REPORTABLE

IN THE TAX COURT

JOHANNESBURG (MEGAWATT PARK)

Case Number: VAT 189
Date: 6 May 2010

In the matter between:

ABC LIMITED Applicant

and

THE COMMISSIONER FOR THE

SOUTH AFRICAN REVENUE SERVICE Respondent

DELETE WHICHEVER IS NOT APPLICABLE	
~~(1)~~ REPORTABLE: YES/~~NO~~	
(2) OF INTEREST TO OTHER JUDGES: YES/NO	
(3) REVISED	
_____	_____
DATE	SIGNATURE

JUDGMENT

C. J. CLAASSEN J:

[1] This is a n applic ation on Notice of Motion wherein the applicant, who is t he taxpayer, seeks the following relief:

"The applicant will seek an order in the following terms:

(a) That the assessment referred to in the respondent's notice filed in terms of Tax Court Rule 10(b) is set aside;

(b) That the respondent pays the cost of this application including the cost of 2(two) counsel where applicable;

ALTERNATIVELY

(a) that the statements of grounds of assessment issued by the respondent on or about 9 December 2009 be set aside for failure to comply with the requirements of Rule 10 of the Tax Court Rules;

(b) that the respondent pays the costs of this application including the costs of 2 (two) counsel where applicable."

[2] It is common cause that this application is an interlocutory review application as contemplated in Rule 26(5) of the rules promulgated under section 107A of the Income Tax Act No 58 of 1962. These rules prescribe the procedures to be followed when lodging objections and noting appeals against assessments made by the respondent, the Commissioner for the South African Revenue Services hereinafter referred to as "SARS".

[3] SARS issued an assessment in respect of the Vat input tax for the years 1999, 2000, 2001 and 2002. These assessments are set out in certain correspondence to which I will refer to briefly.

[4] The first letter from SARS is dated 14th July 2003 and headed as follows: "VALUE ADDED TAX EXPENDITURE INCURRED IN THE MAKING OF NON TAXABLE AND EXEMPT SUPPLIES AND APPORTIONMENT OF CERTAIN INPUTS". The letter proceeds to refer to a certain European Court of Justice decision which held that where a taxable person supplies services to another taxable person who uses such services for an exempt transaction, that person is not entitled to deduct the input VAT whether the ultimate purpose of the transaction is the carrying out of a taxable or non-taxable transaction. Based

on this decision, the letter maintains that the ultimate purpose for incurring the expenses are irrelevant for purposes of judging whether the VAT payable constitutes an input tax or not.

[5] The letter further argues that section 17(1) of the Value Added Tax Act No 89 of 1981, is not applicable to a "change in use" scenario. Section 17(1) of the aforesaid Act provides expressly for situations where goods or services are acquired or imported by a vendor partly for consumption, use or supply in the course of making taxable supplies and partly for another intended use. Any tax which has become payable in respect of the supply or importation of goods or services to the vendor, as the case may be, shall be an amount that bears a relation to the full amount of such tax or amount, in the same ratio as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services. The letter then proceeds to question the applicant as to whether or not some of its input tax claims fell within the provisions referred to in the letter.

[6] The next letter is dated 14th May 2004. It is stated herein that assessments were raised in each of the December 1999, 2000, 2001 and 2002 tax periods as indicated in the tax schedules. It further alleges that the expenditure for drafting the annual financial statements have not been written back as this expenditure falls for inclusion in the "mixed use" category and is subject to the apportionment calculation. This apportionment calculation refers to the section 17 calculation mentioned above.

[7] The next relevant letter is the response by SARS after the applicant objected to the aforesaid assessments. This letter states the following:

> "1. Having considered several judgments of the European Court of Justice and having taken into account the interpretive effect in terms of the South African legislation, the South African Revenue Services has concluded that the Value Added Tax incurred on the expenses per the schedule attached to my letter dated 14 May 2004, does not constitute input tax."

SARS disallowed these amounts as input tax and also raised certain penalties and interest. However, the penalties were subsequently withdrawn. Attached to this letter is the formal VAT 201 document, which states that the applicant's objection is disallowed for the reasons as conveyed in the letter of 14 July 2003.

[8] The applicant appealed this decision and in accordance with the rules, the respondent filed a Rule 10 statement containing its "grounds of assessment". The particular provision in Rule 10 which comes up for scrutiny in this application is Rule 10(3) which reads as follows:

> "The statement of the grounds of assessment must be in writing and be signed by the Commissioner or his or her representative and must be divided into paragraphs-
>
> (a) setting out a clear and concise statement of the grounds upon which the taxpayer's objection is disallowed; and
>
> (b) stating the material facts and legal grounds upon which the Commissioner relies for such disallowances."

[9] This Rule 10 statement was filed some 5 (five) years later after the correspondence referred to earlier in this judgment. It is this particular Rule 10 statement which the applicant seeks to set aside alternatively to have it declared as non-compliant with the requirements of Rule 10 of the Tax Court Rules.

[10] It is common cause between the parties that the Rule 10 statement indeed raises a new ground which was not relied upon previously by the Commissioner in any of the preceding letters. I agree with Mr Vorster for the taxpayer, that the

Commissioner indeed changed tack by adopting in its Rule 10 statement a different attitude which conflicts with that expressed in the letter dated 14th July 2003. The grounds stated in the Rule 10 submission by SARS, now states that the ultimate purpose for incurring the disputed expenses is indeed very relevant. Where the first letter stated that section 17(1) of the Act is not applicable, the respondent now relies in the Rule 10 statement on an apportionment principle to be applied. It may be necessary briefly to state the background to this dispute.

[11] The applicant is an incorporated entity with certain subsidiaries. It raises capital by issuing shares for purposes of buying up certain properties which were required for its portfolio. These shares were listed, and certain expenses were incurred in this whole process. SARS divided these expenses into 2 (two) categories namely:

1. Corporate Service expenses: SARS conceded in its Rule 10 statement that the assessment in respect of corporate services cannot stand in its current form and admitted that the assessments in respect to such corporate services must be set aside and referred back to SARS in terms of section 33(3) for further consideration.

2. Buyback Service expenses: In terms hereof certain shares were bought back by the applicant. In doing so certain expenses were incurred by the applicant's agent. SARS describes these buyback services as expenses which were not incurred for the business of the applicant at all and were not incurred in the course of an enterprise as defined in the VAT Act. Thus, they were not input expenses that could have been deducted from the output tax.

[12] The Rule 10 statement seeks to apply an apportionment to the corporate services and apportionment to the buyback services in the alternative.

[13] The application is brought in terms of Rule 26(5) which reads as follows and I quote:

> "26(5) Where either party fails to comply with any requirement contained in these rules the Court may, upon application on notice by the other party, order the defaulting party to comply with that requirement within such time as the Court deems appropriate."

[14] It may be noted that the Notice of Motion does not require an order from this Court obliging SARS to comply with Rule 10 within a certain period of time. However, that does not seem to be a problem as the application was argued by both parties' counsel on the basis that the crux of this matter is whether or not SARS' Rule 10 statement complied with the prerequisites stated in Rule 10. If I were to hold that it does so comply, then the parties agreed that the application should be dismissed with costs. On the other hand should I hold that it does not so comply, then the proper order to be made would be to set aside the Rule 10 statement submitted by SARS.

[15] Neither party was able to refer me to any previous decision directly in point dealing with the interpretation of Rule 10 of the Tax Court Rules. It seems to me I will have to traverse new ground for purposes of resolving the issues.

[16] The question which requires an answer is whether or not it is permissible for SARS to include in the Rule 10 statement the new basis for supporting the assessments raised by SARS which is not only contrary to but also absent from the correspondence preceding the filing of the Rule 10 statement. Mr Vorster strenuously contended that it is not permissible to do so on two grounds:

(i) On a proper construction of Rule 10 in the light of the Act and other Rules, it is impermissible to do so; and

(ii) that it will constitute an unfair administrative decision by SARS which falls foul of section 33 of the Constitution.

[17] It is therefore necessary to commence with a construction and an interpretation of Rule 10. What immediately attracts one's attention is the fact that Rule 10(3) is formulated in the present tense. In Rule 10(3)(a) it requires SARS to set out the grounds upon which the taxpayer's objection "is" disallowed and not "was" disallowed. Furthermore in Rule 10(3)(b) it states that the document must set out the material facts or legal grounds upon which the Commissioner "relies" and not "relied" for such disallowance.

[18] On a pure linguistic interpretation according to the "golden rule", the present tense would indicate that the statement is to set out the current grounds and material facts as at the date of its filing and not the grounds as at the date when the disallowance took place. I am fortified in this conclusion by comparing the similar present tense wording used in the statement of the grounds of appeal to be filed by the taxpayer in accordance with Rule 11. In terms of Rule 11(2)(d) the taxpayer is obliged to set out the material facts and legal grounds upon which he or she "relies" and not "relied" for such appeal. The duties flowing from the parties to the appeal as set out in Rules 10 and 11 seem to me to oblige both parties to set out the various grounds and facts which each will rely on when the appeal is heard. In fact, in common parlance, it has become accepted terminology to refer to these two statements as the "pleadings" filed by the respect parties in any appeal.

[19] Rule 12 dealing with the issues in the appeal expressly state the following:

> "12. The issues in an appeal to the Court will be those defined in the statement of the grounds of assessment read with the statement of the grounds of appeal."

It will be noticed that the rule does **NOT** state that the issues are defined by any preceding correspondence.

[20] I have no doubt that the legislative intention as well as a proper construction of Rule 12, leads one to conclude that the issues before the Tax Court are those defined in the pleadings i.e. the Rule 10 and 11 statements filed by the parties. The issues before Court are therefore limited to those set out in the pleadings. There is in my view no ambiguity as far as these 3 (three) rules are concerned.

[21] Mr Vorster argued that such an interpretation will lead to a prejudicial result burdening the taxpayer with an unfair disadvantage. He submitted that the preceding correspondence sets out the reasoning adopted by SARS for making the assessments and disallowing the taxpayer's objection thereto. If SARS is permitted thereafter to add fresh or additional or different grounds in its Rule 10 statement, the taxpayer will be at a disadvantage in not being able to know the true reasons for the decision to disallow the objection. The taxpayer would only become aware of such reasons for the first time when receiving the Rule 10 statement. He submitted that the taxpayer may be unfairly taken by surprise when a new or different ground appears in a Rule 10 statement.

[22] I cannot agree with this contention nor is the taxpayer at a disadvantage if the Rule 10 statement incorporates additional or different grounds. First of all, it cuts both ways. Both SARS and the taxpayer will be entitled to add additional grounds or additional defences in their statements. No disadvantage flows from the aforesaid interpretation, because each party will have an opportunity by adding new or different arguments and therefore be in a position to state his case better or more fully than the case set out in the preceding correspondence.

[23] Secondly, the taxpayer is entitled to ask for reasons for having disallowed its objection pursuant to the provisions of Rule 3. In the present instance the applicant did not utilise this benefit afforded it in terms of that rule. Mr Vorster submitted that the preceding correspondence was, in his view, sufficient to enable the taxpayer to appeal the disallowance by SARS of its objection. However, had it asked for the reasons in terms of Rule 3, it would no doubt have caused the respondent to include such additional and/or different reasons in its reply, at a point in time even before it filed its Rule 10 statement. It would be difficult for the taxpayer to argue that the respondent is precluded from altering its stance from that contained in the preceding correspondence. A change in reasoning for a particular decision may have a bearing on credibility, but I fail to see how it can be prohibited. If a change cannot be prohibited in preceding correspondence, I fail to see the logic in prohibiting such change in the Rule 10 statement.

[24] Mr Vorster further submitted that it would leave the Rules open-ended if SARS is permitted to add any new ground irrespective of what the preceding correspondence contain. That may be so. But in my view, that will not cause the taxpayer any prejudice because the taxpayer will have the opportunity when filing his Rule 11 statement to counter and/or deal with any new ground in SARS' Rule 10 statement. It must be remembered that any new ground contained in the Rule 10 statement cannot be a vague statement in vacuum. Rule 10(3) expressly requires SARS to set out "a clear and concise statement of the grounds why the objection was disallowed" and in addition, it is also required that "the material facts and the legal grounds" for the Commissioner's conduct is to be set out. If any new or different ground clearly and concisely stated in the Rule 10 statement, I can see no reason for holding that the taxpayer will be at a disadvantage. It will be faced with a document setting out a clear statement of the grounds upon which its objection was disallowed as well as a statement containing all the material facts for such disallowance. This

will or ought to enable the taxpayer to defend itself fully and properly in its Rule 11 statement.

[25] One may ask, rhetorically, well what more does the taxpayers want? If Mr Vorster's submissions are correct it would mean that the Commissioner is bound by any previous grounds referred to in any preceding correspondence. In my view, the clear wording used in the Rules militates against Mr Vorster's contentions.

[26] I was referred to cases which were decided prior to the promulgation of these Rules (which occurred in 2003). However, the principles therein set out seem to me to comply with the literal and linguistic interpretation of Rules 10 and 11 which I referred to above.

[27] The first decision was that of Davis J in **Warner Lambart SA (PTY) Limited** no 10700 decided on 12 February 2001. In that case the argument that the particular expenditure was of capital nature was first raised in argument before the court. The court then allowed both parties to file additional written submissions dealing with that particular point. Counsel for the taxpayer in that case made similar submissions to that made by Mr Vorster regarding the unfairness if the Commissioner is allowed to raise new grounds at the hearing. Davis J dealt with this argument as follows:

> "Mr Emslie further contended that it would be inherently, unreasonable and indeed unfair if a taxpayer, having been assessed on a particular basis in respect of which he has objected, the objection having been considered and an appeal having been noted, were to bear the burden of proving not only that he was not taxable on the basis assessed but on any other basis which the Commissioner might choose to raise at the hearing of the appeal."

[28] That argument was rejected in circumstances where the Income Tax Act at that point in time bound the taxpayer to its grounds of objection. One may have thought it unfair to bind the taxpayer to his defences but allow the Commissioner to have the freedom to alter the grounds for its assessment. Yet the court held that the Commissioner's freedom not to be limited by the original reasons for disallowing the objection, was fair. Subsequently, the Rules of the Tax Court were promulgated which amended this *lacuna*. It would seem to me that there would be no unfairness if a party is permitted to change its reasoning either in the pleadings or thereafter, provided adequate steps are taken to protect the other party from any resultant prejudice by, for example, the granting of a postponement or leave to lead fresh evidence or permission to file new submissions.

[29] Davis J also dealt with the Constitutional implications of permitting such a course of action on the part of the Commissioner. In this regard Davis J held as follows:

> "Section 39(2) of the Constitution provides that when interpreting legislation and developing common law and customary law every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights. The implication of Mr Emslie's argument is that the interpretation of "decision" in section 82 which is most congruent with the principles of fairness and equality in the Constitution is that which insists that what is imposed upon the taxpayer is a burden of proof to show that the decision which included the reasons given at the time the assessment was raised, was wrong."

[30] It was further submitted to Davis J that the taxpayer upon whom the burden of proof rests would have to discharge the *onus* with regard to a whole range of issues which the Commissioner may never have contemplated in actually arriving at its assessment. Davis J rejected this argument based on pre-constitutional authority which is in conflict with this approach. Thus in ITC 583; 14 SATC 1011, Englen P said at 112:

> "It is of course possible for this court to deal with the question of law arising on the facts and to decide it adversely to the appellant notwithstanding that the ground for its decision are other than those relied upon by the Commissioner always providing that the maxim *audi alterem partem* has been observed."

[31] The aforesaid dictum found support in **Baily v CIR** 1933 AD 204 at 220 where it was stated:

> "A Special Court is a court of revision with power to investigate matters before it and to hear evidence thereon; and if it arrives at the conclusion that the appellant is liable for the tax which the Commissioner has levied, it is not precluded from upholding the same, merely because its conclusion is based on a ground other than that advanced by the Commissioner in support of its levy provided that the maxim *audi alterem partem* is observed."

[32] Davis J concluded that the aforesaid principles apply to any particular appeal case in a tax court and does not violate the Constitutional rights of a taxpayer. Davis J held further that, if there were to be any prejudice suffered by the taxpayer, he would always be entitled to seek a postponement in order to prepare properly for any arguments raised by the Commissioner. I am in respectful agreement with the conclusion of Davis J.

[33] In the present instance the applicant has not yet filed its Rule 11 statement. The applicant will be perfectly entitled to deal with all new or different grounds raised by the Commissioner in its Rule 11 statement and, if the applicant needs more time for doing so, it would be at liberty to ask for an extension of the 30 (thirty) days within which it is obliged to file the Rule 11 statement. Furthermore a taxpayer in the position of the applicant has an additional remedy namely by amending his statement in terms of Rule 11 if he is confronted with a new or different ground raised by the Commissioner or for that matter raised in Court. This remedy may be exercised by making application as provided for in Rule 13 of the Rules of the Tax Court. The taxpayer's rights are therefore doubly protected to avoid any trial by ambush,

surprise or any prejudice which might result from a new or different ground being raised by the Commissioner in its Rule 10 statement.

[34] I must just refer to the fact that the applicant is not complaining that the Rule 10 statement filed by the Commissioner is incomplete or inadequate. The complaint is limited to the one sole ground and that is that it contains new matter which was not contained in the preceding correspondence. There is no attack on the adequacy of that which is contained in SARS' Rule 10 statement. It must therefore be assumed that, although it contains a different ground for its decision to disallow the objection, such ground is adequately and comprehensively stated to such extent that the applicant will be able to deal with it in its Rule 11 statement.

[35] My conclusion means that the Commissioner is entitled to add new grounds to its Rule 10 statement different to that contained in the preceding correspondence. The taxpayer will have a second bite to the cherry when it comes to the final appeal hearing. It is in that hearing that the rules of natural justice (*audi alterem partem)* will be satisfied. The taxpayer is not in this interlocutory application required to finally or once and for all respond to any new grounds raised by the Commissioner in his Rule 10 statement.

[36] In the subsequent appeal hearing any new ground will be properly ventilated. The taxpayer will be entitled to lead evidence to counter whatever new grounds have been raised by the Commissioner in the Rule 10 statement. The taxpayer will also be entitled to call for further discovery of documentation if needs be to counter any such new ground. There are therefore many built-in structures in the rules to protect the taxpayer from the very mischief which Mr Vorster referred to in argument.

[37] And then the last consideration: This new ground actually relieves the taxpayer from proving his case in certain respects. Why do I say that? SARS conceded that certain aspects of the assessment were incorrect. The addition of this new ground has therefore, to a certain extent, benefited the taxpayer in that it is no longer necessary to prove its case in respect of those aspects conceded to be incorrect.

[38] For all of the above reasons I am of the view that there can be no prejudice to the applicant if Rules 10 and 11 are interpreted as above because of all the built-in safeguards which are available to a taxpayer. The application should therefore be dismissed.

[39] The question of costs has not really been debated with me by Mr Vorster and I intend to make an order that, should Mr Vorster feel that he wishes to add additional arguments in regard to costs, I will grant him leave to do so in writing within 7 (seven) days from this judgment.

[40] The order I therefore make is as follows:

1. The application is dismissed.
2. The applicant is to pay the costs which are to include costs of 2 (two) counsel.
3. The applicant is given leave to submit within seven days of today, further written argument in regard to costs.

JUDGE C. J. CLAASSEN – PRESIDENT

JUDGMENT GIVEN ON 6 MAY 2010