THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case No: 310/2016

In the matter between:

NEW ADVENTURE SHELF 122 (PTY) LTD **APPELLANT**

and

THE COMMISSIONER OF THE SOUTH AFRICAN REVENUE SERVICES **RESPONDENT**

Neutral citation: *New Adventure Shelf 122 v Commissioner : SARS* (310/2016) [2017] ZASCA 29 (28 March 2017)

Coram: Shongwe, Leach, Wallis, Mocumie JJA and Nicholls AJA

Heard: 19 February 2017

Delivered: 28 March 2017

Summary: Revenue: capital gains tax arising from the sale of immovable property: sale cancelled more than three years after assessment of capital gains tax but before purchase price paid in full: seller not entitled to have assessment reconsidered in the light of the subsequent cancellation: regard to be had to the cancellation in assessing a capital gain or capital loss in year of cancellation.

ORDER

On appeal from: The Western Cape Division of the High Court, Cape Town (Binns-Ward J sitting as court of first instance), judgment reported as *sub nom New Adventure Shelf 122 (Pty) Ltd v Commissioner for South African Revenue Service* Case No: 7007/2015; 17 February 2016; (2016) 78 SATC 190:

The appeal is dismissed with costs, such costs to include the costs of two counsel.

JUDGMENT

Leach JA (Shongwe, Wallis and Mocumie JJA and Nicholls AJA concurring)

[1] The issue in this appeal relates to the consequences in regard to capital gains tax where the sale of an asset is cancelled before the seller has been paid in full, with the unpaid balance of the proceeds of the sale being forfeited and the asset being returned to the seller. During the 2007 tax year, the appellant company sold a piece of immovable property near Stilbaai at a price which resulted in it receiving a substantial capital gain as envisaged in the Eighth Schedule of the Income Tax Act 58 of 1962 (the Act). This capital gain was taken into account in the assessment of the appellant's liability for tax in respect of that year. Unfortunately, the purchaser thereafter paid only a portion of what

it had agreed to pay, which led to the sale being cancelled by agreement several years later. In terms of the cancellation agreement, the property was returned to the appellant who retained what payments had been made by the purchaser as predetermined damages for breach of contract.

[2] In these circumstances, as it had in fact received much less than the agreed price at which it had sold the property, the appellant attempted to persuade the respondent, the Commissioner of the South African Revenue Services (SARS) to withdraw its tax assessment for the 2007 tax year and to reduce its tax liability for that year. This, SARS was not prepared to do. When its attempts failed, the appellant applied to the Western Cape Division of the High Court, Cape Town seeking an order reviewing SARS's decision and directing it to do so. The matter came before Binns-Ward J who dismissed the application. The appeal to this court is with leave of the court a quo.

[3] The background facts are common cause. In 1999 the appellant, a company with its registered address in Riversdal, Western Cape, purchased the property at a price of R185 000. Subsequently, on 20 September 2006, a date which fell within the appellant's 2007 tax year of assessment, the appellant concluded a written deed of sale in terms of which it sold the property to Kalipso Twintig (Pty) Ltd (Kalipso) at an agreed price of R17 720 000. The deed of sale required Kalipso to pay the purchase price by way of a deposit of R1 200 000 (which had already been paid on 13 November 2005), with a further sum of R1 million to be paid on the date of registration of transfer. It provided for Kalipso to register a bond over the property on transfer in order to secure payment of the balance R15 520 000. This was to be paid by way of three equal annual instalments of R500 000 commencing on 31 October 2007, with a final

payment of R14 020 000 to be made on 31 October 2010. Pursuant to this agreement, the property was duly transferred to Kalipso and the envisaged bond was registered over it.

[4] In the light of these events, in respect of the 2007 tax year the appellant declared a taxable capital gain of R9 746 875 as envisaged in Schedule Eight to the Act derived from the agreed sale price (I shall return to statutory provisions relating to the taxation of capital gains in more detail in due course.) In an assessment issued on 1 August 2008, SARS accepted this as being correct and assessed the appellant as being liable to pay tax of R1 587 277.54 for the 2007 tax year. Of this, R1 413 006.73 related to 'normal tax' – being the amount levied on the capital gain less R 1 000 in respect of a loss – with the balance, an amount of R174 270.81, being interest imposed under s 89 *quat* of the Act.

[5] The appellant accepts that these amounts were correctly calculated. Importantly, it raised no objection to the assessment which therefore became final and conclusive under s 81(5) of the Act. For completeness I should mention that the appellant failed to pay the tax so assessed and had still not done so when the application which is the subject of this appeal was heard in the court a quo in February 2016. Presumably this is due at least in part to its only asset having been the property which it had sold to Kalipso and for which it was not paid as had been agreed.

[6] Kalipso had purchased the property for purposes of effecting a residential development. For various reasons, including a failure to have the property re-zoned, these plans went awry. More importantly for present purposes, it did not honour its obligations in regard to payment. Despite an extension having been

granted, by November 2011 Kalipso had paid the appellant only R4 549 082 rather than the full purchase price of R17 720 000. This breach led to the appellant negotiating a written agreement with Kalipso on 18 November 2011, in terms of which the sale was cancelled, with Kaliso undertaking to restore registered title of the property to the appellant (this was done on 19 April 2012). Further provision was made for the appellant to retain the payments Kalipso had made as agreed damages and for no further amount to bowing due to the cancellation.

[7] As a result of this saga, the appellant in fact received only R4 549 082 from the sale and not the R17 720 000 Kalipso had agreed to pay. Its problem was that it had been taxed on a capital gain that it had not received and that all it could obtain as a result of the cancellation of the sale was an assessed capital loss, with no corresponding gain to set off against the loss. This led to the appellant seeking to have its unpaid tax liability for the 2007 year revised and reduced. On 12 March 2012 the appellant, by way of what purported to be an objection to the 2007 assessment, essentially applied to SARS to withdraw that assessment under s 98(1)*(d)* of the Tax Administration Act 28 of 2011 – which at the time provided for an assessment being withdrawn should SARS be satisfied, inter alia, that it imposed 'an unintended tax debt in respect of an amount that the taxpayer should not have been taxed on' or that the recovery of the debt under the assessment 'would produce an anomalous or inequitable result'.[1] This attempt was unsuccessful as SARS took the view that the 2007 assessment had to be regarded as final and could not be re-opened.

[1] This section has since been amended.

[8] The appellant then took various further steps to obtain relief. These included asking the Legal Delivery Unit of SARS to reconsider the matter, an approach to the Tax Omsbud, and having a tax consultant making representations on its behalf. It is unnecessary for present purposes to detail the negotiations that ensued and the various submissions made on behalf of the appellant, although it must be mentioned that both sides placed considerable reliance upon the Tax Administration Act of 2011. However, they now accept that the relevant events occurred before that Act came into effect on 1 October 2012 and that its provisions do not apply to their current dispute.

[9] In any event, the negotiations came to nought and, eventually, on 14 April 2015, the appellant gave notice under s 11(4) of the Tax Administration Act of its intention to institute proceedings in the High Court. And in due course, on 21 April 2015, it instituted review proceedings in the court a quo, seeking an order setting aside the assessment for the 2007 tax year and certain ancillary relief. The refusal of such relief led to this appeal.

[10] In the light of this background, I turn to consider the appellant's contention that on the facts described above its 2007 tax assessment ought to have been re-opened, revised and reduced. So called 'capital gains tax' was introduced into this country with effect from 1 October 2001 by way of the Eighth Schedule to the Act. Simply put, the essential factor to which regard is had is the difference between the amount at which a person acquires a capital asset and the amount of the proceeds received on its subsequent disposal. Should such proceeds exceed the amount at which it was acquired, there is a capital gain; conversely, should they be less, there will be a capital loss. The aggregate of capital gains and capital losses are then taken into account to

calculate a net capital gain (this being the difference between the aggregate capital gain of a year and the aggregate capital loss of the previous year)[2] and a percentage then applied to the net capital gain to calculate the taxable capital gain for the year of assessment.[3] In terms of s 26A of the Act, that taxable capital gain then falls to be included in the taxable income of the person concerned.

[11] The learned authors of *Silke on South African Income Tax* comment as follows upon the provisions of this scheme:

'Although one refers colloquially to the terms "capital gains tax" or the "capital gains tax provisions", in truth, it is not a separate tax. Taxable capital gains do not constitute "gross income" or "income", but are added directly to a taxpayer's other taxable income and subjected to normal (income) tax. This result is achieved by the charging provision, s 26A, which includes in a person's taxable income for any year of assessment a percentage of his taxable capital gains, as determined in accordance with the provisions of the Eighth Schedule. The effective consequence is that the taxable capital gains are aggregated with other taxable income and taxed according to the normal (income) tax rates.'

[12] The essential starting point of the scheme is the so called 'base cost' of an asset. Although paragraph 20 of the Eighth Schedule provides in considerable detail for the determination of base cost in particular circumstances, it is in simple terms set out in paragraph 20(1)*(a)* as being 'the expenditure actually incurred in respect of the cost of acquisition or creation of that asset'. However, capital gains fall only to be assessed from 1 October 2001, the so called 'valuation date' when capital gains tax was introduced. Accordingly, in respect of assets acquired before that date – referred to as 'pre-valuation date assets' – and in order to levy capital gains tax only on increments in value occurring after

[2] Paragraph 8*(a)* of the Eighth Schedule.
[3] Paragraph 10 of the Eighth Schedule.

the valuation date, the legislature devised a scheme in paragraph 25 of the Eighth Schedule to exclude any increment in value of an asset that may have taken place before the valuation date.

[13] For purposes of this judgment it is unnecessary to have regard to the considerably detailed provisions prescribed in Schedule Eight in order to achieve this end.[4] Suffice it to say that the parties are agreed that although the appellant bought the property for R185 000 in 1999 (it was therefore a pre-valuation date asset), its base cost for purposes of determining its taxable capital gain when sold to Kalipso in the 2007 tax year[5] was a sum in excess of R7m. And although certain of the instalments due in respect of the purchase price were to be paid after the conclusion of the 2007 tax year, by reason of paragraph 35(4) of the Eighth Schedule, these fell to be 'treated as having accrued to [the appellant] during that year'. This led to the calculation of the appellant's capital gains tax liability for the 2007 year as already set out above.[6]

[14] In the light of the appellant's failure to object to its 2007 assessment for more than three years, the initial obstacle the appellant has to overcome is to be found in s 81 of the Act. Under s 81(1) a taxpayer aggrieved by an assessment may object 'in the manner and under the terms and within the period prescribed by this Act'. Section 81(2)*(b)* goes on to provide that the prescribed period for objections may not be extended 'where more than three years have lapsed from the date of the assessment' whilst, as already mentioned, s 81(5) provides that should no objections be made to an assessment, it 'shall be final and conclusive'. Consequently, the now disputed assessment seemingly had become

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[4] For those who might be interested see De Koker and Urquart *Income Tax in South Africa* par 5A.4.4.
[5] Arrived at by applying the time-apportionment method of calculating base cost set out in paragraph 30 of the Eighth Schedule and having regard to certain expenses.
[6] See para 4.

final and conclusive under s 81, and if that is so it is fatal to the relief the appellant seeks. This was SARS's simple answer to the appellant's claims.

[15] The appellant's argument as I understood it, however, was that this did not apply in respect of tax levied on a capital gain. This argument was founded in the main upon paragraph 35 of the Eighth Schedule which, inter alia, provided:

'35(1) Subject to subparagraphs (2), (3) and (4), the proceeds from the disposal of an asset by a person are equal to the amount received by or accrued to, or which is treated as having been received by, or accrued to or in favour of, that person in respect of that disposal . . .

(2) . . .

(3) The proceeds from the disposal of an asset by a person, as contemplated in subparagraph (1) must be reduced by –

(a) any amount of the proceeds that must be or was included in the gross income of that person or that must be or was taken into account when determining the taxable income of that person before the inclusion of any taxable capital gain;

(b) any amount of the proceeds that has been repaid or has become repayable to the person to whom that asset was disposed of; or

(c) any reduction, as the result of the cancellation, termination or variation of an agreement or due to the prescription or waiver of a claim or release from an obligation or any other event of an accrued amount forming part of the proceeds of that disposal.'

[16] In the light of these provisions, the appellant argued as follows: Under paragraph 3 of the Schedule, a person's capital gain is calculated with reference to the proceeds received or accrued from a disposal of an asset. The capital gain received or accrued is calculated in terms of paragraph 35(1) of the Eighth Schedule. That paragraph includes sub-paragraph 35(3), which says that the

gain is to be reduced by certain amounts. One of these is that contained in paragraph 35(3)*(c)*, namely, any reduction in those proceeds as the result of the cancellation, termination or variation of an agreement. This is what occurred here. In almost all instances falling within this sub-paragraph, the reduction of proceeds by virtue of cancellation or the like will occur in a later year of assessment. Paragraph 25(2) requires the taxpayer, in those circumstances, to re-determine the base cost of the asset and the capital gain in the light of the change in circumstances. That can only relate to the original assessment. Accordingly, so the argument went, it is the original assessment that must be re-opened and revised in the light of the redetermination of the base cost and the amount of the capital gain.

[17] The appellant sought to buttress its argument that there should be such a redetermination of the capital gain by arguing that unlike 'normal' income tax (in respect of which s 81 would clearly apply) the assessment of capital gains tax was not necessarily an annual event. It argued that the only way that there can be a matching of capital gains arising in one tax year and capital losses arising out of the same transaction in a later tax year, is to allow such a redetermination, the mechanism of which lies in paragraph 25 of the Eighth Schedule. Sub-paragraph 25(1) provides a scheme to exclude any increment in value of a pre-valuation date asset that may have taken place prior to the valuation date. Sub-paragraphs 25(2) and (3) go on to provide:

'(2) If a person has determined the base cost as contemplated in subparagraph (1) of a pre-valuation date asset which was disposed of during any prior year of assessment and in the current year of assessment─

(a) any amount of proceeds is received or accrued in respect of that disposal which has not been taken into account in any prior year in determining the capital gain or capital loss in respect of that disposal;

(b) any amount of proceeds which was taken into account in determining the capital gain or capital loss in respect of that disposal has become irrecoverable, or has become repayable or that person is no longer entitled to those proceeds as a result of the cancellation, termination or variation of any agreement or due to the prescription or waiver of a claim or a release from an obligation or any other event during the current year;

(c) any amount of expenditure is incurred which forms part of the base cost of that asset which has not been taken into account in any prior year in determining the capital gain or loss in respect of that disposal; or

(d) any amount of base cost of that asset that has been taken into account in any prior year in determining the capital gain or capital loss in respect of that disposal, has been recovered or recouped,

that person must redetermine the base cost of that asset in terms of subparagraph (1) and the capital gain or capital loss from the disposal of that asset, having regard to the full amount of the proceeds and base cost so redetermined.

(3) The amount of capital gain or capital loss redetermined in the current year of assessment in terms of subparagraph (2), must be taken into account in determining any capital gain or capital loss from that disposal in that current year, as contemplated in paragraph 3 (1)*(b)*(iii) or 4 (1)*(b)*(iii).'

[18] There are a number of difficulties confronting this argument. Bearing in mind the provisions of the basic scheme under which capital gains tax is levied, the assessment of capital gains tax is, an annual event in the sense that, if any occurrences during a tax year render the provisions of Schedule Eight applicable to an accrual of a taxable capital gain, the amount thereof is to be included in the taxpayer's taxable income for that year. This is in line with the general principle that income tax is an annual fiscal event so that, as was stated by Botha JA in *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* 1975 (1) SA 665 (A) at 677H-678A:

'. . . events which may have an effect upon a taxpayer's liability to normal tax are relevant only in determining his tax liability in respect of the fiscal year in which they occur, and cannot be relied upon to re-determine such liability in respect of a fiscal year in the past.'

[19] Consequently, the fact that in a particular year there may not be any events which lead to the accrual of a taxable capital gain is no reason to find that when they do occur, and when a taxable capital gain is included in a taxpayer's taxable income, provisions relating to an assessment of tax liability such as those in s 81 should not apply.

[20] In addition, the appellant's argument requires paragraph 35 of the Eighth Schedule to be construed as applying not only to the determination of capital gains in a particular year, but also to require a redetermination in a later year of a capital gain already accrued. But that is inconsistent with the overall scheme of paragraph 35(3). In the first place the sub-paragraph relates to the determination of the proceeds of a disposal 'during a year of assessment'. It provides that the proceeds in that year, and that year alone, are to be reduced by three items.

[21] The first of these is any amount of the proceeds of the disposal of the asset that have already been taken into account in the taxpayer's gross income. That can only apply during the year in which the disposal occurs. It is directed at the situation where the accrual constitutes gross income as would be the case with a disposal by a person who deals in shares or the disposal by a property developer of all or part of the development. As that is the income-earning activity of those taxpayers the proceeds from such disposals constitute gross

income. They must accordingly be excluded from the calculation of capital gains.

[22] The second item deals with the situation where the taxpayer has to repay part of the price, or other proceeds of disposal, to the party to whom the disposal was made. This deals with a number of commonplace situations, such as the redetermination of the purchase price of a business in the light of a post-sale determination of the value of stock on hand or book debts. Another would be a refund of portion of the price to address a complaint that the goods sold were defective. A third would be the need to meet warranty claims. Again these are events that will ordinarily come to light in the year in which the disposal occurs.

[23] The third item, a reduction of the proceeds of the disposal caused by a cancellation or variation of an agreement, is also likely to occur in the same year as the disposal. Thus all three situations envisaged by the sub-paragraph are directed at ensuring that where a disposal occurs in a particular tax year, events during that year that operate to diminish the proceeds received by the taxpayer in that year are taken into account to reduce those proceeds and hence the capital gain arising from the disposal. That is the ordinary and natural construction to be given to paragraph 35 and I agree with the argument by SARS that the amendments effected in 2015 with effect from 2016, which clearly spell that out to be the case, are confirmatory of that construction.[7]

[7] *Patel v Minister of the Interior & another* 1955 (2) SA 485 (A) at 493A-D and *National Education Health and Allied Workers' Union v University of Cape Town & others* 2003 (3) SA 1 (CC) para 66.

[24] Moreover, the provisions of paragraphs 3, 4 and 25 of the Eighth Schedule do not support the appellant's argument. As set out in paragraph 25(2), the base cost of a pre-valuation date asset which was disposed of during any prior year of assessment, as well as the capital gain or capital loss from the disposal of that asset, is to be redetermined 'in the current year of assessment' should certain events occur. Paragraph 25(3) further provides that if such events take place, the amount of the redetermined capital gain or capital loss 'in the current year of assessment . . . must be taken into account in determining any capital gain or capital loss from that disposal in that current year, as contemplated in paragraph 3*(b)*(iii) or 4*(b)*(iii).' As appears from this, should there be a redetermination of a capital gain or a capital loss that occurred in a prior year of assessment, that redetermination is to be taken into account in the determination of a capital gain or a capital loss, not in the prior year but in the current year ie in the tax year in which the events giving rise to the redetermination take place.

[25] This conclusion is reinforced by the provisions of paragraphs 3 and 4 to which paragraph 25(3) refers. They read:

'3 A person's capital gain for a year of assessment, in respect of the disposal of an asset

(a) . . .

(b) in a previous year of assessment, is equal to

(i) so much of any amount received by or accrued to that person during the current year of assessment, as constitutes part of the proceeds of that disposal which has not been taken into account

(aa) during any year in determining the capital gain or capital loss in respect of that disposal;

(bb) in the redetermination of the capital gain or capital loss in terms of paragraph 25(2); or;

(ii) . . . or

(iii) the sum of

(aa) any capital gain redetermined in terms of paragraph 25(2) in the current year of assessment in respect of that disposal; and

(bb) any capital loss (if any) determined in respect of that disposal in terms of paragraph 25 for the last year of assessment during which that paragraph applied in respect of that disposal.

4 A person's capital loss for a year of assessment in respect of the disposal of an asset

(a) . . .

(b) in a previous year of assessment, is equal to

(i) so much of the proceeds received or accrued in respect of the disposal of that asset that have been taken into account during any year in determining the capital gain or capital loss in respect of that disposal

(aa) as that person is no longer entitled to as a result of the cancellation, termination or variation of any agreement, or due to the prescription or waiver of a claim or a release from an obligation or any other event during the current year of assessment;

(bb) as has become irrecoverable during the current year of assessment; or

(cc) as has been repaid or has become repayable during the current year of assessment, and which have not been taken into account in the redetermination of the capital gain or capital loss in terms of paragraph 25(2);

(ii) . . . or

(iii) the sum of

(aa) any capital loss redetermined in terms of paragraph 25(2) in the current year of assessment in respect of that disposal; and

(bb) any capital gain (if any) determined in respect of that disposal in terms of paragraph 25 for the last year of assessment during which that paragraph applied in respect of that disposal.'

[26] As clearly appears from their terms, the provisions of paragraphs 3*(b)* and 4*(b)* are of application only in a current year of assessment. They establish convincingly that should any events occur which require the redetermination of a capital gain or a capital loss which accrued in a previous year, such redetermined capital gain or capital loss is to be taken into account in determining the taxpayer's capital gain or capital loss in the current year in which those events occur. That being so, the argument that paragraph 35(3) entitles the taxpayer to have a confirmed tax assessment of a previous year re-opened as a result of a cancellation, termination or variation of an agreement which reduces an accrued amount forming part of the proceeds of an earlier disposal of an asset, is wholly inconsistent with the provisions of the Eighth Schedule and is, quite simply, unsustainable.

[27] The court a quo dealt extensively with the manner in which the cancellation agreement was to be taken into account in respect of the 2010 tax year for purposes of the assessment of capital gains tax. In doing so it endorsed a calculation of the appellant's capital gains tax liability for that year handed up in argument by counsel for SARS to the effect that as a result of the cancellation a capital loss of some R7.7 million had accrued to the appellant. It is unnecessary for purposes of this judgment either to do the arithmetic, or to express any opinion either on how it should be performed or the resultant outcome. Suffice it to say that if there is indeed an accrued capital loss arising from the cancellation which the appellant can use to set off against any future aggregate capital gain, this to a large extent militates against the appellant's argument that reducing its tax liability for the 2007 tax year is the only way in which it could be fairly treated. An assessed capital loss is a valuable asset in the hands of a taxpayer. Whether it is ever used to off-set a future capital gain is a matter entirely within the control of the taxpayer.

[28] In any event, even if in certain instances it may seem 'unfair' for a taxpayer to pay a tax which is payable under a statutory obligation to do so, there is nothing unjust about it. Payment of tax is what the law prescribes, and tax laws are not always regarded as 'fair'. The tax statute must be applied even if in certain circumstances a taxpayer may feel aggrieved at the outcome.

[29] In summary, the cancellation of the sale did not entitle the appellant to have his tax liability for the 2007 year re-assessed. The cancellation and its consequences were factors relevant to an assessment of any capital gain or, more likely, capital loss that accrued during that current tax year and not the year that the capital gain had initially accrued. Consequently, the court a quo correctly concluded that the appellant was not entitled to the relief that it sought. The appeal must therefore fail. There is no reason for costs not to follow the event.

[30] The appeal is dismissed with costs, such costs to include the costs of two counsel.

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L E Leach

Judge of Appeal

APPEARANCES

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