REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT JOHANNESBURG)

CASE NO.: **VAT 1788**

(1) REPORTABLE: YES / NO

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

(3) REVISED.

_____ _____

SIGNATURE DATE

In the matter between:

SAMU **APPELLANT**

and

THE COMMISSIONER FOR **RESPONDENT**

THE SOUTH AFRICAN REVENUE SERVICE

J U D G M E N T

MAKUME J

[1] This is an appeal against the findings and determination of VAT payable by the appellant to the respondent for the Tax period 07/2012 to 08/2016.

[2] During or about September 2017 the respondent issued additional assessment in the amount of R38 680 683.01 as well as imposed understatement penalties of R1 199 503.28 and late payment penalties of R3 868 067.90 and interest in the sum of R13 592 176.06 making it a total assessment of R57 340 430.25 payable by the appellant to the respondent.

[3] The appellant disputes this additional assessment.

BACKGROUND FACTS

[4] The appellant, "SAMU", is a division of SAMU (Africa) (Pty) Ltd and conducts business as shaft sinkers in various mines in South Africa. Its Head office is situated in Johannesburg and is registered for Value-Added Tax with registration number XXX.

[5] The appellant employs a number of persons some at the Head Office and others at mines in the country where such employees are deployed to carry out projects relating to the construction activities of the appellant.

[6] The appellant as employer provides employees deployed outside of the Head Office with accommodation at or near the project/construction site. The accommodation in this instance was at Province Guest House as well as Thills Guest House.

[7] The appellant paid the accommodation charges of the employees and did not recoup such expenditure from the employees. The total amount incurred by the appellant for accommodation and meals is the sum of R38 680 683.01. That expenditure related to certain employees accommodated close to the mines at which they had been deployed by the appellant. An amount of R21 185 611.20 related to Head Office Staff who were required from time to time to leave Johannesburg and spent time at the projects sites and to oversee work carried out at such sites. Those employees were obliged to spent nights away from their usual place of residence and usual place of work which is at the Head Office.

[8] In submitting its VAT returns the appellant claimed in put tax in the sum of R21 185 611.20 in respect of their head office employees and the sum of R17 495 071.81 being in respect of project specific employees.

[9] On receipt of the tax return SARS issued additional tax basically rejecting the claim for input tax and further imposed understatement penalties, late payment penalties as well as interest for the tax period 06/2012 to 08/2016.

[10] On receipt of the additional assessment the appellant filed an objection on the 2nd October 2017.

[11] On receipt of the objection SARS the respondent partially allowed the objection in respect of late payment penalty in the sum of R3 868 067.90. The rest of the objection was rejected. That resulted in the appellant lodging this appeal during March 2018 after dispute resolution had failed.

ISSUES IN DISPUTE

[12] The first issue in dispute in this matter is whether the appellant was entitled to claim input tax in respect of expenses it incurred to provide accommodation and meals to its employees.

[13] The second issue is whether SARS the respondent was entitled to impose an understatement penalty of 10%.

[14] The last issue is in respect of costs of this appeal.

THE LEGISLATIVE REGIME REQUIREMENT

[15] At the commencement of the hearing, it was brought to the attention of this court by way of joint minutes signed by the parties that SARS the respondent had conceded the correctness of input tax being claimed in respect of the appellant's Head Office employees. This accordingly leaves only the issue of the project specific employees to be determined by this Court.

[16] Section 17(1) and (2) of the VAT Act states:

> "**17. Permissible deductions in respect of input tax**—(1) Where goods or services are acquired or imported by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to the vendor or the importation by the vendor as the case may be, if such goods under section 7(3) or any amount determined in accordance with paragraphs (*b*) or (*c*) of the definition of 'input tax' in section 1 is input tax shall be an amount which bears to the full amount of such tax or amount as the case may be, the same ratio (as determined by the Commissioner in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act or section 41B) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services, provided that—
>
> …

(2) Notwithstanding anything in this Act to the contrary a vendor shall not be entitled to deduct from the sum of the amount of output tax and refunds contemplated in section 16(3) any amount of input tax—

(*a*) In respect of goods or services acquired by such vendor to the extent that such goods or services are acquired for the purposes of entertainment provided that this paragraph shall not apply where—

(i) Such goods or services acquired by the vendor for making taxable supplies of entertainment in the ordinary course of an enterprise which—

(*aa*) …

(*bb*) Supplies entertainment to any employee or office holder of the vendor or any connected person in relation to the vendor to the extent that such taxable supplies or entertainment are made for a charge which covers all direct and indirect costs of such entertainment."

[17] The key words in this legislative structure are "entertainment and input tax". Entertainment in section 1 of the VAT Act "means the provisions of any food beverages, accommodation, entertainment, amusement, recreation or hospitality of any kind by a vendor whether directly or indirectly to any one in connection with an enterprises carried on by him".

[18] Input tax is described as tax charged under section 7 and payable in terms of that section by –

(i) A supplier on the supply of goods or services made by that supplier to the vendor; or

(ii) The vendor on the importation of goods by that vendor; or

(iii) The vendor under the provisions of section 7(3).

[19] Put simply it means that any input tax incurred during the relevant tax period whether before or after the collection of an amount of output tax must be deducted from such output tax and it is only the difference if any that is payable to SARS. And if the input tax exceeds the output tax in respect of a VAT period, the vendor will be entitled to a VAT refund from SARS.

[20] In their Audit Findings letter dated the 4th July 2017 SARS informed the appellant as follows:

"SAMU is a division of SAMU Africa and is involved in shaft sinking activities on various mines. It was noted that SAMU" is claiming input tax on items prohibited by section 17(2)(*a*)(ii). During the Audit it was established that SAMU were claiming input tax deductions on accommodation and entertainment expenses for Province Guest House, Thills Guest House amongst others for their employees that were not away from the usual place of work but did not recoup those expenses."

THE EVIDENCE

[21] It is not disputed by the respondent that the expenses in respect of which input tax was claimed by the appellant was for accommodation and meals in respect of project specific employees and further that those expenses were actually incurred by the appellant.

[22] As I have indicated earlier on the final determination of this matter rests on the interpretation of the statutory provisions of the VAT Act in particular the words input tax and entertainment. It is common cause that most of the facts in this matter are not seriously dispute and are in fact common cause.

[23] The respondent adjusted the appellants VAT Return for the period 07/2012 to 08/2016 to exclude input tax deductions in terms of section 17(2)(*a*)(i). The end result is that the respondent now claims payment from the appellant in the sum of R17 495 071.81 which is the amount spent in respect of the project specific employees.

[24] The appellant presented oral evidence by Mr Mark a qualified Civil Engineer employed by SAMU as Head of Estimating/New Business. In his capacity as such when he prepares tenders for appointment of the appellant by Companies like Subsidiary A he needs to establish what the costs would be for appellant to perform the services required in terms of the tender.

[25] He testified further that when the cost of accommodation and meals is estimated an allowance is made for the costs of accommodation and meals which form part of the costs rendering the services by the appellant to its client such service is rendered at a fee that includes VAT.

[26] It is interesting to note that Mr Mark in his testimony told this Court that the costs of accommodation and providing meals is included in the cost estimate that is done for the work which appellant tenders. He testified further that the appellant is not in the business of entertainment and that accommodation is just like any other cost it incurs. It was costs related to the tender rate and was not a cost for entertainment.

THE LAW APPLIED TO THE FACTS

[27] Proviso (i)(*bb*) to section 17(2)(*a*) provides that the deduction of input tax is not prohibited on entertainment expenses where the goods or services are acquired for making taxable supplies of entertainment in the ordinary course of an enterprise which supplies entertainment to any employee of the vendor to the extent that such taxable supplies of entertainment are made for a charge which covers all direct and indirect costs of such entertainment.

[28] It is trite law that VAT on the subsistence expenses that is food and accommodation can be claimed as input tax by an employer provided no allowance is paid to the employees for such expenses in which case no input tax will be allowed.

[29] The facts in this matter are that the specific project site employees were appointed with purpose to have them based on construction sites and were provided with accommodation and meals. Therefore, such employees usual place of employment is the site where they work as a result they are not protected by the provisions of section 17(2)(*a*)(ii).

[30] Section 17(2)(*a*)(i) is applicable to –

- goods and services acquired by the vendor.
- for making taxable supply of entertainment (e.g. hospitality companies).
- in the ordinary course of an enterprise.

This section clearly relates to entertainment business and appellant is not one of such companies.

[31] The argument raised by the respondent that appellant is not in the hospitality entertainment business is correct. Section 17(2)(*a*)(i)(*bb*) is only applicable if appellant as a vendor supplies meals and accommodates to its employee and recoups same from such employees. Appellant did not charge its employees for such entertainment, as a result appellant is excluded from claiming the benefit as referred to in the clause.

[32] The word entertainment in the VAT Act has received attention in a judgement of this division in AB (Pty) Ltd v Commissioner for the South African Revenue Services Case Number 1015 decided on the 29th September 2014. In that judgement the Court found that the definition of "entertainment" is not ambiguous and should not be restrictively interpreted.

[33] The taxpayer in that matter was a vendor that provided service in the mining industry such as the sinking of shafts just like SAMU. It also provided such service at mining sites where the taxpayer was obliged to provide accommodation and meals for its employees whilst working on the project.

[34] The taxpayer outsourced the provisions of meals and accommodation to a third party who levied tax on such suppliers which the taxpayer was obliged to pay. When the taxpayer, AB, claimed input tax in respect of the VAT paid this was rejected by SARS on the basis that accommodation and meal constituted entertainment.

[35] This matter is on all fours with the decision in AB (Pty) Ltd (supra) and I am not persuaded that I should find in favour of the appellant. The Appeal as regards claiming of input tax by the appellant is dismissed. What is left is the understatement penalty as well as costs.

UNDERSTATEMENT PENALTY

[36] In terms of section 221 of the Tax Administration Act an understatement penalty is incurred when prejudice is caused to SARS as a result of a default in rendering a return, an omission in a return an incorrect statement in a return or failure to pay the correct amount of tax, which have a negative impact on the amount of tax payable.

[37] SARS maintains that appellant by claiming input VAT to which it is not entitled, appellant made an understatement as defined in section 221 of TAA.

[38] On the other hand, appellant maintains that it should be absolved from paying the levied 10% understatement penalty because firstly SARS did not provide any reason in the letter of Audit finding for its intention to impose an understatement penalty, secondly appellant says that SARS has not established the facts in evidence that there was a shortfall entitling it to impose an understatement penalty. Appellant argues that the jurisdictional facts for imposing understatement penalty have not been established.

[39] The appellant in order to succeed in this respect must demonstrate that the understatement results from a *bona fide* inadvertent error. In addition to that and in terms of section 223(3) of TAA SARS –

> "must remit a penalty imposed for substantial understatement if SARS is satisfied that the taxpayer—
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> (*a*) made a full disclosure of the arrangement as defined in section 34 that gave rise to the prejudice to SARS or the fiscus by no later than the date that the relevant return was due and
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> (*b*) was in possession of an opinion by an independent registered tax practitioner that—
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> (i) was issued by no later than the date that the relevant return was due;
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> (ii) was based upon full disclosure of the specific facts and circumstances of the arrangements and in the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance provision of a Tax Act, this requirement cannot be met unless the taxpayer is able to demonstrate that all of the steps in or parts of the arrangements were fully disclosed to the tax practitioner whether or not the taxpayer was a direct party to the steps or parts in question; and
>
> (iii) confirmed that the taxpayer position is more likely than not to be upheld if the matter proceeds to court."

[40] Sections 221 and 223(3) sketch two scenarios. Firstly, it is that for appellant to be absolved from paying the understatement penalty it must prove a *bona fide* inadvertent error. Secondly if the taxpayer fails to prove that, then SARS will only remit the understatement penalties if the taxpayer proves and places itself squarely within the jurisdictional requirements of section 223(3) set out above being that the taxpayer made a full disclosure of any arrangements and or that the taxpayer acted upon an opinion obtained from a tax practitioner.

[41] I am satisfied that the taxpayer does not meet any of the requirement for the remittance of the 10% understatement penalty imposed by SARS.

BONA FIDE INADVERTENT ERROR

[42] The appellant contends that if there was indeed an "understatement" then the penalty should not have been imposed because the understatement was as a result of a "*bona fide* inadvertent error."

[43] It is so that the Act does not define what "a *bona fide* inadvertent error" is. Both parties have referred this Court to the judgement by Boqwan J as she then was in ITC 1890 79 SATC 62 in which the honourable court considered the meaning of that phrase. After referring to the definition as appears in the Oxford Dictionary as well as The Merriam-Webster online dictionary the Court at paragraph 45 of that judgement concludes as follows:

> "[45] It follows from the above that *bona fide* inadvertent error has to be an innocent misstatement by a taxpayer on his or her return resulting in an understatement while acting in good faith and without the intention to deceive."

[44] The evidence of Ms Orio who testified on behalf of the appellant revealed that the VAT returns are compiled by personnel employed in the different division of appellant where after these are subjected to scrutiny not only by the senior finance manager but also by the Internal Audit department. In particular, Ms Orio told the Court that the audit department was requested to consider whether claiming of input tax in respect of the provisions of meals and accommodation to employees complied with the Act. The finance department was assured by the audit department that input tax under those circumstances was claimable.

[45] Ms Orio further testified that their external auditors AB Company did not raise any concern about appellant claiming input tax in respect of the provision of meals and accommodation for employees.

[46] The appellant didn't obtain the tax opinion from the tax expert in the process of submission of the Vat returns to SARS.

[47] SARS initially maintained that appellant was not entitled to claim input tax in respect of their Head Office employees only to concede later that appellant was indeed entitled to claim that portion of input tax.

[48] In my view all these facts put together amount to a bona fide inadvertent error on the part of appellant. In the circumstances SAMU's treatment of claiming input tax in respect of their project specific employees whilst an understatement same was done not with the intention to deceive. This entitles appellant to an order that SARS remit the 10% understatement penalty.

[49] Having considered all the evidence placed before me I have come to the conclusion that the following order be made:

ORDER

1. The Appeal against the additional assessment amounting to R17 495 071.81, (Interest and penalties) issued for the tax period 06/2012 to 08/2016 is dismissed.

2. SARS is directed to remit the 10% understatement penalty.

3. Each party shall pay its own costs of this appeal.

Dated at Johannesburg on this 30 day of August 2023

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M A MAKUME
JUDGE OF THE HIGH COURT
GAUTENG DIVISION, JOHANNESBURG

MR B. MATHIBELA : COMMERCIAL MEMBER

MR M. MAHLARE : ACCOUNTANT MEMBER