REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT MEGAWATT PARK, JOHANNESBURG)

CASE NO: 0037/2019

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

01 June 2020	**L P SIGOGO**
DATE	SIGNATURE

In the matter between:

ABC (PTY) LTD APPLICANT

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE RESPONDENT

J U D G M E N T

SIGOGO AJ

INTRODUCTION

[1] The applicant, ABC (Pty) Ltd, is a logistics company, a subsidiary of DEF whose key activities entail providing services relating to transport, warehousing, forwarding procurement and sales. The applicant provides its services to its local and international clients and is a registered vendor in terms of the Value-Added Tax Act 89 of 1991.

[2] The applicant brought the present application in terms of the tax court Rules,[1] seeking an order directing SARS to provide the applicant with reasons, in terms of Rule 6(1) of the Rules promulgated under section 103 of the Tax Administration Act 28 of 2011, that the court regards as sufficient to enable the applicant to formulate its objection in terms of Rule 7, to the additional assessment issued by the respondent on 15 and 18 April 2019.

[3] The applicant had submitted original self-assessment of the tax liability[2] in respect of the relevant VAT periods and SARS had re-opened these assessments and issued additional assessments in terms of section 92 of the TAA.

[4] Rule 52(2)(*a*)[3] permits a taxpayer to institute application to the tax court if SARS fails to provide the reasons under Rule 6 required to enable the taxpayer to formulate an objection under Rule 7. In the event that such failure occurs a taxpayer may apply to a tax court for an order compelling SARS to provide the reasons regarded by the court as required to enable the taxpayer to formulate the objection.

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1 Rules promulgated under section 103 of the Act, prescribing the procedures to be followed in lodging an objection and appeal against an assessment or a decision subject to objection and appeal referred to in section 104(2) of that Act, procedures for alternative dispute resolution, the conduct and hearing of appeals, application on notice before a Tax Court and Transitional Rules.

2 As envisaged in section 91 of the Tax Administration Act which provides that:

> "91(2) If a tax Act requires a taxpayer to submit a return which incorporates a determination of the amount of a tax liability, the submission of the return is an original self-assessment of the tax liability."

3 Rule 52(2)(a) provides as follows:

> "(2) A taxpayer or appellant may apply to a tax court under this Part—
>
> (*a*) if SARS fails to provide the reasons under rule 6 required to enable the taxpayer to formulate an objection under rule 7, for an order that SARS must provide within the period allowed by the court the reasons regarded by the court as required to enable the taxpayer to formulate the objection."

THE MERITS

[5] The issue in dispute is whether the reasons for additional assessment as set out in SARS's audit findings letter, the finalisation of audit letter and its response to the taxpayer meet the requirements outlined in Rules 6 and 7. SARS contends that it provided sufficient reasons, but the applicant denies this and has described the reasons provided by SARS as "plainly inadequate and do not sufficiently enable the applicant to understand the basis of additional assessment, or to formulate its objection."[4]

[6] The background leading to the present dispute was as follows:

[6.1] On 19 November 2018, and pursuant to an investigation, SARS issued a letter of audit findings against the applicant, proposing to make adjustments in respect of the applicant's Value-Added Tax declarations for the periods 01/2014 to 12/2017.[5]

[6.2] SARS took the view that the applicant incorrectly treated the transactions relating to services provided to its local clients by charging VAT at the zero rate instead of at standard rate.

[6.3] On 15 January 2018, the applicant's tax representatives replied to SARS's letter of audit findings, contending that SARS failed to establish the jurisdictional requirements for issuing additional assessments in terms of section 92 of the Tax Administration Act 28 of 2011.[6]

[6.4] The applicant's grounds for contending as aforesaid were that "there does not appear to be any such prejudice to SARS or the *fiscus* because the zero-rating applied by the taxpayer and the deduction of input by its customer produce exactly the same result". It was alleged that the letter of audit findings failed make reference as to what, if any, prejudice has been suffered by SARS or the *fiscus*.[7]

[6.5] Between 21 January 2019 and 15 March 2019, there were further exchanges between the parties regarding the abovementioned issue, resulting in a stalemate.[8] On 26 March 2019, the applicant provided its submissions in reply to SARS's audit findings.[9]

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4 Founding affidavit, para 27.
5 Founding affidavit, para 12 and Annexure "AS2".
6 Founding affidavit, para 13.1 to 13.3.
7 Annexure "AS3".
8 Founding affidavit, para 14 to 22.
9 Founding affidavit, para 23.

[6.6] On 15 April 2019, SARS issued a finalisation of audit letter,[10] making adjustments to the applicant's VAT assessments for the periods 01/2014 to 12/2017, in the amount of R40 422 687.37 and imposing understatement penalty of R1 264 367.30, for substantially the same reasons stated in the letter of audit findings.[11]

[6.7] On 24 April 2019, the applicant requested reasons for the assessments in terms of Rule 6.[12] The applicant *inter alia* contended as follows:

> "3. The taxpayer is aggrieved by SARS' assessment and wishes to lodge an objection inter alia to SARS' rejection of the taxpayer's zero-rating of local services and handover fees in terms of section 11(2)(*d*), of the Income Tax Act 58 of 1962, but is unable to formulate an objection to SARS' rejection due to reasons not provided by SARS. Such failure is therefore prejudicial to the taxpayer
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> 4. The letter of finalisation of audit dealt in the main with a general application of section 11(2)(*a*), (*c*) and (*d*), but merely assessed the taxpayer on the basis that it is not allowed to apply the zero-rating to local services charged to resident clients where the services did not meet the requirements of section 11(2)(*a*), (*c*) and (*d*)
>
> 5. Kindly provide reasons why SARS is satisfied that the zero-rating in terms of section 11(2)(*d*), based on the taxpayer's facts and the application of section 11(2)(*d*), does not reflect the correct application of section 11(2)(*d*)
>
> 6. In our letter in reply to your audit findings we explained that even if SARS is satisfied that a taxpayer adopted an incorrect application of a tax Act (which we deny), but there is no prejudice to SARS or the *fiscus* then SARS cannot make an additional assessment
>
> 7. SARS made no attempt to deal with this aspect in the letter of finalisation of audit and we cannot see that SARS has indeed made a determination as to the prejudice
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> 8. Kindly furnish reasons why, under these circumstances, SARS or the *fiscus* has been prejudiced and how SARS has determined the output tax on the consideration, which the taxpayer received, is the prejudice which SARS or the fiscus has suffered".[13]

[6.8] On 22 May 2019, SARS replied to the applicant's request,[14] contending that "SARS has provided adequate reasons for the additional assessments issued in the finalisation letter dated 15 April 2019; to place you in a position to submit an objection".[15]

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10 Founding affidavit, para 24.
11 Annexure "AS13".
12 Founding affidavit, para 25.
13 Annexure "AS14".
14 Founding affidavit, para 26.
15 Annexure "AS15", Answering affidavit, para 18 to 18.7. & Replying affidavit para 5 to 11 and 24 to 27.

[7] The applicant alleges that SARS's response failed to provide any, alternatively adequate reasons.[16]

THE FINALISATION OF AUDIT LETTER

[8] The finalisation of audit letter[17] comprises 13 pages in extent. Its reading reveals that its sets out a summary of factual and legal grounds relied upon by SARS for making adjustments to the taxpayer's assessments in respect of the relevant periods. It also contains a diagram mapping the audit methodology followed during the audit.

[9] Furthermore, it outlines under separate headings a summary of adjustments made by SARS, explanations of adjustments made in respect of various transactions as regards the facts established by SARS and the applicable legal provisions relied upon by SARS for contending non-compliances with the provisions of the VAT Act, by the applicant.

[10] Moreover, it sets out an overview of services provided by the applicant, practical application of audit procedures, SARS comments to the applicant's replies to the audit findings and basis for imposition of understatement penalty and re-opening assessments in terms of section 99 of the Tax Administration Act.

APPLICABLE LEGAL PRINCIPLES

[11] Section 92 of the TAA enjoins SARS to issue additional assessments as follows:

> "**92. Additional assessments.**—If at any time SARS is satisfied that an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the *fiscus*, SARS must make an additional assessment to correct the prejudice."

[12] Rule 6 creates a positive duty on the part of SARS to provide the reasons for the assessment required to enable the taxpayer to formulate an objection in the form and manner referred to in Rule 7. Merely regurgitating the statutory provisions or setting out conclusions will not suffice as reasons.

[13] Having regard to the test to be applied as set out in *CSARS v Sprigg Investment 117 CC t/a Global Investment* [2011] 3 All SA 18 (SCA), the question at this stage of the inquiry "is simply whether the respondent has sufficiently been furnished with the Commissioner's actual reasons for the assessments to enable it to formulate its objection thereto."[18]

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16 Founding affidavit, para 9 to 11.
17 Annexure "AS14".
18 At p 24, para 14.

[14] In the present matter, the applicant's major complaint is that SARS failed to provide a direct answer to the applicant's question, namely, what prejudice was suffered by SARS of the *fiscus* as a result of the alleged incorrect tax treatment of the relevant transactions?

[15] Building on this hypothesis Mr E argued on behalf of the applicant that SARS cannot make an additional assessment if there is no prejudice to SARS or the fiscus. Further that such prejudice cannot be inferred from the circumstances as to do so would render the word "prejudice" redundant.

[16] He contended that prejudice must be decided on a case by case basis, in which event a taxpayer's offer to obtain information to the contrary from its customers would suffice. Accordingly, it was contended that the reasons purportedly furnished by SARS as they relate to central issues – prejudice and the applicability of section 11(2)(d) of the VAT Act – are not really reasons, and fail to enable the applicant to formulate its objection to the additional assessments.

[17] Mr L on behalf of SARS argued that it is apparent from the finalisation of audit letter that it summarised the reasons for assessment and conclusions reached by SARS in respect of the applicant. In his words, "no one is as blind as he who doesn't want to see".

[18] He contended that prejudice is not a self-standing requirement for purposes of raising assessment as the applicant seeks to elevate it to be. Further that prejudice can be inferred and is implicit when SARS determined that the applicant ought to have applied standard rate of VAT and not zero rate.

As regards prejudice

[19] I agree with the above submissions on behalf of SARS. In addition, whether or not SARS or the *fiscus* suffered prejudice cannot be answered only with reference to financial loss.

[20] This is apparent from the judgment of Justice Kriegler in the matter of *Metcash Trading Limited v Commissioner for the South African Revenue Service and Another* 2001 (1) BCLR 1 (CC),[19] where the following appears:

> "[16] …The first significant point to note is that VAT, quite unlike income tax, does not give rise to a liability only once an assessment has been made. VAT is a multi-stage tax, it arises continuously. Moreover, VAT vendors/taxpayers bear the ongoing obligation to keep the requisite records, to make periodic calculations of the balance of output totals over and above deductible input totals (and any other permissible deductibles) and to pay such balances over

[19] At p9 to 11.

to the *fiscus*. It is therefore a multi-stage system with both continuous self-assessment and predetermined periodic reporting/paying.

[17] An even more important feature of VAT, particularly in contradistinction to income tax, is that vendors are in a sense involuntary tax-collectors. In principle VAT is payable on each and every sale; the VAT percentage, the details for its calculation and the timetable for periodic payment are statutorily predetermined, and it is left to the vendor to ensure that the correct periodic balance is calculated, appropriated and paid over in respect of each tax period. By like token the regularity of VAT payments on the one hand ensures a steady and generally more accurately predictable stream of revenue via a multi-staged taxation that is perceived as resting less heavily on the taxpayer, but on the other hand it does require a great deal of book-keeping by vendors and policing by the revenue authorities.

[18] A special feature of VAT relates to exports. VAT is payable only on consumption in South Africa and as a result output tax is not payable on goods sold and exported. In the arcane language of the Act, they are zero-rated. Therefore, a merchant who buys and sells goods in South Africa and also sells some goods that are exported does the periodic calculation by adding up all input taxes for deduction from the sum of output taxes but, in calculating the latter, includes no output tax on the value of the exports. No output tax is payable on the exported goods but a full credit is given for the input tax. This exemption, which aims at promoting exports and enhancing their competitiveness in the world market, holds self-evident benefits for export-orientated vendors. Unfortunately, those benefits not only attract honest exporters but are a notorious magnet for crooks who devise all manner of schemes to exploit the system to their advantage.

[19] In the case of VAT the spectre of dishonesty extends beyond export related frauds, however. Although VAT as a system of raising revenue clearly has many advantages, it undeniably also has weaknesses. For present purposes only a few drawbacks need be mentioned. VAT spreads the tax base wide, thus promoting an equitable tax burden, which can be scored as a plus. But at the same time the multiplicity of vendors, many of them small and possibly ill-equipped to perform their statutory duties, places a heavy burden on the revenue authorities. They have to administer a sophisticated system and supervise the performance of a large body of vendors with limited human and material resources. In his affidavit the Commissioner complains of a lack of staff adequately trained in accounting and makes the point that a backlog in the training of accountants' country-wide puts trained people at a premium in the private sector, leaving the Department chronically unable to obtain and retain a sufficient number of skilled staff.

[20] The Commissioner also emphasises that unscrupulous vendors take advantage of his Department's notorious staffing embarrassment."

As regards the reasons provided

[21] A determination whether or not the reasons provided by SARS under Rule 6 are sufficient requires consideration of the purpose to be served by the reasons sought, namely to formulate an objection under Rule 7. If the reasons provided by SARS are adequate for purposes of formulating an objection under Rule 7, the application must fail and if inadequate, then the application must succeed.

[22] The applicant alleges that it is unable to formulate an "objection to SARS' rejection due to reasons not provided by SARS."[20] This relates to the grounds of objection as envisaged in Rule 7(2)(*b*) prescribing that an objection must:

> *"(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;
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> (ii) which of the grounds of assessment are disputed; and
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> (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] In my view, SARS's finalisation of audit letter met all the attributes that were found to be present in the matter of *CSARS v Sprigg Investment 117 CC t/a Global Investment*,[21] namely that:

[23.1] it stated in plain terms that the applicant was being assessed VAT;

[23.2] it explained the reasons for the imposition of VAT and the ancillary penalties and interest;

[23.2] the evidential basis for SARS' main factual findings, those findings and the legal consequences that flowed from them were clearly set out, namely relating to incorrect treatment of transactions with local clients' resulting in non-compliances with the VAT Act.

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[20] Annexure "AS14", para 3.
[21] Judgment, p 24, para 17.

[24] For reasons set out above, I am of the view that SARS's finalisation of audit letter is comprehensive and contains more than mere reiteration of the findings or regurgitations of the law or conclusions. It contains adequate details and explanations to enable the applicant to formulate the grounds of objection. I am fortified in my aforesaid conclusion amongst others based on the contentions contained in the applicant's heads of argument at paragraph 40, namely that:

> "40 More specifically, what prejudice has been suffered within the specific factual context of this matter? The applicant has alleged that if it had charged VAT, as output tax, at the standard-rate (as SARS alleges ought to have been done), its customers would have in any event claimed the same amount as deductible input tax, and that the overall fiscal result would have been entirely neutral and indeed the same as the position where the applicant zero-rated the relevant services and no input tax was deducted by its customers."

[25] The above argument on behalf of the applicant confirms that indeed the applicant understands, although it disagrees with the facts, the legal interpretation of the relevant provisions and conclusions relied upon by SARS as a basis for raising additional assessments, as set out in SARS' finalisation of audit letter. Furthermore, the above quotation from the applicant's heads of argument confirms that there is no reason why the respondent would be unable to formulate its objection, *inter alia*, advancing its arguments set out above in its objection.

[26] I agree with counsel for SARS that the applicant in its request for reasons sought to engage SARS on the issue of interpretation of the provisions of the Tax Administration Act, the VAT Act and the Income Tax Act. This is now quite clear having regard to arguments advanced on the applicant's behalf that the applicant understands the facts relied upon and the conclusions reached by SARS.

[27] Similarly, the applicant's request for reasons on which SARS alleges that the taxpayer incorrectly applied the provisions of section 11(2)(*d*) of the VAT Act as well as the contention that SARS is not entitled to make an additional assessment, these issues call for the interpretations of the relevant legislation and Rule 52(2)(*a*) is not an appropriate remedy in the circumstances.

[28] SARS contends that the applicant intentionally disregarded the reasons proffered by SARS for additional assessments, displaying a conduct that warrants a punitive costs order. I disagree, the applicant's application was not frivolous or vexatious to merit a punitive costs order.

ORDER

[29] Accordingly, I make the following order:

[29.1] The application in terms or Rule 52(2)(a) launched on 19 June 2019, seeking an order directing SARS to provide the applicant with reasons, in terms of Rule 6(1) of the Rules promulgated under section 103 of the Tax Administration Act 28 of 2011, that the court regards as sufficient to enable the applicant to formulate its objection in terms of Rule 7, to the additional assessment issued by the respondent on 15 and 18 April 2019, is dismissed.

[29.2] No order as to cost.

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JUDGE OF THE HIGH COURT OF SOUTH AFRICA

GAUTENG DIVISION

Date of hearing: 10 December 2019

Date of judgment: 1 June 2020

Judgment electronically delivered per email