

SOUTH AFRICA / JUDGMENT

LDC Taxpayer v Commissioner for the South African Revenue Service (IT 24888) [2021] ZATC 6; 84 SATC 129 (18 June 2021)

[2021] ZATC 6

COURT

Tax Court

BEFORE

J Cloete, P Surtees, Q Joseph

CASE / FILE NUMBER

IT 24888

Source: saflii.org · Research copy typeset by Esheria. Not court-issued or certified.

Source record**Republic****of South Africa****IN****THE TAX COURT OF SOUTH AFRICA****(CAPE****TOWN)****Case****No: IT 24888****LDC****TAXPAYER****Appellant****and****THE COMMISSIONER FOR THE SOUTH AFRICAN****REVENUE****SERVICE****Respondent****Court:**Justice J Cloete, Prof P Surtees (Accountant Member) et
Mr Q Joseph (Commercial Member)**Heard:**19, 20 and 21 April 2021, supplementary heads of argument filed 5 May 2021
Delivered electronically: 18 June 2021

JUDGMENT

CLOETE J:

Introduction

- [1] On 26 September 2016 the appellant close corporation, which trades in properties and building work, concluded a written sale agreement (“the agreement”) with a purchaser (“KMC”) in terms of which it sold to the latter an immovable property, being erf 20886 Brackenfell (“the property”) for the sum of R25.2 million including VAT.
- [2] At the time of sale the property consisted of a piece of land with development rights for subdivision into 72 erven. Clause 2 of the agreement provided that the purchase price was payable in tranches of R350 000 ‘...on transfer of each erf to the end user purchaser’ from KMC. Registration of transfer to KMC was subsequently effected on 27 October 2016.
- [3] The agreement was thus concluded, and transfer effected, during the appellant’s 2017 year of assessment. However it did not declare the capital gain of the sale proceeds[1] in its 2017 income tax return, since it was of the view that the capital gain on the sale would only accrue to it on transfer of the individual erven to third party end users.
- [4] Following an internal audit the respondent (SARS) however included it in the appellant’s taxable income for that year in terms of s 26A of the Income Tax Act (“ITA”)[2] which reads as follows:

‘ 26A. Inclusion of taxable capital gain in taxable income.---

There shall be included in the taxable income of a person for a year of assessment the taxable capital gain of that person for that year of assessment, as determined in terms of the Eighth Schedule.’

- [5] In turn, paragraphs 11(1)(a) and 13(1)(a)(ii) of the Eighth Schedule stipulate that:

‘11. Disposals.---(1) Subject to subparagraph (2), a disposal is any event, act, forbearance or operation of the law which results in the creation, variation, transfer or extinction of an asset, and includes---

- (a) the sale, donation, expropriation, conversion, grant, cession, exchange or any other alienation or transfer of ownership of an asset;...’

[Subparagraph (2) is not relevant for present purposes].

‘13. Time of disposal.---(1) The time of disposal of an asset by means of---

- (a) a change of ownership effected or to be effected from one person to another because of an event, act, forbearance or by operation of law is, in the case of---...

(ii) any agreement which is not subject to a suspensive condition, the date on which the agreement is concluded...’

[6] SARS accordingly issued an additional assessment on 29 March 2018 in which inter alia it imposed a 25% understatement penalty of R798 372 in terms of s 222 as read with s 223 of the Tax Administration Act (“TAA”).[3] The other aspects of the additional assessment have since been resolved, and accordingly the only matter still in dispute is the imposition of that understatement penalty.

[7] Paragraph 4.3 of the SARS rule 31 statement reads as follows:

‘The omission of the proceeds of R22 105 263 (VAT excl.) from the disposal of an asset in the Appellant’s income tax return for the 2017 year of assessment for capital gains purposes, resulted in a loss to the prejudice of the fiscus, rendering the Appellant liable for the payment of an understatement penalty at the rate of 25% for a behaviour category of “reasonable care not taken in completing a return” on a standard case imposed in terms of section 222 read with section 223 of the TAA.’

[8] SARS also pleaded that clause 2 of the agreement did not constitute a suspensive condition but rather a suspensive time clause, and accordingly obligations came into existence upon conclusion of the agreement despite the full operation of those obligations being postponed until a future event.

[9] In its rule 32 statement the appellant pleaded that clause 2 was a suspensive condition of the sale, alternatively if found that it was a time clause, the accrual of the capital gain would only occur at a later stage. In addition, it pleaded that if the clause was a time clause, then no prejudice was suffered by SARS because the same tax amount would ultimately have been paid to it; and ‘only the present value of future proceeds may be taken into account in assessing the appellant to a tax liability in its 2017 year of assessment already’.

[10] The formulation of the remaining issues in the subsequent pre-trial minute was not entirely clear. Accordingly the parties reformulated them as follows at the commencement of the hearing:

10.1 Whether there was an understatement, properly classified (in the form of an omission from a return), which caused prejudice to SARS or the fiscus as provided in the definition of “understatement” in s 221 of the TAA;

10.2 If so, whether the understatement arose from (a) behaviour on the part of the appellant which may appropriately be described as ‘reasonable care not taken in completing a return’; (b) unreasonable actions on the part of the appellant; or (c) a bona fide and inadvertent error on its part.

[11] During the hearing the second leg of the dispute narrowed down to SARS' sole reliance on 'reasonable care not taken in completing a return', in accordance with its stance at paragraph 4.3 of the rule 31 statement. The parties were ad idem that SARS bore the onus of proving the facts upon which it relied in imposing the penalty in question.[4]

[12] It is common cause that in its IT14SD[5] for the 2017 year of assessment the appellant provided a VAT reconciliation schedule disclosing total gross sales of R25 176 200

in relation to erf 20886. Similarly, in its VAT 201[6] for the 10/2016 VAT period the appellant disclosed standard rated supplies of R25 316 449 (inclusive of the proceeds from the sale of erf 20886).

[13] In its rule 31 statement, SARS relied inter alia on these disclosures in contending that the appellant was precluded from claiming that the capital gain did not accrue during the 2017 year of assessment. In turn, the appellant pleaded in its rule 32 statement that no reliance could be placed by SARS on these disclosures since 'a sale such as the present is recognised on different bases for VAT and accounting purposes compared to the capital gains tax regime in the Act'.

The evidence

[14] The only witness who testified (for SARS) was Ms Mmamolete Marothodi, a risk profiler in its specialised audit division, and who raised the additional assessment in the present matter.

[15] The salient aspects of her testimony were as follows. Having considered the terms of the agreement (amongst other documents and SARS internal records) she concluded that the appellant became entitled to the full proceeds of the sale once the property was sold and transferred to KMC during the 2017 year of assessment. As such, the proceeds were a capital gain to the appellant during that year and ought to have been disclosed as part of its taxable income. Its failure to make this disclosure constituted an omission from its tax return.

[16] This omission caused prejudice to SARS because the tax on the capital gain was not collected from the 2017 year of assessment, and SARS also had to use its resources for this specific case to be audited.

[17] The failure to take reasonable care in completing the return lay in the disclosure of that gain for VAT purposes on the one hand and the omission in disclosing it for income tax purposes on the other, since both arose from the same transaction.

[18] During cross-examination Ms Marothodi accepted that by 2020 all of the erven had been on-sold by KMC and accordingly SARS would in any event have recovered the tax due on the overall capital gain by that date (or shortly thereafter). According to counsel for the appellant any financial prejudice to SARS would thus, in any event, have only been of a temporary nature.

- [19] She disagreed, testifying that National Treasury places an obligation on SARS to collect a certain amount from any given tax year. The fact of the matter, according to her, is that it should have been paid in full from the 2017 year of assessment and since it was not this caused the financial prejudice.
- [20] She also disagreed with the proposition that she spent an insignificant amount of time in dealing with the issue. She considered it to be complex, and not only involved conducting an audit which included obtaining additional information from the appellant, perusal of various documents, and having recourse to certain SARS internal record systems, but also attending an audit committee meeting in which she had to make recommendations for it to consider and determine whether the additional assessment was correct
- and a penalty should be imposed. In other words, according to her, this was far more than a run of the mill verification process.
- [21] Part of the appellant's case was that it was not a question of failing to take reasonable care in completing a return but rather, as accepted by SARS, the matter was complex, and the appellant had taken a tax position which could not fairly be considered as a lack of reasonable care in the circumstances.
- [22] Again she disagreed, maintaining that the appellant's business was buying and selling property; it could therefore reasonably be expected to be knowledgeable on matters pertaining to capital gains tax; and according to SARS' records, capital gains had indeed been disclosed (or declared) by the appellant in respect of other property transactions.
- [23] In her later testimony it emerged that in arriving at her conclusion that the appellant failed to exercise reasonable care in completing a return she had regard to (a) the nature of the appellant's business as evidenced by its financial statements; (b) the SARS integrated business register (IBR) reflecting that the appellant had conducted a number of property transactions in the past; and (c) the disclosure of a capital gain on another such transaction in the same income tax return.
- [24] She accepted that "timing rules" for VAT purposes are not always aligned with those for capital gains purposes, candidly conceding that VAT does not fall within her area of speciality, which is income tax. In particular she accepted that paragraph 13 of the Eighth Schedule to the ITA, dealing with the "timing event" for capital gains purposes, does not necessarily mirror the time of supply rules in s 9 of the VAT Act.[7] However she was adamant that for purposes of capital gains tax the capital gain should have been declared in the 2017 year of assessment. She explained that she had not only based her conclusion on the VAT declaration. Fundamentally the reason for her conclusion
- was that both the sale and transfer occurred during the year of assessment in question.
- [25] When asked why the VAT documentation submitted played a role in reaching her conclusion that the appellant had failed to take reasonable care in completing its return she replied:

‘Because the declaration on the VAT side, the output, was in addition to – it was aligning to the dates, selling dates on the sale agreement together with the transfer date. So, to me, I thought if this side they can declare it, consider it as a sale transaction concluded, and again the supporting documents that they provided for income tax purposes, it means the timing difference now on this specific case is aligned, is the same.’

[26] She accepted that for purposes of paragraph 13(1)(a)(ii) of the Eighth Schedule, the crucial date is that of conclusion of an agreement which is not subject to a suspensive condition. Put differently, that is the date upon which the accrual occurs for purposes of capital gains tax. However she confirmed in her later testimony that, given the provisions of paragraph 11(1)(a) of the Eighth Schedule, the subsequent transfer of the property during the same year formed part and parcel of the disposal of that asset, rendering it liable to be disclosed (or declared) for capital gains purposes.

[27] When asked to expand upon her conclusion that the appellant failed to take reasonable care in completing its return, Ms Marothodi responded that one of the factors she took into account was its failure to correct the omission even after being issued with a verification request (on 14 November 2017) which resulted in the appellant’s submission of its IT14SD. In particular the relevant portion of that letter read as follows:

‘The notice of assessment, ITA34 reflects all the information which SARS obtained from your return. Please review this information against your relevant material, including the related VAT and/or PAYE returns. If you find any errors, correct these by submitting a revised income tax return. Where you do not detect errors, you are required to complete and sign a supplementary declaration, IT14SD.’

[28] While accepting the appellant’s version that the failure to disclose the capital gain was the result of a tax position adopted on advice of its auditors, she nonetheless maintained that she did not consider the position adopted to be reasonable, given its presumed knowledge of capital gains tax due to the nature of its business, its VAT treatment, the relevant provisions of the Eighth Schedule which were met, and the opportunity afforded to the appellant to correct its tax position. In her view the admitted complexity of the matter made no difference.

[29] The understatement penalty percentage table in s 223(1) of the TAA lists six separate categories of behaviour with corresponding percentage penalties. As stated above the behaviour category which Ms Marothodi selected (and which was apparently approved by the audit committee) was item (ii), i.e. ‘reasonable care not taken in completing a return’ which carries a penalty of 25% in a standard case.

[30] In item (iii) of the table the behaviour category is ‘no reasonable grounds for “tax position” taken’ and carries a penalty in a standard case of 50%. Significantly, when asked why she had not relied instead on item (iii) Ms Marothodi

replied ‘Okay, looking at the facts, I must say that SARS lost an opportunity in using that 50%... I think I should have actually put the 50%.’

Discussion

[31] In *Commissioner for Inland Revenue v People’s Stores (Pty) Ltd*[8] it was confirmed that “income”, although expressed as an “amount” in the definition of “gross income”

in s 1 of the ITA, need not be an actual amount of money but may be ‘every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value... including debts and rights of action’.[9] Furthermore:

‘The second proposition – that no more is required for an accrual in terms of the definition of “gross income” than that the person concerned has become entitled to the “amount” in question – is a practical application of the first one. The pith of the supporting reasoning is that any right (of a non-capital nature) acquired by the taxpayer during the year of assessment and to which a money value can be attached forms part of the “gross income” irrespective of whether it is immediately enforceable or not, but that its value is affected if it is not immediately enforceable.’[10]

[32] This disposes of the appellant’s argument that the accrual did not take place during the 2017 year of assessment. The appellant also ultimately accepted that its failure to disclose (or declare) the capital gain in question in its 2017 income tax return constituted ‘an omission’ for purposes of s 221 of the TAA (alternatively ‘an incorrect statement in a return’).

[33] It disputed however that this resulted in any prejudice to SARS or the fiscus, submitting that SARS placed no evidence before the court to this effect. Mr Marais (who together with Mr Bothma appeared for the appellant) relied on Purlish[11] in which, he submitted, it was held that “prejudice” as contemplated in the definition of “understatement” in s 221 amounts to more than mere financial loss to the fiscus. This was presumably a reliance on the last sentence of para [23] of that decision where the Supreme Court of Appeal stated that:

‘As correctly conceded by counsel for the appellant in argument before this court, prejudice is not only determinable in financial terms.’

[34] To my mind the quoted passage does not mean that SARS had to prove financial loss as well as something more in order to discharge the onus resting upon it. Be that as it may, we disagree with the appellant’s submission concerning the absence of any evidence regarding prejudice, primarily for the following

reasons.

- [35] It became common cause during Ms Marothodi's testimony that the issue pertaining to declaring the capital gain was a complex one. Second, while it may be that the SARS risk engine initially flagged certain risks in the appellant's return, it was not disputed that the risk which ultimately resulted in the imposition of the understatement penalty was identified, not by the risk engine, but by Ms Marothodi herself during the course of conducting a verification process in relation to the other risks.
- [36] Third, the appellant was not able to materially dispute the time spent by Ms Marothodi in relation to this part of the additional assessment, and her testimony in this regard was both clear and consistent. As a matter of logic, had she not been obliged to spend the considerable amount of time which she did on this matter she would have been able to attend to other matters for SARS.
- [37] As far as financial prejudice is concerned, in its rule 32 statement the appellant relied on Lategan[12] in contending that prejudice of this nature was absent, since only the current value of the future proceeds could be taken into account in assessing the appellant's 2017 tax liability. Put differently '...a debt payable in the future must be included in the "gross income" at its present value'.[13]
- [38] However no evidence was adduced on the value to the appellant of the 'debt payable in the future' in the form of the capital gain which accrued to it during the 2017 year of assessment, and Ms Marothodi's testimony that income tax would have been recovered earlier from that tax period, had the capital gain been declared, went unchallenged. Moreover, no reliance was placed on Lategan during argument before us. We must therefore accept that the fiscus suffered some form of financial prejudice as a consequence (even if not quantified in terms of the reduction in the monetary value of the accrual).
- [39] Ms Tsoai (who together with Mr Mabeqa appeared for SARS) referred to various decisions which provide guidance on the meaning of "prejudice" for purposes of s 221 of the TAA (given that the section itself does not contain a definition thereof).
- [40] In IT13725[14] it was stated that:
- [45] Although it was not debated in argument it does strike me that the application of resources to audits of the affairs of taxpayers like the appellants is in itself prejudice to SARS. In terms of section 221 "understatement" means any prejudice to SARS or the fiscus. The word "any" is "a word of wide and unqualified generality. It may be restricted by the subject-matter or the context, but prima facie it is unlimited." (Per Innes CJ in *R v Hugo* 1926 AD 268 at 271). There is nothing in the context of the provisions of the Act relating to understatement penalties to suggest that the word was used in a limited sense in section 221. On the contrary, a comparison of the sense of the words "means ... prejudice to SARS or the fiscus", with and without the insertion of the word "any", suggests that its insertion indicates that the broadest range of prejudice must be taken into account when considering whether any of the stated defaults have resulted in prejudice to SARS

or the fiscus.’

[41] In ITC1908[15] it was found that:

‘[41] The uncontroverted evidence before us is that SARS suffered prejudice in the form of the opportunity cost occasioned by its delayed recovery of the income tax and VAT amounts due to it. Although SARS had the funds in its possession throughout, it was not entitled to the use thereof as the funds were reflected as a credit in the account of the taxpayer (for which Mr P sought a refund from SARS). Indeed, the interest that accrued to the funds during the time when SARS had the funds in its possession was for the taxpayer’s account.

[42] Public funds are derived mainly from two sources, namely contributions by citizens through taxation and public borrowings whose repayment is borne by taxpayers...’

[42] Based on Ms Marothodi’s testimony on this aspect, the delay in paying tax when due caused prejudice to SARS or the fiscus. In each year SARS is given a target by National Treasury to collect a certain amount of taxes. In order to reach that particular target, every cent surely counts. Where taxes are due in a particular year and are not recovered in that year, the delay must logically affect SARS’ ability to collect the revenue as mandated by Treasury, which ultimately affects government’s ability to fulfil its constitutional obligations to its citizens.

[43] Government allocates yearly budgets based on what is in its coffers. It is thus important for SARS to collect taxes when they are due and not when taxpayers believe they should pay them. Further, the fiscus would have suffered a loss if SARS had not conducted the audit to ascertain that the disposal of the asset resulted in the accrual of proceeds in the hands of the appellant in the 2017 year of assessment. Given its extent, the audit undoubtedly entailed a resource allocation in the form of additional time and human capital.

[44] We are thus persuaded that: (a) there was an omission from the appellant’s 2017 income tax return;

(b) which resulted in prejudice to SARS or the fiscus; and (c) which qualified as an understatement for purposes of s 221 of the TAA. SARS thus became entitled to impose an understatement

penalty in terms of s 223 thereof.

[45] The question which then arises is whether SARS correctly categorised the understatement as being the result of ‘reasonable care not taken in completing a return’. Although during argument SARS advanced various reasons why it was correctly categorised as such, it is bound by the concession of its own witness Ms Marothodi that this was, in hindsight, incorrect and that the penalty should rather have been based on ‘no reasonable grounds “for tax position” taken’ which would have attracted a penalty of 50%.

[46] Put differently, SARS pinned its colours firmly to the mast of failing to take reasonable care in the tax return completion process as pleaded in its rule 31 statement, which was the case the appellant was called upon to meet. However the evidence established that the cause of

the understatement was, in SARS' view, a tax position based on unreasonable grounds, although we refrain from making any finding thereon since we were not required to adjudicate upon this. However we are nonetheless bound to conclude, in the circumstances, that on its own version SARS erred in imposing the understatement penalty in item (ii) of 25% as opposed to

item (iii) of 50% in the understatement penalty percentage table contained in s 223(1) of the TAA.

[47] Counsel were given the opportunity to file supplementary heads of argument dealing with two questions, one being whether, in the event of the Court reaching the conclusion in the preceding paragraph, we have a discretion to increase the penalty to 50% in terms of s 129(3) of the TAA which provides that:

‘(3) In the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the tax court ... may reduce, confirm or increase the understatement penalty.’

[48] The short answer is that we are precluded from doing so. In Purlish it was held as follows:

‘[25] The next question is whether the Tax Court was entitled to increase the understatement penalties levied by SARS. Section 129(3) of the TAA empowers the Tax Court to increase an understatement penalty. But, that only arises if the issue has been properly raised for adjudication before that court. This is determined by Rule 34, which provides:

“The issues in an appeal to the tax court will be those contained in the statement of the grounds of assessment and opposing the appeal read with the statement of the grounds of appeal and, if any, the reply to the grounds of appeal.”

It was fairly conceded by counsel for SARS, that SARS had never raised the issue of the increase of the reduced penalties for adjudication

before the Tax Court. In its Rule 31 statement, SARS only sought to justify the reduced penalties. It follows that it was incompetent for the Tax Court to have increased the reduced penalties. To that extent the appeal against the decision of the Tax Court must succeed. It follows that the understatement penalties of 100 per cent imposed by the Tax Court in respect of both income tax and VAT for the relevant periods must be set aside and SARS' understatement penalty of 25 per cent in respect of income tax and 50 per cent in respect of VAT reinstated.’

[49] On our interpretation of the above quoted passage this does not mean that the appellant then escapes liability for the penalty imposed by SARS, but simply that it nonetheless remains liable for the reduced 25% penalty.

Costs

[50] The second question which counsel were given the opportunity to deal with by way of supplementary heads of argument pertained to costs.

[51] The nub of the appellant's submission is that pleadings were exchanged at a time when the matters in dispute placed the case beyond the jurisdiction of the Tax Board but that, after settlement of the other disputes the only one remaining – that of the understatement penalty – fell squarely within the jurisdiction of the Board. The appellant approached SARS to consent

to the Board adjudicating the remaining issue but such consent was not forthcoming.

[52] In our view nothing much turns on this. The refusal by SARS to consent to the issue before us being referred for decision by the Tax Board does not constitute a 'decision' for purposes of a costs award when regard is had to s 101, s 104(2) and s 130 of the TAA.

[53] Section 130 of the TAA provides inter alia that a tax court may, in dealing with an appeal, grant an order for costs in favour of an aggrieved party if a 'decision' by SARS is held to be unreasonable. In turn, s 101 of the TAA defines 'decision' as meaning one referred to in s 104(2). Section 104(2) provides as follows:

'The following decisions may be objected to and appealed against in this same manner as an assessment ---

- (a) a decision under subsection (4) not to extend the period for lodging an objection;
- (b) a decision under section 107(2) not to extend the period for lodging an appeal; and
- (c) any other decision that may be objected to or appealed against under a tax Act.'

[54] The respondent's refusal to refer the tax appeal to a Tax Board is not a decision envisaged in s 101 in the TAA since it is not subject to objection and appeal.

[55] In any event, given that the appellant was represented by two counsel in the hearing, it is fair to assume that it would similarly have been represented before the Tax Board. Moreover the parties were ad idem that the issue was complex.

[56] As previously stated we have deliberately refrained from making any finding as to whether the tax position adopted by the appellant was unreasonable since that was not an issue before us for adjudication. However for the reasons already given we are persuaded that there was indeed an understatement, albeit that the appellant "benefits" from the incorrect percentage penalty having been imposed by SARS. In our view, in these circumstances, there should be no order made as to costs.

[57] In the result the following order is made:

1. The taxpayer's appeal is dismissed.
2. No order is made as to costs.

J I CLOETE

- [1] Which excluding VAT amounted to R22 105 263.
- [2] 58 of 1962.
- [3] 28 of 2011. The sum of R798 372 equates to 25% of the difference between the initial assessment of R168 769.72 and the revised assessment of R3 362 259.32
- [4] In terms of s 102(2) of the TAA.
- [5] A supplementary declaration in which companies and close corporations must reconcile income tax, VAT, PAYE and customs declarations after initial submission of an income tax return (ITR14/IT14).
- [6] Reflecting VAT charged on supplies or for which it is liable to declare output tax.
- [7] Value-Added Tax Act 89 of 1991.
- [8]
- [1990] ZASCA 1; 1990 (2) SA 353 AD.
- [9] Approving *Lategan v Commissioner for Inland Revenue* 126 CPD 203 (2) SATC 16.
- [10] At 365A-C.
- [11] *Purlish Holdings v The Commissioner for the South African Revenue Service* (76/18) [2019] ZASCA 04 (26 February 2019).
- [12] See fn 9 above.
- [13] See fn 8 at 365E-G.
- [14] 8 February 2018, Tax Court KwaZulu-Natal Local Division, Durban.
- [15]
- (2018) 80 SATC 299.

Source & reproduction note

Judgment wording, source notices and original paragraph numbers are retained. Esheria supplies the layout and this PDF's page numbers; these are not the source pagination. This is a research copy, not an official or certified court document. Check quotations, citations and publication restrictions against the original source before relying on it.

ORIGINAL SOURCE <https://www.saflii.org/za/cases/ZATC/2021/6.html>

CASE PAGE <https://chat.esheria.ai/case-law/south-africa/ldc-taxpayer-v-commissioner-unknown-topic-atc-2021--6a3ea5143b1caa912980becb>

Prepared on 10 October 2026 · Esheria