether the delay should be overlooked, which is a flexible approach.[12] One of the factors to be taken into account is the conduct of the applicant concerned, particularly for State litigants (which would be SARS in the present case) because they are often best placed to explain the delay and are subject to a higher duty to respect the law.[13]

[30] I am not aware of any authority which would militate against applying the same principles to SARS in the instant matter, particularly since s 33 of the Constitution entrenches the right of everyone to administrative action that is lawful, reasonable and procedurally fair. This leads me to the issue of prejudice to the taxpayer.

[31] It is undisputed that the nature of the taxpayer's business is such that it is crucial to its operations to be reflected on the SARS' e-filing system as tax compliant. The additional assessments raised total some R8.4 million, which is a substantial amount. On 11 June 2020 (i.e. the day after expiry of the initial period in which SARS was required to provide reasons but failed to do so) the taxpayer submitted a request to SARS in terms of s 164(2) of the TAA for suspension of payment.

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[11] 2019 (4) SA 331 (CC).
[12] *Buffalo City* at paras [53] to [54].
[13] Referring to *Merafong City Local Municipality v Anglogold Ashanti Ltd* 2017 (2) SA 211 (CC) at para [61].

[32] Section 164(6) stipulates *inter alia* that during the period commencing on the day that SARS receives a request for suspension under s 164(2) until 10 business days after notice of SARS' decision, or revocation of suspension, has been issued, no recovery proceedings may be taken by SARS unless it holds a reasonable belief that there is a risk of dissipation of assets by the taxpayer concerned.

[33] There is no suggestion in its papers that any SARS official held such a belief, yet SARS nonetheless proceeded with collection steps and issued the taxpayer with a final demand for payment on 18 June 2020. After its error was pointed out by the taxpayer, SARS eventually formally approved the payment suspension request on 3 September 2020. Accordingly, from that date onwards, SARS was obliged to reflect the taxpayer's status as compliant on the e-filing platform, which may be viewed by any person who requests the taxpayer's permission to do so. This notwithstanding, SARS nonetheless insisted that the taxpayer first pay the disputed (yet suspended) tax debt before it would reflect it as compliant in relation to its tax affairs.

[34] Accordingly on 26 January 2021 the taxpayer notified SARS in terms of s 11(4) of the TAA that it would be approaching the High Court for an order compelling SARS to reflect its status as tax compliant. SARS finally corrected the status to "tax compliant" on 29 January 2021.

[35] However following the partial disallowance of the objection(s) on 22 February 2021, SARS informed the taxpayer that the payment suspension had been revoked, purportedly on the basis that the dispute had been *'resolved'*.

[36] Section 164(4) of the TAA expressly provides that a payment suspension is only revoked with immediate effect where (a) no objection is lodged; (b) an objection is disallowed and no appeal is lodged; or (c) an appeal to the tax board or court is unsuccessful and no further appeal is noted. Given that SARS had partially disallowed the objection(s) on 22 February 2021, the period in which the taxpayer had to file its notice(s) of appeal had not even expired, and accordingly SARS was not permitted to rely on s 164(4)(b) of the TAA.

[37] It was only once the hapless taxpayer pointed out that the dispute was far from resolved that on 29 March 2021 (about a month later) SARS confirmed that suspension of payment had been reinstated. However it failed to consequentially revert the taxpayer's status to compliant and by 10 August 2021, when the taxpayer launched the present application for final relief, this was still the case. Although SARS subsequently rectified this, it yet again altered the taxpayer's status to non-compliant, without any notice to the taxpayer, on 14 September 2021.

[38] The taxpayer set out the respects in which SARS' conduct in relation to its tax compliance status had caused it severe prejudice. From a regulatory perspective the taxpayer is required to be registered with certain regulatory bodies in order to

be able to obtain specific export permits whereby it may export its products for sale abroad. A tax compliance status confirmation is a prerequisite, and a fresh application following a cancellation can take up to 18 months to process. In early 2021 the taxpayer was informed that it would immediately forfeit one such registration because of SARS' reflecting its status as non-compliant, and this is why, it would seem, the taxpayer had to notify SARS of its intention to approach court.

[39] In addition the taxpayer has credit facilities with two major banking institutions, both of which require proof of consistent tax compliance for credit purposes; and in order for the taxpayer to qualify for funding from the Department of Trade and Industry to attend international trade exhibitions, it must be able to produce proof that its status is tax compliant.

[40] The taxpayer thus asserted that while its dispute with SARS is still pending there is an ongoing risk of its status being unlawfully indicated as non-compliant. This renders finalisation of the dispute urgent, and the time and costs incurred in having to force SARS to comply with its statutory obligations has also caused prejudice to it. If it is unable to continue with its operations some 50 employees will lose their jobs.

[41] The taxpayer is also unable to arrange some of its financial affairs with any reasonable degree of predictability, since it remains unclear whether or not its dispute with SARS will be resolved in its favour. The crux of the dispute pertains to the income tax treatment of various aspects of an insurance product taken out

by it. The taxpayer is aware that this specific product is also the subject of other tax disputes in which SARS is involved. For so long as the present dispute remains pending the taxpayer has no clarity as to how it should treat the product for income tax purposes, which has caused it to delay submitting any insurance claims for the time being.

[42] None of these allegations were challenged by SARS in any meaningful way. All that Sehloho stated was that since he has no knowledge thereof, they are denied. The highwater mark of SARS' attempt to address the taxpayer's evidence on this score was the allegation that *'…in an effort to minimise the applicant's prejudice and incurring further unnecessary costs* [the tax litigation unit] *did offer the wasted costs occasioned by this application'.*[14]

[43] It may be so that Sehloho himself had no personal knowledge of the manner in which SARS had treated the taxpayer's compliance status, but there must have been other officials who could have placed evidence before the court, particularly given that it is SARS which seeks an indulgence. The reasons why the official(s) concerned simply disregarded the taxpayer's right to fair administrative action needed to be explained, and justified, if the court was to take this into account as one of the relevant factors weighing in favour of SARS.

[44] Moreover SARS had two opportunities to take the court into its confidence. The first was when its answering affidavit coupled with its condonation application was filed. The second was in response to the taxpayer's answering affidavit in the counter-application when the taxpayer explained that, as recently as

[14] SARS' answering affidavit para 104.

15 September 2021, its deponent was informed that SARS had once again unilaterally altered its tax status to non-compliant. SARS did not even address this allegation in its replying affidavit and it thus also stands uncontested.

[45] Under the rubric of *'bona fide defence'* Sehloho dealt with the merits of SARS' case. Thereafter he submitted that the appeal itself raises novel issues that have not yet been tested by the courts. In the context of setting out reasons why condonation should be granted, he submitted that the delay was not unreasonable, but even if it was, on the taxpayer's own version the matter raises *'highly technical'* issues involving the deductibility of insurance premiums.

[46] He contended that condonation should thus be granted having regard to the *'public importance'* of the matter; to ensure that *'the rule of law'* is upheld; and that *'all the issues… are placed before the court and are properly ventilated based on the correct legal principles, thus the interests of justice served'.*

[47] Whatever gloss SARS seeks to put on it, the facts set out above demonstrate, in my view, that the delay was egregious; there has been no reasonable explanation for the delay; and the consequent prejudice to the taxpayer (which prejudice SARS admits, since it sought to ameliorate it) is severe.

[48] Put simply, the evidence shows that in the present case SARS has failed dismally to fulfil its obligations, both under s 195 of the Constitution as well as the TAA and its rules. It has displayed an egregious lack of regard for the taxpayer's constitutionally entrenched right to fair administrative action and, cut to its bare

bones, has been reduced to relying on what it considers to be a novel issue of public importance to persuade this court to grant condonation.

[49] One must then ask oneself why, if the issues are of such public importance, SARS itself delayed in the manner it did. Even assuming in SARS' favour (despite the absence of evidence to this effect) that at each stage the official(s) concerned was required to apply his or her mind afresh, the following remarks of the Constitutional Court (albeit in the context of a self-review) are apposite:

> *'…The City contended that knowledge by the BEC of Aurecon's involvement in the pre-feasibility study could not be imputed to the BAC and subsequently to the City… The distinction that the City attempts to draw between what was within its own knowledge and what is within the knowledge of its committees is superficial. It is common cause that the BEC and the BAC are committees mandated by the City for purposes of the tender-procurement process. These committees form part of an internal arrangement by the City. Accordingly it may reasonably be expected that all information regarding the tender process which is within the knowledge of the BAC or BEC may be deemed to be within the City's knowledge. In my view that is a weak attempt by the City to deny knowledge of what it ought reasonably to have known.'*[15]

Prospects of success

[50] In considering this factor there is an overlap between the condonation sought by SARS and the taxpayer's application for final relief. The parties were thus given the opportunity to address the court on the merits as well.

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[15] *Cape Town City v Aurecon SA (Pty) Ltd* 2017 (4) SA 223 (CC) at paras [38] to [39].

[51] In the minute of a pre-trial conference held on 10 January 2022, the parties agreed that:

> *'3.1 The sole issue to be determined is whether payment of the insurance premiums to the insurance houses qualified as an "expense" as contemplated in IFRS for SME'S.'*

[52] SARS refused a deduction of insurance premiums paid by the taxpayer to RMB Structured Insurance Limited ("RMB"). It is apparent that the refusal was based on the application of s 23L(2) of the Income Tax Act ("ITA")[16] which was introduced with effect from 1 April 2014.[17]

[53] Section 23L(2) provides as follows:

> *'**23L. Limitation of deductions in respect of certain short-term insurance policies.***
>
> *(2) 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…'* [18]

[54] SARS set out its defence to the final relief sought by the taxpayer as follows:

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[16] Act 58 of 1962.
[17] By s 60(1)(d) of the Taxation Laws Amendment Act 31 of 2013.
[18] IFRS means International Financial Reporting Standards.

'75. …section 23L [was introduced] *to curb avoidance in the case of disguised investments in the wrapper of short-term insurance policies. More specifically, section 23L targets short-term insurance policies where the insurer fails to accept significant risk from the policyholder. This type of policy is viewed as an investment policy, meaning that the policyholder may not deduct premium payments in respect of the policy.*

76. [The taxpayer] *bought short-term insurance from* [X] *in the 2016 year of assessment for R6.15 million and increased the contract with additional R13.5 million in the 2018 year of assessment.* [The taxpayer] *owned a* [X] *policy with an experience cash value of R19.9 million as at 31 August 2018 with a policy indemnity limit of R23.9 million. The insured value covered by* [X] *is R3.98 million. The total risk identified by* [the taxpayer] *is R106 million.* [The taxpayer] *bought short-term insurance for R3.98 million which is 3.76% of the identified risk, with the condition that the first loss incurred up to R19.9 million will be for* [the taxpayer]. *The remaining loss over the policy indemnity limit of R82 million will be for* [the taxpayer's] *account. It can be concluded that the risk of 3.76% transfer to* [X] *is not significant as* [X] *did not accept the first loss from* [the taxpayer]. *The premiums must be linked with the risks, in that it must be consideration for the risks undertaken by the insurer which is not the case with* [the taxpayer].

77. For accounting purposes, no official standard exists regarding the treatment of insurance policies in the hands of policyholders. However, it is generally accepted that a policyholder must treat the premiums paid in respect of a policy as an asset (as opposed to an expense) only if the insurance contract is more properly viewed as an investment…'

[55] According to the taxpayer, RMB administers the policy through a so-called "experience account," with the balance accumulated at any given time being utilised to pay claims up to the maximum of the policy indemnity limit. In the event that the claim exceeds the balance of the experience account, the maximum claim is restricted to the policy indemnity limit.

[56] The parties were previously in agreement that IFRS 4 does not apply, since it only addresses the accounting treatment of insurance contracts in the hands of policy issuers/administrators and not policy owners/holders. In other words, in the present case IFRS 4 applies to how RMB (and not the taxpayer) accounts for the payments made by the taxpayer in terms of the insurance contract.

[57] The parties are in agreement that there is no specific IFRS standard dealing with the accounting treatment of insurance contracts from the perspective of the policy holder. The taxpayer thus obtained the expert opinion of accounting specialists on the application of IFRS. They advised that in circumstances where there is no specific standard that applies to a particular transaction, the International Accounting Standards Board has developed the Conceptual Framework for Financial Reporting ("CFFR") to assist preparers of financial statements to develop consistent accounting policies.

[58] The CFFR defines "expenses" as '*decreases in assets'* or *'increases in liabilities'* which result in a *'decrease in equity'* other than those relating to distributions to holders of equity claims.[19] The question is therefore whether the payment of the premium to RMB by the taxpayer constitutes an "asset" and, if not, whether such payment results in a decrease of the taxpayer's equity.

[19] CFFR at 4.69.

[59] The CFFR defines an asset as a *present economic resource* which is *controlled* by an entity as a result of past events.[20] Accordingly, so the taxpayer submits, to determine whether the premiums and the obligation to pay thereunder constitute an asset, two questions must be asked: first, whether there is an *economic resource* and second, whether the taxpayer *controls* the economic resource.

[60] In terms of the CFFR, an economic resource is a right that has the *potential* to produce economic benefits.[21] Under the policies, RMB would either have to settle claims from the experience account (if any) or if no claim was submitted, pay out the sums held by it to the taxpayer at the end of the policy period. Consequently, the argument goes, the taxpayer may receive either the remaining balance on the experience account or the insured amount if a risk materialises. Under these circumstances, so the taxpayer submits, it appears that an economic resource can be said to exist in the form of the potential remaining balance on the experience account or the insured amount if a risk materialises.

[61] However, the taxpayer argues that it is clear that it does not *control* the economic resource. In terms of the CFFR, an entity controls an economic resource if it has the *present ability to direct the use of the economic resource* and obtain the economic benefits that may flow from it.[22] This control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. Under the policies it is RMB and not the taxpayer which directs the use of the insurance premiums for

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[20] CFFR at 4.3
[21] CFFR at 4.4.
[22] CFFR at 4.20.

the duration of the policy. Put differently, the taxpayer has no access to the funds accumulated and no control over the credit risk. Accordingly, the taxpayer contends, payment of the insurance premium by it results in a decrease in its asset base and thus constitutes an expense.

[62] Against this, and despite SARS having previously agreed that IFRS 4 does not apply, in both its affidavit (as set out above) as well as its heads of argument, reliance was placed squarely on IFRS 4. This much is evident in particular from paragraph 76 of the SARS affidavit as well as the following extract from its heads of argument.

> *'80. Appendix B of IFRS 4 states as follows:*
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> > *"The definition of an insurance contract refers to insurance risk, which this IFRS defines as risk, other than financial risk, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract."*
>
> *81. It can be concluded that the risk of transfer to* [X] *is not significant as* [X] *did not accept the first losses from* [the taxpayer]*. The premiums must be linked with the risk, in that it must be consideration for the risks undertaken by the insurer which is not the case…*
>
> *82. In essence, a contract will not be classified as an insurance contract under IFRS unless the insurer accepts a significant risk to the insurer in the event of the happening of the event that is insured…'*

[63] Moreover during argument counsel for SARS confirmed that in its view IFRS 4 does not apply, but that the dispute centres around *'what then does apply'*. Put

plainly therefore the defence which SARS raised in its papers is contradicted by, and is at odds with, its own argument. In these circumstances the only reasonable inference to be drawn is that, on its own version, SARS lacks prospects of success on the merits on its defence as currently formulated.

[64] For sake of completeness it must be added that a dispute arose during argument as to whether or not the case made out by SARS in its rule 31 statement differs in certain respects from the stance it has taken thus far. Since the statement was not part of the papers it was handed in by agreement so that the court could consider this as well if need be. However, given the view that I have taken, it is not necessary for me to have regard to the contents of that statement.

[65] To my mind the taxpayer's case has sufficient merit to enable me to grant it final relief. It is also supported by independent expert opinion. During the hearing the parties were in agreement that if the taxpayer is to succeed on the *'sole issue'* then its remaining grounds of appeal will logically have to succeed as well. In the result the taxpayer is entitled to the final order it seeks by default against SARS.

Costs

[66] Section 130(1) of the TAA provides that the tax court may, in dealing with an appeal and on application by an aggrieved party, grant an order for costs in its favour if *inter alia* the SARS' grounds of assessment or decision are held to be unreasonable. In its notice of motion the taxpayer sought costs against SARS on the party and party scale. No mention was made of a request for a punitive costs order in its papers either. It was only in heads of argument filed on its behalf that

costs were sought against SARS on the attorney and client scale. While in tax matters an award of costs is the exception rather than the norm, having regard to the facts in this matter, I am of the view that a costs award in favour of the taxpayer is warranted. However, given that the request for a punitive costs order came at the eleventh hour, it would not be appropriate to make such an order since SARS was not given the opportunity to deal with it in its papers.

[67] **The following order is made:**

1. **The respondent's counter-application for condonation is dismissed.**
2. **The applicant's appeals in relation to its 2016 to 2018 years of assessment are upheld; and**
3. **The respondent shall pay the applicant's costs in both the main and counter-applications on the scale as between party and party as taxed or agreed.**

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J I CLOETE

For applicant: Adv Pieter-Schalk **Bothma**
Instructed by: Dr Albertus, Mr/s A Marais (AJM Tax),
Marais Pacitti, Michelle Clift.
For respondent: Adv Nkateko **Tshabalala** (Sandton)
Instructed by: State Attorney, Pretoria, Mr Ronald Baloyi