REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT JOHANNESBURG)

CASE NO.: **IT 14305**

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

_________________ **24 August 2023**
SIGNATURE DATE

In the matter between:

FAST (PTY) LTD **APPELLANT**

and

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

J U D G M E N T

VALLY J

Introduction

[1] There are two interlocutory applications before court today. Both the respondent, the Commissioner of the South African Revenue Service (Commissioner) and the appellant, FAST (Pty) Ltd (FAST), sought to amend the respective statements they had filed in court. Neither party consented to the amendment sought by the other party, thus compelling each party to seek the court's approval for its intended amendment. The first application is brought by the Commissioner to amend his rule 31 (of the Tax Court Rules) statement that he filed in response to the appeal lodged against his assessment of FAST's tax liability for the 2011 year. The second is an application by FAST to amend its rule 32 statement of grounds of appeal in respect of the 2011 year of assessment. The two applications were heard separately, but on the same day. Broadly, the facts relating to the assessment and the appeal are the same. It is therefore prudent to issue one judgment.

THE APPLICATION BY THE COMMISSIONER TO AMEND HIS RULE 31 STATEMENT

Facts

[2] The Commissioner filed his rule 31 statement regarding the tax liability of FAST for the 2011 year on 24 July 2018. FAST filed its rule 32 statement of grounds of appeal on 28 September 2018. After attending to various procedural matters, the parties held a pre-trial meeting on 19 September 2022 where each indicated to the other that its statement would be amended.

[3] FAST is a wholly owned subsidiary of FAST Holdings (Pty) Ltd. FAST Holdings (Pty) Ltd is in turn a wholly owned subsidiary of FAST Nederland BV, which is a wholly owned subsidiary of FAST SE incorporated in Germany. Another wholly owned subsidiary of FAST SE is FAST Metals GmbH, more commonly referred to as FAST Zug. FAST Zug, though, is incorporated in Switzerland. The role of FAST Zug is central to this case.

[4] FAST's principal activity concerns manufacturing, selling and importing chemical products. It manufactures and sells catalysts which are used in the abatement of exhaust emissions from motor vehicles. The manufacturing process involves coating the catalysts. The coating is derived from certain XYZs. The XYZs are bought by FAST from FAST Zug. The XYZs are liquefied and mixed with other chemicals in order for them to be applied as coating to the substrate that form the catalysts. The catalysts are sold to South African customers referred to as original equipment manufacturers (OEMs).

[5] In January 2014 the Commissioner initiated an audit on FAST in relation to its 2009 – 2011 financial years. The audit focused specifically on transfer pricing. To that end it examined the relationship and transactional arrangement between FAST and FAST Zug in the context of definitions in section 1 of the Income Tax Act, No 58 of 1962 (IT Act): "a connected person"; "resident" and "non-resident". This led to the conclusion that both FAST and FAST Zug are each "a connected person", FAST is a "resident" and FAST Zug is a "non-resident".

The Commissioner's case

[6] In accounting for the transactions of purchasing XYZs from FAST Zug and selling the catalysts – after processing them with the XYZs – FAST includes the costs and selling price of XYZs in its own accounts. Further, it takes the risk on the XYZs and accounts for this risk. The XYZs constitute input into the manufacturing of the catalysts. The XYZs are regarded as inventory by FAST. It holds these and bears the risk of holding them as inventory. In assessing the nature of the transaction of purchase from FAST Zug the Commissioner examined the consideration received by FAST in the sale of the final product to the OEMs. He came to the conclusion that it was not an arms-length transaction, and accordingly adjusted the taxable income of FAST. The conclusion was conveyed to FAST in the assessment issued by the Commissioner.

[7] To arrive at his conclusion, the Commissioner decided that a benchmarking study was necessary to provide him with comparable data for the manufacturing and distribution of catalysts. To this end, he identified a set of independent companies to set a benchmark. He compared the full cost mark-up (FCMU) of these companies for the relevant years and measured their interquartile ranges. He compared these ranges with that of FAST and found that the interquartile range of FAST "fell below the range of the comparable set of companies for the same period". Essentially, the Commissioner applied the transactional net margin method (TNMM) of assessing the profit earned by FAST. This method compares the nett profit earned by a party (FAST in this case) of a controlled transaction with the nett profit earned in uncontrolled transactions. TNMM is based on a view that companies which are functionally similar and are operating in a similar market tend to make similar profits over time.

[8] FAST unsuccessfully objected to the assessment. It proceeded to lodge an appeal. The Commissioner obligingly responded to the notice of appeal by filing the necessary rule 31 statement. In the statement he said that he had provided FAST an opportunity to respond to his analysis. FAST had failed to take advantage of the opportunity and, in particular, it had failed to provide any persuasive evidence for the selection of "any particular point" (any particular company as a suitable or appropriate comparator) that would produce a different result to the one he arrived at. As such, his conclusion that the tested transaction was not an arms-length one had to stand. As a result, section 31 of the IT Act, which specifies that tax

payable in respect of international transactions is to be determined on the arm's length principle, was engaged.

[9] FAST filed its rule 32 statement wherein it identified what it maintains are the shortcomings of the approach adopted by the Commissioner. A contention made in the rule 32 statement is that the Commissioner failed to have regard to the extraordinary increases in the price of rare earth minerals when conducting its transfer pricing analysis. It went further and said that the Commissioner's choice of comparable companies was not appropriate – as they were distinguishable from itself – thus rendering his analysis valueless in determining whether the tested transaction was an arms-length one or not. Put differently, it contended that an appropriate benchmarking study is one that chooses comparator companies which utilise XYZs as well as other precious metals in the manufacturing process rather than only XYZs.

[10] During preparation for the appeal the Commissioner took particular note of the criticisms levelled at the approach he adopted in determining whether the tested transaction was an arms length one or not. This prompted him to engage the services of an economist specialising in the field of transfer pricing, Dr Emann, to scrutinise the approach adopted by himself (the Commissioner) – the TNMM with an FCMU. He also mandated Dr Emann to consider the approach suggested in the rule 32 statement of FAST.

[11] The introduction of Dr Emann was clearly designed to collect relevant admissible evidence with probative value for the appeal. Dr Emann collected data which he separated into three categories or "samples" (in his parlance) of comparative companies: companies across a broad range of industries that utilise precious metals as part of the inputs in the manufacturing process, companies that "specifically document" the use of precious metals in the manufacturing process, and finally companies that "specifically document" the use of XYZs in the manufacturing process. This approach, as mentioned, was inspired by the critique levelled at the Commissioner's approach by FAST. He presented his findings in a report which the Commissioner has filed and intends to use as evidence at the appeal hearing.

[12] The Commissioner intends to call Dr Emann to testify at the appeal as an expert witness and has issued the necessary rule 37 notice to this effect. His conclusion was that, even on the criteria or approach suggested by FAST, the tested transaction was not an arms-length one.

The amendment sought

[13] To ensure that Dr Emann's evidence is not prohibited at the hearing of the appeal the Commissioner seeks to amend his rule 31 statement. The rule 31 statement made no mention of an alternative basis to test the transaction. It only made reference to the TNMM approach adopted during the audit stage of the process. Since then the evidence of Dr Emann – elicited as a result of a claim in the rule 32 statement of FAST – has come to light. This evidence, the Commissioner says, has to be placed before the appeal court in order for justice to prevail. The Commissioner wishes to prevent a situation where the appeal court is required to rule on the admissibility of its evidence in circumstances where he had failed to foreshadow it in his rule 31 statement. In other words, the Commissioner desires to have the evidence linked to his rule 31 statement in order to prevent it being disallowed. To this end, the Commissioner wishes to amend his statement by introducing a second ground of assessment, which is "in the alternative" to the first ground, and which should only become relevant if the first ground is not upheld by this court. In other words, the primary ground for the assessment remains the conclusion reached by application of the TNMM method of assessing the particular transaction. The alternative ground merely relies on the study of Dr Emann to show that, even if the approach suggested by FAST is adopted, the tested transaction was not an arms-length one.

The opposition thereto

[14] FAST opposes the application for amendment on the basis that it constitutes a justification of the additional assessment on grounds that were absent when the assessment was made. It is an *ex-post facto* justification and requires the admission of evidence that was not before the Commissioner and was therefore not taken into account by the Commissioner at the time the assessment was made. The Commissioner cannot now on the basis of new evidence justify the assessment. His defence of this assessment must be limited to what evidence he considered when he made it, not what new evidence supports it. If he wishes to rely on the new evidence he should withdraw the additional assessment and replace it with a new one. In short, FAST's case is that by relying, albeit on an alternative basis, on a new comparator for testing the transaction the Commissioner introduces a wholly new factual ground for the assessment, which is prohibited by sub-rule 31(3) of the Tax Court rules.

The legal requirements

[15] At the time the Commissioner requested FAST's consent to amend its rule 31 statement, sub-rule 31(3) provided:

> "SARS may not include in the statement a ground that constitutes a novation of the whole of the factual or legal basis of the disputed assessment or which requires the issue of a revised assessment."

[16] On a plain reading it is clear that the sub-rule prohibits the Commissioner from relying on a new ground for the whole of the factual or legal basis of his assessment. He is allowed to rely on a new ground, however, as long as the new ground does not constitute a change of the whole of the factual or legal basis of his assessment. Should that occur he is obliged to withdraw the assessment and replace it with a new one. For it to constitute a new ground for the whole of the factual or legal basis of his assessment, the ground stated in the rule 31 statement must in substance be different from that in the assessment. On this understanding, augmenting the ground relied upon in the assessment with corroborative evidence in the rule 31 statement, albeit with some new facts, does not infringe the provisions of sub-rule 31(3).

Does the amendment sought fall foul of the provisions of sub-rule 31(3)?

[17] The question restructured is: has the Commissioner, by amending his rule 31 statement, novated the whole of the factual or legal basis that underlies his assessment? The answer, I hold, is no. Pre-amendment, the case of the Commissioner has been that the tested transaction is not an arms-length one. The case remains the same post-amendment. The evidence the Commissioner relied upon to make his assessment in the first place remains the evidence he intends to rely upon to make out his case at the appeal. His primary case is that the appropriate approach to adopt in determining whether the tested transaction was an arms-length one or not is the TNMM with a FCMU profit level indicator for comparative companies using XYZs as part of the manufacturing process. In addition, and in response to a contention of FAST, the Commissioner has produced facts that meet the contention. The facts are designed to meet the case FAST claims it will be making at the hearing. The Commissioner acted proactively by collecting the evidence necessary to see if FAST's claim is correct. The study he commissioned could well have concluded that the tested transaction is an arms-length one. In that case he would have been obliged to withdraw the assessment. The decision to commission the study was a prudent one. Its outcome was unknown. Once completed it became relevant evidence that carries probative value. The Commissioner, by asking for the amendment, is seeking no more than to be given an opportunity to meet the case FAST intends to bring. FAST makes much of the fact that the evidence of Dr Emann introduces facts that were not before the Commissioner at the time he made the assessment. His assessment was not based on those facts, and therefore it would be inappropriate to allow him to introduce new facts as they shift away from "the whole of the factual basis of the [initial] disputed assessment". This is not correct. The Commissioner, as pointed out, has not abandoned the basis of his assessment. It remains his primary case. The amendment does not detract from this. The Commissioner is not "replacing an old obligation with a new one",[1] he is not novating. He is not changing the facts of the tested transaction. He is simply introducing a different

1 *Income Tax Case No IT* 13950 [2017] ZATC 5 at [37].

comparator – companies that "specifically document" the use of precious metals in the manufacturing process – to test the transaction. In so doing, the Commissioner may be introducing new "facts" in that he is scrutinising the profits of companies that did not feature in his initial assessment, but that is not the same as changing the facts of the tested transaction. The facts of the tested transaction are the facts upon which he based his conclusion regarding its arms-length nature. He is not changing the facts as to how much FAST paid for the purchase of the XYZs from FAST Zug, or about how much profit FAST made. Those are fixed, both in his assessment and in his amended – as well as in his unamended – rule 31 statement. The amended rule 31 statement does not alter the assessment.

[18] Furthermore, for the prohibition set out in sub-rule 31(3) to be applicable there must be "a novation of the whole factual or legal basis of the assessment". Here he is not "novating the whole" of the facts of his assessment.

[19] In these circumstances, the application to amend the rule 31 statement should be allowed.

THE APPLICATION BY FAST FOR LEAVE TO AMEND ITS RULE 32 STATEMENT

[20] In the same vein as the Commissioner, FAST applies to amend its rule 32 statement. The amendment it seeks can be grouped into three categories, (i) the price paid by FAST to FAST Zug for XYZs was agreed to by the OEMs, (ii) the Commissioner made calculation errors when calculating the FCMU of FAST's catalyst division and (iii) FAST was compensated for the risk it took in holding XYZs. There are in total 7 amendments that FAST wishes to make. Amendments 1, 2, 4, 5 and 7 fall into category (i), amendment 3 falls into category (ii) and amendment 6 falls into category (iii).

[21] The Commissioner opposes the application on the ground that it is prohibited by sub-rule 32(3). The Commissioner says further that the amendment should be refused because FAST inordinately delayed in bringing the amendment, and as a result thereof he has suffered prejudice that cannot be cured by a costs order. His other ground of objection is directed mainly at the first amendment.

[22] Before embarking on an analysis of sub-rule 32(3) it is necessary to consider rules 7 and 10. Rule 7 lays down the procedural as well as substantive requirements that have to be met by a taxpayer who objects to the assessment of the Commissioner. Sub-rule 7(2)(b) in particular is pertinent in this case. It provides:

> "(2) A taxpayer who lodges an objection to an assessment must—
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> (*b*) specify the grounds of the objection in detail including—
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> (i) the part or specific amount of the disputed assessment objected to;

(ii) which of the grounds of assessment are disputed; and

(iii) the documents required to substantiate the grounds of objection that the taxpayer has not previously delivered to SARS for purposes of the disputed assessment;"

[23] The taxpayer is not only required to specify the ground of objection in detail, including the part or the amount objected to, but is also required to submit all documentation that substantiates the objection, but which was not previously presented to the Commissioner. Sub-rule 10(3) is almost identical to sub-rule 32(3). It prohibits a taxpayer from raising in its notice of appeal on "a ground that constitutes a new objection against a part or amount of the disputed assessment not objected to under rule 7". So far so good. The prohibition appears to be cast in stone. There are, however, two sub-rules that appear to negate the prohibition. They are sub-rules 10(4) and 33(2).[2] They read:

Sub-rule 10(4)

"If the taxpayer in the notice of appeal relies on a ground not raised in the objection under rule 7, SARS may require a taxpayer within 15 days after delivery of the notice of appeal to produce substantiating documents necessary to decide on the further progress of the appeal."

Sub-rule 33(2)

"The reply to the statement of grounds of appeal must set out a clear and concise reply to any new grounds, material facts or appreciable law set out in the statement."

Can the provisions of sub-rules 10(3) and 32(3) be reconciled with the provisions of sub-rules 10(4) and 33(2)?

[24] Sub-rule 33(2) is similar in content to that of sub-rule 31(3). As with sub-rule 31(3) (relating to the Commissioner) it places a prohibition on a taxpayer who objects to an assessment from seeking to make out a new case at the appeal court. The taxpayer is not allowed to raise a ground of appeal in its rule 32 statement which was not previously raised in its objection – which is to be set out in compliance with sub-rule 7(2)(*b*) – to the assessment. The sub-rule reads:

"The appellant may not include in a statement a ground of appeal that constitutes a new ground of objection against a part or amount of the disputed assessment not objected to under rule 7."

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[2] Rule 10 attends to the procedural and substantive requirements for the lodging of an appeal against the denial of an objection. Rule 33 allows for the Commissioner to reply to the statement of grounds of appeal (rule 32 statement). It attends to the procedural and substantive requirements for the Commissioner's reply.

[25] We will recall that the prohibition in sub-rule 31(3) ties the Commissioner down to his assessment. The prohibition in sub-rules 10(3) and 32(3) ties the appellant down to its objection. Basically, neither the Commissioner nor the taxpayer is able to make out one case before the appeal is lodged – in the assessment in the case of the Commissioner and in the objection in the case of the taxpayer – and another one once the appeal is lodged. That said, sub-rules 10(3) and 32(3), appear to be undermined if not contradicted by the provisions of sub-rules 10(4) and 33(2).

[26] There is weighty authority to support the conclusion that the provisions of sub-rules 10(3) and 32(3) must be given effect to. The underlying logic for this is that any aspect of an assessment not objected to becomes final,[3] – the taxpayer is "precluded from raising it on appeal before the Tax Court"[4] – and they serve the public interest of having matters finalised.[5]

[27] The apparent confusion created particularly by sub-rules 10(4) and 33(2) has been judicially considered in *IT 1912,*[6] where the court scrutinised them and concluded that the consequence of including sub-rules 10(4) and 33(2) is that the taxpayer is now no longer bound to the grounds of objection set out in rule 7. The conclusion is articulated as follows:

> "[28] It seems to me to be clear from the scheme of the TCR [tax court rules] that an appellant taxpayer is no longer restricted, on appeal, to the grounds of objection originally filed under TCR 7. Provision is made for new grounds to be advanced in TCR 10(4) and in TCR 33. The latter rule introduces the innovation that SARS may now file a reply to the appellant's TCR 32 statement. That reply must deal with "any new grounds". The innovation was included in the present TCR that were promulgated in 2014. The other relevant innovations included in the present rules were TCR 31(3) and 32(3). It is also significant that under the present rules statements made under TCR 31, 32 and 33 may be amended, either by agreement or on application to court. This is further evidence of an intention to broaden, rather than to restrict, the ambit of the issues that can be dealt with in the tax appeal process.
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> [29] In my view, M is correct in its submission that these changes demonstrate a new flexibility in the tax appeal process and a move away from the rigidity that previously characterised the regime. This development is in line with the constitutional right to access to court, which guarantees a fair hearing. Rigidity in the legal process can thwart the fairness of proceedings. There would seem to be no good reason to restrict unduly the ambit of a tax appellant's grounds of appeal. This is particularly so when one has regard to the fact that a tax

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3 *The Commissioner for the South African Revenue Service v Airports Company South Africa* [2022] ZASCA 132 (7 October 2022) at [25].

4 *Computek v The Commissioner, SARS* [2012] ZASCA 178 (29 November) at [8].

5 *CSARS v Brummeria Renaissance (Pty) Ltd and Others* 2007 (6) SA 601 (SCA) at [26]; *CSARS v The Executor of the Estate Lot Maduke Ndlovu* (A395/2016) [2020] ZAGPPHC at [36] and [37].

6 *Income Tax Case No 1912* 80 SATC 417.

> appeal to the Tax Court involves a full hearing, with the leading of witnesses, cross-examination and discovery. …
>
> [30] In my view, M's interpretation of TCR 32(3) is correct. It is not aimed at prohibiting the introduction of a new ground of objection not raised under TCR 7. The ambit of the prohibition is more limited: what a tax appellant may not do is to use TCR 32(3) to appeal against a portion of the assessment (either in terms of an amount or part) not previously objected to under TCR 7. An appellant may raise a new ground of objection in the TCR 32 statement, provided that it relates to a part or an amount in the assessment that was placed in dispute by the objections stated under TCR 7."[7]

[28] I believe, the conclusion, albeit stated in very broad terms in [28] and [29], is correct. A taxpayer is not faced with an absolute bar to raising a new ground. The taxpayer is only barred from raising a ground that is completely novel, one that was not at all raised in the objection filed in terms of rule 7. It is difficult to articulate the legal principle more precisely. The principle can only be clarified on the facts of each case. Such facts would be the only way of testing if the ground of appeal differs so radically from the ground of objection that it would fall foul of the prohibition. Some differences are minor and would therefore be allowed in terms of sub-rules 10(4) and 33(2), thus avoiding the prohibition contained in sub-rules 10(3) and 32(3). There must at least be a connection "between the amounts previously disputed and thus the subject to the disputed assessment, and the new ground".[8] The new ground in the appeal must not be "an entirely new case".[9]

[29] Understood this way the apparent conflict between the two sets of sub-rules is resolved. At the same time, there is no departure from the common law referred to in [26] above.

Does FAST's amendments, if allowed, fall foul of the prohibition set out in sub-rules 10(3) and 32(3)?

[30] The first category of amendments sought is captured in paragraphs 1,2,4,5 and 7 of FAST's application for leave to amend its rule 32 statement (rule 35 notice). It involves an averment to the effect that the prices paid for the XYZs were agreed to by the OEMs. The appellant says that this is supportive of its claim that the price paid to FAST Zug for the XYZs was an arms-length transaction. FAST claimed in its rule 7 objection statement that the price it paid for the XYZs was the same price for which it on-sold the XYZs to OEMs. By the amendment it wishes to establish a similar but slightly different fact, one that demonstrates that there was an agreement between it and the OEM's. The amendment is aimed at making

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[7] Id at [28] – [30].

[8] *Taxpayer B v Commissioner for the South African Revenue Service* (IT 45710) [2022] ZATC 10 (29 November 2020) at [75].

[9] Id.

out a case that the prices at which the XYZs were sold, together with the market prices of XYZs, represents "the external comparable uncontrolled transactions". This it wishes to introduce as part of its case that the Comparable Uncontrolled Transaction (CUP) method instead of the TMNN with FCMU profit level indicator method ought to have been used to test whether the transaction was an arms-length one. This case is slightly different to the one it raised in its rule 7 statement of objection, but it does not represent a complete new ground of objection. There is certainly a connection between what it now wishes to introduce on appeal – its rule 32 statement – to what it claimed in its rule 7 objection statement. Accordingly, amendments 1,2,4,5 and 7 should be allowed.

[31] The second category captured concerns an averment that the Commissioner overlooked certain income – some R77m – that FAST earned. It is submitted by FAST that by this amendment it is only amplifying one of its grounds of objection, namely that the Commissioner erred in his calculation. I disagree. This averment was not made at all in the rule 7 objection statement. All that was said there was that the Commissioner incorrectly calculated the FCMU of FAST's catalyst division. What it now says is that the incorrect calculation was not a mathematical or arithmetical error but was one that was caused by insufficient data input in the Commissioner's calculation. This claim should certainly have been made in the rule 7 statement, and the supporting documents should have been produced for the Commissioner to attend to in his assessment. By the amendment FAST is making out an entirely new case – one that is very different from the one it made out in its rule 7 statement. It is for the first time in the appeal (should leave be granted for it to amend its rule 32 statement) that FAST would be claiming that the Commissioner overlooked some R77m of profit. It is prohibited from doing so in terms of sub-rules 10(3) and 32(3). Accordingly, leave should not be granted to FAST to amend its rule 32 statement as per paragraph 3 in its notice in terms of rule 35.

[32] The third category of the amendment sought relates to compensation FAST received for holding XYZs. This was in the form of a surcharge levied on OEMs. This, too, is a novel claim. It was not raised in the rule 7 objection statement, and there is no other allegation or averment in the rule 7 statement to which it could be connected. It is an entirely new case that it wishes to raise in this court. It is prohibited from raising it in its rule 32 statement. Leave to include it by way of an amendment would have to be refused.

Costs

[33] Given the conclusions I have reached in each of the applications, I am firmly of the view that the only just and fair outcome on the issue of costs is that each party bear its own costs.

Order

[34] The following order is made:

In the application of the respondent (Commissioner) to amend his rule 31 statement

a. The respondent is granted leave to amend his rule 31 statement of grounds of assessment, specifically to make those additions and deletions which comprise the proposed amendments in the proposed amended rule 31 statement, which was served on the appellant on 2 February 2023 with the respondent's notice of intention to amend.

b. Each party is to pay its own costs.

In the application of the appellant (FAST) to amend its rule 32 statement

c. Leave is granted to the appellant to amend its rule 32 statement as stated in paragraphs 1,2, 4,5 and 7 of its notice in terms of rule 35.

d. The appellant is refused leave to amend its rule 32 statement as stated in paragraphs 3 and 6 of its notice in terms of rule 35

e. Each party is to pay its own costs.

Vally J
Judge: Tax Court, Johannesburg