REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA

(HELD AT KWAZULU-NATAL LOCAL DIVISION, DURBAN)

CASE NOS: 14184 (Income Tax)

14186 (PAYE)

1544 (VAT)

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

....

DATE SIGNATURE

In the tax appeal of

XYZ CC APPELLANT

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE RESPONDENT

J U D G M E N T

VAN ZŸL J

[1] The hearing of this tax appeal represents the culmination of a long, tortuous and at times somewhat acrimonious series of disputes between the respective parties. Its forerunner was the hearing also before me of a tax appeal involving the taxpayer's sole member on issues closely related to those of the taxpayer in the present matter. That appeal was settled between the parties during the course of a protracted hearing during September 2017.

[2] Initially the issues between the parties in the present matter were wide ranging and involved assessments relating to income tax (IT), secondary tax on companies (STC), pay as you earn (PAYE) deductions relating to both the member and employees of the taxpayer, as well as value added tax disputes extending over the 2008 to 2012 tax years. In addition and also in dispute were penalties and interest imposed by SARS.

[3] The commencement of the tax appeal was previously derailed by a dispute involving the ambit of the issues subject to appeal. The taxpayer then applied for leave to amend its grounds of appeal to include inter alia the issue of PAYE, which was argued at length and was granted during April 2018. Subsequently SARS withdrew the disputed PAYE assessments.

[4] On 1 July 2019 I met with the representatives of the parties at the Tax Court in Johannesburg in an attempt to expedite matters, as a result of which there followed further pre-trial meetings and the exchange of documentation between the parties in preparation for the hearing of the appeal due to commence on 2 September 2019. As a result and as the date for the hearing approached progress was made so that, at its commencement a consent order was taken (received as exhibit “A”) disposing of significant areas of dispute. Regrettably the parties were not, however, able to reach consensus upon the remaining issues, which then formed the subject matter of the hearing that followed.

[5] The remaining issues and which formed the subject matter of the hearing were set out in paragraph 14, as amended, of the consent order of 2.

[6] September 2019 (exhibit “A”), as follows:

> “14. The parties agree that the disputes concerning the Understatement Penalties imposed in respect of income tax and STC and the interest in terms of section 89*quat* of the Income tax Act, Act 58 of 1962 be dealt with at the Tax Court hearing due to commence on 2 September 2019.”

[7] To place matters in perspective it is convenient at the outset to deal with the background to the various events and ultimately the remaining issues. The taxpayer is a close corporation with a single member (the member) and at all material times its primary business activity involved construction during the course of low cost housing projects for which it successfully tendered.

[8] The taxpayer originally commenced business during or about 1998 and was at that time owned and controlled by the mother of the current member. The nature of its business then was to provide cleaning services and supplying foodstuffs. The current member of the taxpayer assumed control of it during 2006 when, as she put it, she inherited the business from her mother who subsequently died during 2008.

[9] After the current member had assumed control of the taxpayer it appears that she decided to drastically change the nature of the business and instead to embark upon construction projects. During the course of her evidence she explained that she set out to obtain construction contracts on tender but that initially these were hard to come by because she needed first to demonstrate that the taxpayer could successfully complete projects awarded to it. In the result the construction activities of the taxpayer started modestly, but gained momentum as it established its reputation in the field of low cost housing construction and later in conjunction with associated entities it became, by all accounts, a successful and profitable concern.

[10] Having started small and informally in the construction business, it appeared that the taxpayer was not tax compliant. According to the member the bookkeeping functions of the taxpayer's business had been entrusted to a firm of bookkeepers called TT Incorporated and who had contracted out the function of preparing its financial statements. It was not clarified during the course of the evidence when TT Inc had been appointed, or by whom, but the evidence suggested that prior to the member taking over control the taxpayer had historically also not been properly tax compliant.

[11] Be that as it may, the member said that as the taxpayer's construction business grew, she realised that it needed to become tax compliant and during early 2008 she then approached SARS's local office for assistance and advice, in order to remedy the situation.

[12] According to the member the assistance she received was not quite as she expected. She was requested to make the records of the taxpayer available to SARS, which she duly did and upon advice received from SARS she approached and appointed a firm of chartered accountants (OO & P) to assist in the accounting of the taxpayer and to prepare its annual financial statements as required for tax purposes. However, SARS

also charged her with fraud involving invoices issued by the taxpayer and which apparently reflected it as a value added tax (VAT) vendor, when it was not so registered. The member explained that she had initially used the taxpayer's close corporation registration number on its invoices, but that the SARS representative had advised her that this should be replaced by a VAT vendor registration number. She then used the number of another close corporation which was so registered on the invoices of the taxpayer, thus apparently giving rise to the fraud charges. However, according to her the charges related to VAT contraventions during the 2006 tax year, which would have preceded the incorrect usage of the false VAT registration number.

[13] In response to the fraud charge the member said that she was advised by the SARS representative to plead guilty and pay a fine. To this she agreed and was accompanied to court by the relevant official, where she duly pleaded guilty and was fined R15 000.00. According to the member her plea explanation was written out in manuscript for her by the SARS official and she signed it upon his advice. Her evidence created the impression that she did not appreciate the significance of a criminal conviction for fraud at the time.

[14] During or about August 2008 SARS also issued a letter of engagement relevant to the taxpayer's 2007/8 income tax and VAT records. During the course of her evidence the member complained that ever since both she herself and more particularly the taxpayer have been under continuous audit by SARS, which had a disruptive and deleterious effect upon trying to conduct the business of the taxpayer.

[15] The member said that after the appointment of OO&P to take responsibility for the taxpayer's bookkeeping and accounting functions, this firm stationed an accountant, one Mr R, at the taxpayer’s premises and that he thereafter supervised and controlled the taxpayer's accounting records. At some stage, according to the member, Mr R left the employ of OO&P, but remained at the taxpayer's premises where he continued to control its accounting functions using the trade name M&M. However, due to unspecified “issues” Mr R finally left the premises of the taxpayer during or about May 2010.

[16] In the meantime and with effect from 1 February 2010 the taxpayer had retained the services of a chartered accountant Mr F who practices under the name of Tax Governance to assist with the taxation disputes involving SARS. Mr F was called as a witness by SARS and confirmed that he knew Mr R whom he described as the bookkeeper and financial manager of the taxpayer and that he left during May 2010. Mr F described how he reviewed the situation of the taxpayer and that there were at the time significant disputes with regard to the 2008 tax year, how he interacted with SARS, raised specific

disputes, noted appeals and was involved in alternate dispute resolution procedures. However, his professional relationship with the taxpayer ceased in mid-November 2010 and although he was approached by the member during March 2011 with regard to her personal tax issues and submitted a proposal, he had no further involvement with either the taxpayer or the member.

[17] Mr F also confirmed that during his involvement a Ms G was one of his employees who had been stationed at the taxpayer's premises where her functions included assisting with filing invoices, financial records and capturing information onto Excel and that she was also involved in rendering VAT returns until November 2010 when he left and Ms G then remained behind. According to the witness, Ms G thereafter improperly continued to use the Sage accounting system and profile of Tax Governance to produce accounts for the taxpayer. On the evidence of the member there was some dispute as to whether Ms G had become an employee of the taxpayer or worked as a contractor. It is apparent that Ms G was neither a qualified accountant, nor a tax practitioner.

[18] Questioned specifically with regard to the 2010 tax year Mr F said that he was not involved in preparing financial statements or submitting a tax return on behalf of the taxpayer. The member, in her evidence had said that it was her understanding that Mr F had prepared and submitted the taxpayer's 2010 tax return. With reference to the 2010 tax return, as submitted to SARS, it was apparent that the name and registration number of the tax practitioner submitting it had been omitted but hat the mobile telephone contact number contained in the return was that used at the time by Ms G. This much was confirmed by both the member and Mr F. It appears that the 2010 tax return was not accompanied by any financial statements when submitted.

[19] Following the departure of Mr F it was put to the member that the member had appointed Mr H who had prepared and submitted tax returns and financial statements for the taxpayer for the 2011 and 2012 tax years, but the member professed not to recall either Mr H or signing the financial statements prepared by this firm.

[20] It appears that the relationship between the parties was less than harmonious. In the process and during or about 2011 further criminal charges were initiated by SARS against the taxpayer's member, apparently relating to alleged VAT contraventions and in addition a charge that she served as its member whilst disqualified by her earlier conviction. The member claimed that these proceedings lasted about three years before the proceedings were stopped, apparently after the intervention of the National Director of Public Prosecutions and she was then acquitted.

[21] It was not disputed that the taxpayer as well as its member had been subjected to audits by various audit teams appointed by SARS. The effect of the member's evidence was to suggest bias and victimization on the part of SARS. In this regard attention was also drawn to the fact that SARS had applied for and obtained an order for the provisional liquidation of the taxpayer as well as preservation orders. Bias was denied and justification for the actions of SARS asserted during the course of the proceedings. These are not, however, issues for decision in the present application and merely constitute part of the background.

[22] The realisation that the affairs of the taxpayer needed to be seriously addressed must have dawned upon the member because towards the end of 2012 a new firm of chartered accountants, namely Mr RS were appointed. As a result it appears that an approach was made to SARS that Mr RS would prepare afresh financial statements for the taxpayer for the disputed tax years 2008 to 2011 and that these should be accepted by SARS as the taxpayer's final and definitive financial statements. Inherent in this approach was a concession on behalf of the taxpayer that its preceding financial statements were unreliable. Inevitably that also cast doubt upon the accuracy of the tax returns previously submitted on behalf of the taxpayer.

[23] It appears that agreement was reached that SARS would have regard only to the final financial statements and ledgers to be produced by Mr RS and disregard the earlier versions produced by their predecessors on behalf of the taxpayer and that Mr RS would produce and submit these during February 2013, which was done.

[24] However, during May 2013 SARS appointed a new audit team headed by Mr E as the responsible senior SARS official and which included Ms DD as head of the SARS audit engagement team. According to Ms DD, who was called by SARS as its first witness, the new team resolved not to place reliance upon the findings of its own earlier audits, to perform an integrated audit procedure extending the audit period to include the whole of the 2012 tax year, as well and to have regard to all tax types and include all taxpayers considered as associated with the taxpayer under audit. According to Ms DD, at a meeting convened on 13 July 2013 to introduce the new audit team to the taxpayer's representatives it was specifically agreed that SARS would have regard to the final general ledgers and financial statements of the taxpayer as prepared by RS only. As a result RS later prepared and submitted the taxpayer's 2012 financial statements and its income tax return based thereon.

[25] The approach of the new audit team included the appointment of the auditing firm of KK Inc to assist SARS with a field audit to be conducted at the offices of Mr RS on 18, 19 and 20 September 2013. In preparation for the audit SARS inter alia gave notice of a random selection of sample transactions which would be examined during the course audit. On 17 September 2013, that is the day before the audit was due to commence, Mr RS on behalf of the taxpayer gave notice of IT3(a) certificates for the tax years 2008 to 2012 issued and based upon the taxpayer's annual financial statements as prepared by RS. Ms DD explained that such certificates reflected remuneration by the taxpayer to its member for work or services from which no employee's tax (PAYE) had been deducted and suggested that they came about because of the list of sample transactions issued by SARS in anticipation of the field audit.

[26] According to Ms DD, SARS was dissatisfied with the accuracy and completeness of the taxpayer's records which had been the subject of the audit. PwC later rendered two voluminous reports, the last of which was dated 28 October 2014. In the meantime SARS wished to verify payments claimed by creditors of the taxpayer as well as payments made to them and on 4 August 2014 commenced with a formal tax inquiry where in all thirty one witnesses were called, as reflected in the list comprising exhibit “B”. Further correspondence and meetings between the representatives of the parties followed.

[27] On or about 26 February 2015 SARS advised that, acting in terms of sections 92 and 95 of the Tax Administration Act 28 of 2011 (the TAA), it had raised additional estimated assessments as against the taxpayer in respect of the tax periods extending over the years 2008 through to 2012, both inclusive, relating to IT, VAT, PAYE and STC. The taxpayer in terms of Rule 6(1) of the Tax Court rules requested reasons before formally objecting and setting the present appeal process in motion.

[28] The settlement reached between the parties and as embodied in the consent order (exhibit “A”) is, in all the circumstances, clearly a settlement as contemplated in section 142 of the TAA which defines a 'dispute' as a disagreement on the interpretation of either the relevant facts involved or the law applicable thereto, or of both the facts and the law and which arises out of an assessment. To “settle” is defined as to resolve a dispute by compromising a disputed liability. This presupposes that neither SARS nor the taxpayer concerned necessarily accepts the other's point of view of the disputed facts or of the law.

[29] Based on this approach, namely that the settlement was a compromise where neither party recognised the validity of the other's point of view, counsel for the taxpayer submitted that with regard to the understatement penalties SARS had failed to establish the jurisdictional requirements for the imposition of such a penalty.

[30] In advancing this submission it needs to be noted that the parties were ad idem that in a tax appeal of this nature this court sits as a court of revision whereby it exercises its own original discretion based upon the facts placed before or determined by it. In *XYZ CC v The Commissioner for the South African Revenue Service*, Case No. 14055/17 Olsen, J. at para 31 pointed out that the correct approach to be adopted by the court in considering a decision by SARS with regard to an understatement penalty (USP) appealed against under the TAA was to exercise its own independent discretion because the proceedings before it required a rehearing of the whole matter. In the present instance that is all the more relevant because the reassessment of the penalties are to be made against the background of the compromise embodied in the consent order of 2 September 2019 (exhibit "A").

[31] Mr J SC, who appeared with Ms N for the taxpayer, submitted that SARS had failed to establish the jurisdictional requirements for the imposition of a USP because, in order to impose a USP, SARS needs to prove a shortfall as envisaged in section 222(3) of the TAA. In this regard counsel pointed out that the TAA came into effect on 1 October 2012, that is after the initial returns for the 2008 to 2011 tax years of assessment had been submitted. Section 222(3) provides that:

> **"222 Understatement penalty—**
>
> (2)
>
> (3) The shortfall is the sum of—
>
> (*a*) the difference between the amount of 'tax' properly chargeable for the tax period and the amount of 'tax' that would have been chargeable for the tax period if the 'understatement' were accepted;"

And in terms of section 221 of the TAA an understatement is defined as –

> " **'understatement'** means any prejudice to SARS or the *fiscus* as a result—
>
> (a) a default in rendering a return;
>
> (b) an omission from a return;
>
> (c) an incorrect statement in a return;
>
> (d) if no return is required, the failure to pay the correct amount of 'tax';
>
> (e) an 'impermissible avoidance arrangement' ".

[32] Relying upon section 102(2) of the TAA placing the burden of proving the facts upon which SARS based the imposition of an USP, counsel submitted that it was apparent that in order to impose a USP, SARS needed to establish a shortfall, as envisaged in section 222(3) of the TAA and that it failed to do so in the light of the compromise.

[33] In this regard counsel submitted that in terms of section 222(3)(*a*) of the TAA an understatement penalty is based upon a shortfall, being the difference between the tax properly chargeable for the tax period and the tax that would have been chargeable if the understatement had been accepted. Accordingly and if the tax properly chargeable has not been determined, a shortfall cannot be calculated and absent a shortfall, no USP could be imposed.

[34] In relation to income tax (IT) only the 2010 tax year was in issue and counsel submitted that due to the compromise agreement reached it was not possible to calculate the shortfall. In this regard counsel pointed out that in the taxpayer's original tax return submitted on 3 November 2011, apparently by Ms G, it declared income tax payable being R6 573 662.48. As per its letter of assessment of 26 February 2015 SARS had estimated the taxpayer's income tax for 2010 at R17 715 659.00 but after objection reduced it to R16 466 809.01. By virtue of the compromise the parties agreed a tax amount of R12 221 765.94 which counsel pointed out was about R20 000.00 less than the tax amount calculated by RS for 2010, namely R12 242 172.00.

[35] In the light thereof counsel for the taxpayer submitted that the amount of tax properly chargeable for the 2010 tax period was not determined by the compromise agreement within the meaning of section 222(3)(*a*) of the TAA because neither party conceded that the other was correct. In this regard reliance was placed upon *Gollach and Gomperts (1967) (Pty) Ltd v Universal Mills & Produce Co (Pty) Ltd and Others* 1978 (1) SA 914 (A) at 921 A-C where Miller, JA equated a transactio with a compromise in full and final settlement and *Wilson Bayly Holmes (Pty) Ltd v Maeyane and Others* 1995 (4) SA 340 (T) at 345 E-F where Nugent, J (as he then was) held that:

> "The contract in the present case was one of compromise. The nature of such a contract is that it is concluded because the rights of the parties are uncertain, and they choose not to resolve that uncertainty. By the very nature of such a contract, there can be little room for finding that the parties must have intended their contract to depend upon the existence of one or other of the factors relevant to their respective rights. It is precisely to avoid testing them that they compromise."

[36] In the alternative and in any event it was submitted that the amount of tax that would have been chargeable for the tax period if the 'understatement' were accepted had to be determined based upon the taxpayer's "final" tax return. Section 27 (1) of the TAA permitted a senior SARS official to authorise a taxpayer to submit further or more detailed returns regarding any matter for which a return under sections 25 or 26 is required or prescribed and it was submitted that this is what happened in this instance by virtue of the agreement to disregard the taxpayer's earlier financial statements in favour of those submitted by Mr RS.

[37] With regard to the STC returns it was pointed out that the taxpayer had submitted a return for the 2008 tax year but failed to submit returns for the years 2009 to 2012 inclusive thereafter. Counsel submitted that the subsequent RS financial statements in fact constituted the taxpayer's STC returns for these tax periods because SARS had accepted that the earlier financial statements had been incorrect.

[38] Upon the approach of the taxpayer its original return submitted on 3 November 2011 had been amplified and corrected by the subsequent financial statements prepared and submitted by Mr RS, so that when the estimated assessment was made on 26 February 2015 it should have been based upon the tax amount calculated by RS for 2010, namely R12 242 172.00, which was more than the agreed tax properly chargeable as per the compromise.

[39] Mr C SC, who appeared with Ms BB for SARS adopted the approach that the terms of the compromise agreement had put an end to the earlier issues in dispute between the parties and that the agreement was decisive of the disputes. Counsel submitted that in terms thereof the parties had finally and unambiguously agreed that the tax declared by the taxpayer for the 2010 tax year was R6 573 662.48, the tax properly payable was R12 221 765.94 and the under declaration of tax for purposes in terms of section 222(3)(*a*) was R5 648 103.46. This, so counsel submitted also qualified as a substantial "substantial understatement" as defined in section 221 because the under declaration exceeded R1 million.

[40] With regard to the supplementary tax on companies (STC) assessments it was submitted that it was common cause that the taxpayer had submitted returns for the 2008 tax year and for which period it had in fact overpaid and that no STC penalty had been raised in respect of that tax year. Thereafter, however, the taxpayer failed to render returns for the remaining tax years under consideration. It was further pointed out that the RS financial statements for the 2009 to 2012 tax years made provision for dividends to be

declared in amounts which broadly corresponded with the SARS calculations, save for the 2012 tax year where the SARS calculation was less than that of RS.

[41] On the approach taken by SARS the understatement is based upon section 222(3)(*a*) of the TAA, namely the difference between the tax properly chargeable for the different tax periods and the tax which would have been chargeable for the tax periods if the understatements were accepted. In the absence of STC returns for the 2009 to 2012 tax years it was submitted that this should be equated to "Nil" returns, so that the understatements amount to the full amounts later determined by agreement between the parties as per the order of 2 September 2019 (Exh A).

[42] It was further submitted that the understatements were substantial understatements for the 2010 and 2012 tax periods and merely understatements for the 2009 and 2011 tax periods. This distinction appeared to be based upon the relevant definitions contained in section 221 of the TAA and that the agreed STC amounts for the 2010 and 2012 tax periods exceeded R1 million, whereas those for the 2009 and 2011 period did not.

[43] An understatement is defined in section 221 of the TAA as follows:

> " **'understatement'** means any prejudice to SARS or the fiscus as a result of—
>
> (*a*) a default in rendering a return;
> (*b*) an omission from a return;
> (*c*) an incorrect statement in a retum;
> (*d*) if no return is required, the failure to pay the correct amount of 'tax'; or
> (*e*) an 'impermissible avoidance arrangement'."

[44] Counsel for SARS, in para 59 of their written argument, submitted that the prejudice to SARS arose, as follows:

> "The understatement concerning STC is the prejudice to the respondent as a result of the appellant's default in rendering a return. Therefore, the tax that would have been chargeable if the understatement were to have been accepted, would have been Rnil."

[45] On behalf of the taxpayer counsel submitted that an under declaration of tax is only an "understatement' as defined, if prejudice to SARS resulted. This was because the potential acceptance by SARS of such "understatement" would create the shortfall as contemplated in section 222(3)(*a*) of the TAA.

[46] Counsel sought to challenge the allegation of any understatement firstly by reliance upon section 25 of the TAA which requires a return to be submitted in the prescribed form, as well as section 27 of the TAA which provides that a senior SARS official may require more detailed and further returns. With reference to the definition of a return in section 1 of the TAA it was submitted that –

> "[a] **'return'** means a form, declaration, document or other manner of submitting information to SARS that incorporates a self-assessment , is a basis on which an assessment is to be made by SARS or incorporates relevant material required under section 25, 26 or 27 or a provision under a tax Act requiring the submission of a return;".

[47] It was therefore submitted that the financial statements compiled by RS also constituted the final "returns" for STC, were accepted as such by SARS in the issuing of the STC assessments during February 2015 and were thus capable of and formed the basis for the alleged outstanding returns. This was because such financial statements were agreed to represent the taxpayer's final declarations to SARS in respect of the 2008 to 2012 tax years. In terms of clause 9 of the compromise agreement (Exh A), the February 2015 STC assessments were reduced for each of the 2009 to 2012 tax years.

[48] Counsel submitted that in these circumstances SARS cannot be said to have suffered any prejudice, which was a jurisdictional requirement for an understatement, as defined. It was further submitted that no "understatement' or "shortfall' was established because the financial statements, as STC returns, had in fact over declared the STC payable for those tax years.

[49] The situation is unusual. The parties had effectively agreed to disregard past disputes, returns and SARS audits and start afresh based upon the RS financial statements to be prepared and submitted. The February 2015 assessments were broadly based upon or consistent with the RS financial statements which were in turn compromised in the agreement made an order of court on 2 September 2019 (Exh A).

[50] If the RS financials were accepted as substantial compliance with the requirements for STC returns, then SARS cannot be said to have suffered any prejudice. However, if these financials did not qualify as STC returns, then the question arises as to whether SARS has been shown to have suffered any prejudice by the failure of the taxpayer to submit returns for the 2009 to 2112 tax years.

[51] Prejudice is not defined in section 221 of the TAA. In terms of the definition of an understatement in that section it includes prejudice suffered due to a failure to render a return, but that still does not identify the nature of any disadvantage or loss which could result in prejudice to SARS.

[52] While generally in terms of section 129(1) of the TAA the tax court, in an appeal against an assessment or “decision”, must decide the matter on the basis that the burden of proof is upon the taxpayer, section 129(3) provides that, in a case of an appeal against an understatement penalty, the burden of proof is upon SARS.

[53] In the particular circumstances of the present matter I cannot conclude that SARS has demonstrated a material failure to render STC returns, but even if I were wrong in this conclusion then SARS has failed to demonstrate any material resulting prejudice upon which it could rely in establishing an “understatement” as defined in section 221 of the TAA. It follows that the appeal against the understatement penalties for STC must succeed.

[54] There remains the understatement penalty in respect of income tax for the 2010 tax year. In terms of the compromise agreement (Exh A) the taxpayer's total income declared and based upon the RS financials was R6 573 662.48, the agreed income for that tax year was R12 221 765.94, resulting in an agreed under declaration of income of R5 648 103.46. Expressed as a percentage it amounts to a 46,21% under declaration.

[55] On behalf of the taxpayer it was not seriously disputed that the taxpayer had been negligent in rendering a return under declaring its income for the 2010 tax year. Instead the main thrust of the argument advanced was aimed at demonstrating that such negligence did not amount to gross negligence.

[56] On behalf of SARS counsel submitted that gross negligence was involved. SARS also sought to rely upon a so-called “repeat case” of similar behaviour in justifying an increased penalty for the under declaration for the 2010 tax year. In this regard counsel submitted that there had been a previous assessment for the 2007 tax year involving similar conduct, being a failure to provide supporting documentation and an inclusion of personal expenses as business expenses.

[57] Counsel for the taxpayer countered and submitted that the repetitive behaviour relied on by SARS emerged from the evidence of Ms DD, who alluded to a 2007 assessment for income tax under re-examination. Counsel pointed out that such assessment was never discovered, nor identified by SARS in making its original

determination. Consequently it was submitted that SARS could not rely on such alleged repetitive behaviour in fixing the penalty for the 2010 under declaration.

[58] In my view and since an understatement penalty imposed by SARS under a tax Act is involved, the provisions of section 129(3) of the TAA require that the burden of proof rests upon SARS. There is, in the circumstances, insufficient evidence on record to make a finding that a so-called "repeat case" of similar behaviour in relation to the taxpayer had been established.

[59] Insofar as the repeat case approach was based upon the alleged behaviour in relation to other tax years during the period 2008 to 2012, Ms DD correctly in my view conceded in evidence that in view of the compromise agreement concluded and made an order of court (Exh A) ,whatever disputes may have existed between the parties regarding any other under declaration of income had not been established.

[60] Turning to the issue of whether the negligence of the taxpayer qualifies as gross negligence counsel for SARS was very critical of the conduct of the taxpayer's sole member. Counsel submitted that whilst there was no impediment preventing a taxpayer from appointing advisors such as auditors with the requisite expertise, this did not relieve the sole member of the taxpayer of her fiduciary duties and statutory obligations.

[61] In considering the concept of gross negligence counsel for both the taxpayer and SARS relied upon the decision in *MV Stella Tingas (Transnet Limited t/ a Portnet v Owners of the MV 'Stella Tingas' and Another* 2003 (2) SA 473 (A) at para 7 where Scott JA held that:

> "It follows, I think that to qualify as gross negligence the conduct in question, although falling short ofdolus eventualis, must involve a departure from the standard of the reasonable person to such an extent that it may properly be categorised as extreme; it must demonstrate, where there is found to be conscious risk-taking, a complete obtuseness of mind or, where there is no conscious risktaking, a total failure to take care. If something less were required, the distinction between ordinary and gross negligence would lose its validity."

[62] The issue of negligence and particularly whether it was gross, needs to be considered against the historical background of the matter. The sole member of the taxpayer took over the close corporation from her mother and then turned it into a low cost housing contractor. The business expanded rapidly and the member, realising that the taxpayer needed to become tax compliant approached SARS for assistance. It is SARS who referred the taxpayer to its initial auditors. According to the member of the taxpayer

professional accountants were thereafter employed by the taxpayer who attended both to the taxpayer's bookkeeping functions and producing its financial statements. The member of the taxpayer explained that she was fully occupied in supervising the taxpayer's construction activities and left the accounting functions of the taxpayer's business in the hands of the various accounting firms employed by the taxpayer in this regard. Judging by the agreed income figures the 2010 tax year was indeed a busy year.

[63] Clearly the member of the taxpayer devoted herself to the construction part of the business and left it to the successive accountants employed by the taxpayer to perform the bookkeeping, accounting and taxation functions. Given that there were a number of tax audits and disputes, culminating in the agreement during 2013 that RS would prepare fresh financial statements for the 2008 to 2012 tax years, the taxpayer's member clearly did not devote adequate time and energy to the accounting side of the taxpayer's business.

[64] But what is noteworthy from the compromise agreement is that out of the five year period under consideration (the 2008 to 2012 tax years), only 2010 showed an under declaration of the taxpayer's income, whilst the years 2008, 2009, 2011 and 2012 all showed over declarations. This would not suggest the conduct of a serial defaulter repeatedly under declaring income, nor a departure from the standards of a reasonable person to an extreme extent, or demonstrate conscious risk-taking, or a complete obtuseness of mind or, absent conscious risk-taking, a total failure to take care.

[65] In the circumstances and against the background of the agreed income declarations for the taxpayer during the tax years under consideration, the 2010 tax year appears to be an aberration and does not give rise to a pattern of misconduct. Whilst I accept that the member and thus the taxpayer was negligent in not taking a greater interest in what its accounting professionals were doing at the time, I cannot conclude that gross negligence has been established for purposes of holding that the under declaration of income for the 2010 tax year amounted to gross negligence.

[66] In terms of section 222(2) of the TAA the appropriate understatement penalty for a shortfall is to be determined according to the table in 023. In column 2 of the table there are six behavioural categories stated in an order of increasing severity. That the understatement in question amounted to a substantial understatement is clear, but that would be the most lenient category which, in my view and against the background of the matter, would be too lenient an approach. Likewise the understatement might qualify as one where reasonable care was not taken in completing the return, but given the extent of the under declaration, it cannot in my view qualify as reasonable. The next category is one where no reasonable grounds for the tax position taken has been shown. The

remaining categories (iv), (v) and (vi) respectively are an “Impermissible avoidance arrangement', which on the evidence has not been established, “Gross negligence' which as already indicated, does not apply to the matter and finally, “Intentional tax avoidance” which has not been shown.

[67] Inevitably in categorising an under declaration a measure of discretion is involved, In my view the first two categories would undervalue the transgression whilst the last three would result in unduly severe consequences for the taxpayer with regard to the 2010 tax year. Having considered the under declaration for 2010 against the background of the matter, including the compromise agreement concluded between the parties, I have come to the conclusion that category (iii) of the table contained in section 223 of the TAA is the most appropriate category in which the under declaration should be classified.

[68] In terms thereof read with section 222(3)(*a*) the percentage penalty to be applied to the difference between the agreed tax properly chargeable, namely R12 221 765.94 and the tax previously declared by the taxpayer in the sum of R6 573 662.48, namely R5 648 103.46, expressed as a percentage, would be 50%.

[69] Finally there remains to be considered the taxpayer's contention that it should be relieved of payment of interest in terms of section 89*quat* of the Income Tax Act 58 of 1962 in respect of the under declaration of income tax for the 2010 tax year. Section 89*quat* (as it then read) at the relevant time (for the 2010 year) stated as follows:

> “(2) If the taxable income of any provisional taxpayer as finally determined for any year of assessment exceeds.. .. and the normal tax payable by him in respect of such taxable income exceeds the credit amount in relation to such year, interest shall, subject to the provisions of subparagraph (3), be payable by the taxpayer at the prescribed rate on the amount by which such normal tax exceeds the credit amount, such interest being calculated from the effective date in relation to the said year until the date of assessment of such normal tax.
>
> (3) Where the Commissioner having regard to the circumstances of the case, is satisfied that any amount has been included in the taxpayer's taxable income or that any deduction, allowance, disregarding or exclusion claimed by the taxpayer has not been allowed, and the taxpayer has on reasonable grounds contended that such amount should not have been included or that such deduction allowance, disregarding or exclusion should have been allowed, the Commissioner may, subject to the provisions of section 103(6) direct that interest shall not be paid by the taxpayer on so much of the said normal tax as is attributable to the inclusion of such amount or the disallowance of such deduction, allowance, disregarding or exclusion.”

[70] Counsel for the taxpayer submitted that since the amount of its taxable income for the years of assessment from 2008 to 2012 had only been agreed upon by way of the compromise made an order of court on 2 September 2019, SARS was not entitled to levy section 89*quat* interest for any period prior thereto. It was further submitted that prior to 2 September 2019 the taxpayer's taxable income had not been finally determined so that the section 89*quat* interest levied by SARS ought to be remitted in full.

[71] Counsel for SARS submitted that it was necessary for the taxpayer to establish the reasonable grounds upon which it contended that it should be excused from paying interest in terms of section 89*quat* of the Income Tax Act and that it had failed to do so in the circumstances.

[72] The “effective date” for purposes of the calculation of section 89*quat* interest is defined in section 89*quat*(1) and section 89*quat*(2) provides for such interest being calculated from the effective date in relation to the said tax year until the date of assessment of such normal tax. If, as was contended on behalf of the taxpayer, the date of the compromise agreement (2 September 2019) represented the date of final assessment of the tax due for the 2010 tax year, then interest would still be payable from the effective date, as defined.

[73] In terms of clause 13 of the compromise agreement (Exh A) the parties are in agreement that the section 89*quat* interest would be recalculated in the light of the outcome of the appeal in relation to the decisions in respect of the USP for the 2010 income tax and the STC for the years 2009 to 2012 inclusive.

[74] In addition the taxpayer seeks an order that SARS be directed to revisit the allocation of payments by the taxpayer after assessments in accordance with the compromise agreement have been issued and taking into account the outcome of the appeal with regard to the USP and section 89*quat* interest. The need therefore was conceded by Ms DD in her evidence.

[75] In the circumstances the following order on the remaining issues in the appeal is made, namely:

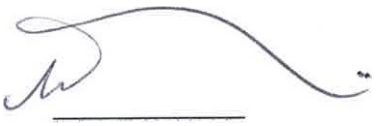
a. The appeal against the determination of an understatement penalty in respect of income tax for the 2010 tax year of 125% succeeds to the extent that the penalty of 125% is set aside and it is replaced with a penalty of 50%.

b. The appeal against the understatement penalties in respect of secondary tax on companies of 50% for the tax years 2009 to 2012 is upheld and the penalties imposed are set aside.

c. The appeal against the levying of interest in terms of section 89*quat* of the Income Tax Act 58 of 1962 is dismissed.

d. The respondent the Commissioner for the South African Revenue Service is directed to revisit and where relevant reconsider the allocation of payments by the taxpayer after the assessments in accordance with the compromise agreement of the parties have been issued and taking into account the outcome of the appeal with regard to the understatement penalties and section 89*quat* interest.

e. By consent there will be no order as to the costs and any costs previously reserved.



VAN zŸL, J.

9 December 2020