

SOUTH AFRICA / JUDGMENT

Flower v Commissioner for the South African Revenue Service (IT 25209)

[2025] ZATC 3 (3 February 2025)

[2025] ZATC 3COURT
Tax CourtBEFORE
CrutchfieldCASE / FILE NUMBER
IT 25209

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REPUBLIC OF SOUTH
AFRICA
IN THE TAX COURT OF
SOUTH AFRICA
(HELD AT MEGAWATT
PARK, JOHANNESBURG)
Case No.: IT 25209

(1)

REPORTABLE: YES / NO

(2)

OF INTEREST TO OTHER JUDGES: YES / NO

(3)

REVISED.

Date: 03/02/2025

In the matter between: FLOWER
Appellant
And
THE
COMMISSIONER FOR THE
Respondent
SOUTH
AFRICAN REVENUE SERVICE

JUDGMENT

CRUTCHFIELD, J

- [1] The appellant, Flower (“Flower” alternatively “the taxpayer”), appeals in terms of rule 56(1) (a). Before me, Flower claims an order in terms s129(2) of the Tax Administration Act, 2011, for the alteration of the additional assessment dated 13 December 2018, alternatively, the setting aside of SARS’s rule 31 statement and ordering SARS to deliver a rule 31 statement that complies with rule 31(3) and ancillary relief, including costs of the appeal.
- [2] The respondent, the Commissioner for the South African Revenue Service (“SARS”), opposes this matter, brought as an interlocutory application by the appellant in the appeal against the respondent. For the sake of clarity, the matter before me comprises an interlocutory application in the appeal proceedings brought by the appellant against the respondent.
- [3] Flower’s complaint is that SARS’s rule 31 statement does not comply with rule 31(3) of the Tax Administration Act, which prohibits new grounds in a rule 31 statement that constitute a novation of the whole of the factual or legal basis of the assessment or requires the issue of a revised assessment.
- [4] SARS alleges that it did not introduce new grounds in its rule 31 statement but simply amplified its position on why the section 11A pre-trade expenditure had not been shown satisfactorily to not be capital in nature.
- [5] Flower is an independent power producer operating a solar photovoltaic electricity generation farm (“the solar facility”) in the Northern Cape Province. Flower’s income results from a single trade, the sale of energy generated by Flower through the solar facility, to Eskom Holdings Society Limited (“Eskom”).
- [6] Flower’s solar facility commenced operating on 21 May 2014. Flower, at that stage, started earning revenue from its trading activities, being the sale of energy to its single client, Eskom.
- [7] Prior to Flower commencing its trading activities, Flower incurred significant expenditure in the construction, erection and establishment of the solar facility. This included not only raising loans and financial credit facilities necessary to fund the initial capital outlay required to reach the position from which Flower could begin its trading activities. Flower, in terms of its revised tax return for the 2014 tax year, deducted certain expenditure incurred prior to the commencement of its trading activities and in preparation for the carrying on of its trading activities, described as “development fees”, in the sum of R320 984 903.00 (“the development fees”).

- [8] The development fees represented the cost of expenditure incurred by Flower in connection with the raising of funds and credit facilities required to provide the monies necessary to pay for the establishment of the solar facility.
- [9] The development fees were not directly included in the various credit agreements concluded by Flower with its creditors that made the funding available.
- [10] Flower alleged that the development fees fell within the meaning of “related finance charges” and the definition of “interest” contained in section 24J of the Income Tax Act, and that Flower was entitled to claim the development fees as deductions from income in the 2014 tax year in terms of section 11A(1)(b) of the Income Tax Act. SARS initially allowed the deduction of the development fees but subsequent to an audit of Flower’s tax affairs by SARS, SARS disallowed the deduction of the development fees in Flower’s 2014 assessment.
- [11] In order to test if the new grounds in the rule 31 statement constitute a contravention of rule 31(3), it is necessary to compare the provisions of SARS’s rule 31 statement with the assessment itself, in this case the amended assessment.
- [12] Whilst SARS argued that the comparison ought to be made against the objection phase, that is incorrect. The scheme of the process and the wording of rule 31(3) itself is such as to make the comparison between the rule 31 statement and what is in the assessment itself. The wording of rule 31(3) makes it plain that the comparison is between the assessment. rule 31(3) is permissive in that it provides that SARS may include in the statement a new ground of assessment or basis for the partial disallowance of the objection unless that new ground 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.
- [13] Accordingly, the comparison arises between the rule 31 statement and the assessment itself and not the objection.
- [14] SARS accordingly cannot introduce new matter that constitutes a novation of the assessment in terms of the objection or appeal stages of the process. SARS’s use of the objection stage as a benchmark, in the circumstances, is legally impermissible.
- [15] SARS issued a letter of audit findings dated 29 October 2018 followed by a letter of finalisation of audit dated 13 December
2018. There is no substantial difference, only minor differences, between the two documents.
- [16] SARS, in its finalisation of audit letter, records the taxpayer’s response to SARS’s previous request for representations from the taxpayer, Flower, in respect of a breakdown of the pre-trade expenses, being the developmental expenses, and an explanation as to why each expense should be allowed as a deduction by SARS.

- [17] Flower relied on the close connection to the obtaining of the loans and the furtherance of the project as a whole. Flower relied on SARS v South African Custodial Services (Pty) Ltd[1] and ITC 1870,[2] which comprised the next iteration of SACS.
- [18] Flower's claims to the deduction of the developmental fees were premised on section 24J and section 11A of the Income Tax Act. Section 11A permits the deduction from income derived from a trade, of expenditure actually incurred by the taxpayer prior to the commencement and in preparation of the carrying on of that trade, if such expenditure would have been allowed as a deduction in terms of certain other provisions of the Income Tax Act, had such expenditure been incurred after the taxpayer commenced carrying on the trade.
- [19] Section 24J(2) permits the deduction of interest expenditure from the income of a trade if that amount was incurred in the production of income, with no limitation or exclusion on the basis that the interest expenditure was capital in nature.
- [20] Flower relied on the definition in section 24J (1) during the 2014 year of assessment, that included the expression "related finance charges". Section 11A(1) permits the deduction of interest expenditure under section 24J, if incurred after trade commenced, which can be deducted under section 11A if such expenditure was incurred prior to the commencement of trade.
- [21] Flower claimed a deduction of the developmental fees on the basis that they comprised pre-trading expenses, pre-commencement expenditure, incurred in anticipation of Flower producing income because Flower was not trading at that time. Section 11A enables the deduction of pre-trade expenses comprising interest and finance charges in terms of section 24J, irrespective of whether it is of an income or capital nature. Section 24J does not have a non-capital requirement in it.
- [22] Flower always acknowledged that the developmental fees were of a capital nature. Section 24J does not have a non-capital requirement and the taxpayer's claim did not arise in terms of paragraph (a) of section 11 of the Income Tax Act but in terms of section 11A, read with section 24J.
- [23] Section 24J provides for two categories of expenditure, an interest charge that is directly related to the amount of credit and the period for which the credit is extended, and secondly, "related finance charges". The latter refer to legal fees, guarantee costs, the cost of raising a loan and financing, brokers and lawyers' fees, all fees being not included directly in the finance agreements themselves.
- [24] SACS found that costs not directly included in credit agreements, being costs associated with credit, so called "category 2 costs" or "category 2 expenses", may be claimed as a deduction.
- [25] SARS, in the finalisation of audit letter, contended that SACS and ITC 1870 only applied to section 11(bA) and not to section 24J. This is contrary to what was held by the SCA in SACS. SARS attempted to distinguish SACS on the basis that it was never the intention of the SCA in

SACS to recognise fees such as legal fees and related finance charges, being fees not arising directly from and not being included in the finance agreements. SARS alleged that the fees, in order to qualify for the deduction, had to be costs or charges that comprise part of the financial arrangement itself, payable in terms of the financial arrangement itself, and not include costs associated with executing a loan. Accordingly, SARS refused the deduction of the developmental fees because they comprised related finance charges, category 2 expenses, and did not, according to SARS, meet the requirements of section 24J. Furthermore, that reliance on SACS and ITC 1870 was misplaced by Flower as a result.

- [26] It is significant that SARS acknowledged in the finalisation of audit findings that it had requested and received from Flower, a breakdown of the pre-trade developmental expenses, which SARS factually accepted as having a close connection to Flower procuring loans and raising finance for the furtherance of the solar farm project as a whole, and which SARS did not challenge factually at that stage.
- [27] Flower, on 24 October 2019, filed a notice of appeal against the additional assessment lodged by SARS for the 2014 year as regards the deductibility of the developmental fees that SARS disallowed, and the consequential understatement penalties that SARS levied against the taxpayer.
- [28] On 19 March 2024, for reasons not relevant hereto, SARS delivered its rule 31 statement, in which SARS conceded that SACS and ITC 1870 applied and that so called “related finance charges”, being category 2 expenses, may be deducted under section 24J.
- [29] SARS position in its rule 31 statement constituted a complete turnaround, whereas SARS previously alleged that SACS and ITC 1870 did not apply to section 24J and did not apply to the matter at hand, now SARS, in terms of its rule 31 statement, conceded that SACS and ITC 1870 apply directly to section 24J, related finance charges and to the matter at hand. SARS, in short did a volte-face.
- [30] SARS, in contrast to the grounds of the amended assessment and the basis for disallowing the objection, conceded Flower’s contention in respect of the applicability of “related finance charges” in the definition of interest in section 24J(1)(a). However, SARS, whilst conceding that Flower incurred the pre-trade expenditure, denied that it was deductible by Flower. The basis for denying the deduction in the rule 31 statement was the paucity of specificity or particularity provided by Flower in respect of the pre-trade expenditure. In other words, SARS, in terms of its rule 31 statement, proffered a factual challenge to a premise that SARS previously accepted.
- [31] According to SARS, Flower claimed a plethora of pre-trade expenses under the heading “developmental fees”, without including the necessary particularity required of Flower in order to discharge the burden of proof in terms of section 102(1)(b) of the Tax Administration Act. >

- [32] SARS contention is surprising as SARS previously acknowledged that Flower had supplied it with a breakdown of the pre-trade expenditure and an explanation as to why that pre-trade expenditure was justifiable as a deduction.
- [33] SARS did not, prior to delivering its rule 31 statement, challenge on a factual level, the closeness of the expenditure to the financial agreements concluded by Flower. SARS previous argument, in terms of the revised assessment, was that a close connection was insufficient to merit the deduction claimed by Flower because the pre-trade expenditure did not arise in terms of the financial arrangements themselves.
- [34] Paragraph 13 of SARS's rule 31 statement comprises a complete novation of the legal basis of the assessment. It is self-evident that SARS in terms of the rule 31 statement, did not merely elucidate or further articulate on the same position previously adopted by it. Contrary to SARS contention, SARS did a complete about turn in the rule 31 statement. SARS, in the revised assessment, contended that Flower's stance was incorrect, that SACS and ITC 1870 did not apply, that those cases applied to section 11(bA) and not to section 24J, that the finance charges had to arise directly from and in terms of the finance agreements. In SARS's rule 31 statement, it alleged that the wide meaning of related "finance charges", always contended for by Flower, was applicable.
- [35] SARS raised the alleged lack of particularity in respect of the pre-trade expenditure for the first time in its rule 31 statement, However, SARS did not raise any such concerns prior to the rule 31 statement. In fact, contrary thereto, SARS accepted the close connection between the pre-trade expenditure claimed as developmental fees and the credit agreements concluded by Flower. There was never a blurring of the nature of the pre-trade expenditure as alleged by SARS in the rule 31 statement. Flower was clear throughout that the developmental fees were of a capital nature.
- [36] SARS contention in the rule 31 statement that there was a lack of particularity that the expenses qualified factually as category 2 expenses that are permitted by SACS and ITC 1870, is a completely new case proffered by SARS at the rule 31 stage.
- [37] Whereas previously SARS accepted that the expenditure was category 2 expenditure but contended that such category 2 expenditure was legally insufficient to justify the deduction, now SARS advanced a wholly different and contrary case.
- [38] The prejudice to the taxpayer resulting from SARS changing its course midstream is significant. Both the legal premise previously proffered by SARS as well as the factual premise of SARS case was novated by the rule 31 statement. SARS new case required the taxpayer to undergo a massive factual enquiry in respect of expenditure incurred prior to 2014, in order to locate the necessary documents and witnesses. This is in circumstances where SARS previously acknowledged in the assessment, that Flower provided a breakdown of the expenditure claimed and an explanation for the deduction claimed by Flower.

- [39] In the circumstances, SARS's rule 31 statement does not comply with rule 31(3) in that it constitutes a novation of the whole of the factual and the legal basis of the disputed assessment and, the new grounds introduced in the rule 31 statement require the issue by SARS of a revised assessment.
- [40] In respect of SARS claim to ring-fencing, this is misplaced because Flower only has a single trade, the generation and supply of energy to Eskom. Flower has a single source of income being Eskom, its only client. Thus, the requirement of the second trade by the taxpayer necessary for ring-fencing to apply, does not arise in this matter and there is no merit to SARS ring-fencing argument.
- [41] As to SARS reliance on *Baseline Civil Contractors Pty Ltd v CSARS*, [3] Baseline provides an answer to SARS contention that Flower must plead over on the merits, and that the merits should proceed to a full hearing
- prior to this procedural point being raised.
- [42] However, the taxpayer can only be expected to plead over to statements that are permissibly included in the rule 31 statement. The taxpayer is not required to plead over to statements that are impermissibly included, as is the case in this matter, where SARS averments in its rule 31 statement contravene rule 31(3), comprising a novation of the entire factual and legal basis of the assessment.
- [43] To allow SARS now to introduce an entirely new case and expect Flower to go back 11 years in order to find the necessary proof, is prejudicial in the extreme, blatantly unfair and simply untenable.
- [44] Furthermore, SARS cannot be permitted to dismiss the objection on grounds that are introduced after the assessment because the taxpayer would not have had an opportunity to object to them.
- [45] It is apparent that SARS abandoned the entire legal basis of the assessment, being SARS legal interpretation of section 24J as being distinguishable from SACS and ITC 1870.
- [46] In the circumstances, given that SARS abandoned the entire legal basis of its assessment there is nothing left of this appeal and the matter stands to be determined in favour of Flower.
- [47] In these circumstances and regard being had to section 129 and section 130 of the Tax Administration Act, 2012, I grant the following order:
- a. The additional assessment dated 13 December 2018 stands to be altered in the following manner:
 - i. The disallowance of the amount of development fees in the sum of R320 984 903 is to be reversed and such amount is to be allowed as a deduction in terms of Section 11A of the Income Tax Act, 1962;

- ii. The understatement penalties consequent upon such disallowance are to be reversed by SARS together with any consequent interest charges;
 - iii. The appellant's pre-trade expenses are not to be ring-fenced but to be included in the calculation of taxable income or assessed loss, where applicable to be carried forward to the following tax year; and
 - iv. The understatement penalties consequent upon the ring-fencing are to be reversed, together with any consequent interest charges.
- b. The respondent is ordered to pay the costs of this application and the appeal, including the costs of two counsel on scale C.

CRUTCHFIELD J

JUDGE OF THE HIGH COURT

JOHANNESBURG

Date of the hearing:

20 August 2024

Date of

judgment:

3 February 2025

[1] SARS v South African Custodial Services (Pty) Ltd 2012(1) SA 522 (SCA) ("SACS").

[2] ITC 1870.

[3] Baseline Civil Contractors Pty Ltd v CSARS [2024 ZAWCHC 113("BaseLine").

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