In the Tax Court of South Africa, Durban

Not Reportable

Case No : VAT 1069

In the matter between :

AD CC Appellant

and

The Commissioner for the South African Revenue Service Respondent

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Judgment

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[1] This is an appeal against the imposition by the respondent of 200% additional tax in terms of s 60(1)(a) of the Value Added Tax Act, 1991 ('the VAT Act').

[2] The imposition of the additional tax was for the tax years 2007, 2008, 2009 and 2010, during which the appellant issued invoices for items of clothing, which invoices included provision for VAT, which was paid to the appellant. The appellant, although previously having been registered as a VAT payer, did not pay over to the Commissioner any VAT for those tax years.

[3] The matter came to light during a routine audit of another entity. During that process, the Commissioner's staff discovered the appellant's invoices, reflecting the VAT charged and recovered. The appellant does not dispute the assessment for the above tax years for the non-declaration of the VAT, nor the 10% penalty imposed by the Commissioner in terms of sub-s 39(1)(a)(i) of the Act, nor the prescribed interest in terms of sub-s 39(1)(a)(ii). The sole issue which we are required to decide is whether the Commissioner incorrectly imposed the additional tax of 200% of the original agreed assessment.

[4] Sub-s 60(1) of the VAT Act provided (at the time) :

'Where any vendor or any person under the control or acting on behalf of the vendor fails to perform any duty imposed on him by this Act and does or omits to do anything, with intent –

(a) to evade the payment of any amount of tax payable by him …

such vendor shall be chargeable with additional tax not exceeding an amount equal to double the amount of tax referred to in paragraph (a) …'

[5] S 60 was repealed by the Tax Administration Act, 2011 ('the TA Act'). In terms of s 271 of the TA Act, the statutory provisions set out in Schedule 1 thereof were to be amended or repealed as indicated, and s 143 of that Schedule repeals s 60 of the VAT Act. The date of commencement of the TA Act was the 1st October 2012. Accordingly, at the time that the appeal in this matter was lodged, on the 11th April 2012, the provisions of s 60 of the VAT Act were applicable.

[6] There are, however, transitional provisions provided for in Chapter 20 of the TA Act which deal with the situation where actions taken under the VAT Act, were not yet finalised by the time of introduction of the TA Act. S 270 of the TA Act provides :

'(1) Subject to this Chapter, this Act applies to any act, omission of proceeding taken, occurring or instituted before the commencement date of this Act, but without prejudice to the action taken or proceedings commenced before the commencement date of the comparable provisions of this Act.

(2) The following actions or proceedings taken or instituted under the provision of a tax Act repealed by this Act but not completed by the commencement date of the comparable provisions of this Act, must be continued and concluded under the provisions of this Act as if taken or instituted under this Act –

…

(d) an objection, appeal to the Tax Board, Tax Court …;

…

(6) Additional tax, … which but for the repeal of the legislation in Schedule 1 would have been capable of being imposed, levied, assessed or recovered by the commencement date of this Act, and which has not been imposed, levied, assessed or recovered by the commencement date of this Act, may be –

(a) imposed or levied as if the repeal had not been effected; and

(b) assessed and recovered under this Act.'

[7] In the present matter the additional tax was imposed or levied or assessed before the commencement of the TA Act. As I understand the provisions of s 270,

this appeal is to continue under the provisions of the TA Act, without prejudice to the actions taken by the Commissioner in levying the additional tax which forms the subject matter of this appeal.

[8] S 129 of the TA Act provides at sub-s (3) :

'In the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the tax court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or increase the understatement penalty so imposed.'

[9] In the present matter the penalty was imposed in terms of the now repealed s 60 and was based upon the allegation that the appellant had failed to perform a duty imposed on him by the VAT Act (the submission of returns or the failure to disclose the VAT collected) with intent to evade the payment of an amount of tax payable by him. In my view it is a question of fact whether he intended to 'evade' the payment of tax and it is accordingly a question for all the members of this court to decide. In accordance with the provisions of s 270, read with sub-s 129(3) of the TA Act, I shall assume (without deciding) for the purposes of this appeal that the Commissioner bears the onus of establishing the basis for the imposition of the additional tax, and the extent thereof.

[10] What then falls to be considered is the discretion, if any, with which I am vested, to interfere on appeal with a decision by the Commissioner to impose additional tax. I refer to the judgment of Southwood J in *ITC 1806 68 SATC 117* and

in particular his analysis of the status of the Tax Court and the fact that it is a court of revision with the power to investigate the matter before it, and hear evidence thereon. It is not a court of appeal in the ordinary sense. Appeals are heard *de novo* as a court of first instance to revisit the decision of the Commissioner which is appealed against.

[11] Mr *X*, who appeared for the appellant, raised four points *in limine*. They may be summarised as follows :

(a) Preservation of secrecy : Mr *X*'s complaint in this regard was that there had been a breach of the secrecy provisions, in that, in the Rule 10 document (containing the statement of grounds of assessment by the Commissioner), the entity being audited, when the appellant's tax invoices were discovered, was disclosed. Mr *X* conceded that the appellant had never questioned the reason why his client had been audited and that no issue arose from the fact that the discovery of the tax invoices was used as a trigger for the audit of the appellant. He complained that the secrecy provisions of the Income Tax Act, 1962 ('the ITA') and the VAT Act had been breached, and that this should be reported back to the Commissioner. In my view as this had no impact on the proceedings, no order is necessary in this regard.

(b) Discovery : Mr *X* complained that the Commissioner had not discovered the minutes of the penalty committee which had decided upon the imposition of additional tax in an amount of 200% of the assessed tax. In addition the Commissioner had failed or refused to disclose the policy manual, which is provided by the Commissioner to members of the penalty committee (now

apparently referred to as the 'Added Tax and Interest Committee'), in order to enable them to make their decision. A Notice of Incomplete Discovery had been sent to the Commissioner by the appellant's representative and this document had been discussed at the Rule 37 conference. The Commissioner had maintained the view that those documents were confidential and not available for public inspection.

In view of the fact that the current proceedings on appeal involve a rehearing of the decision to impose the 200% additional penalty, and do not operate as conventional appeal or review proceedings, the reasons for the decision of the penalty committee are not relevant. In a very short judgment at the end of the argument on the points *in limine,* I indicated that I considered those documents to be irrelevant to the present proceedings, and accordingly ruled that it was unnecessary for me to decide on the question of discovery. In the circumstances I dismissed this point *in limine*;

(c) The Onus of Proof and the Duty to Begin : Mr *X* submitted that in terms of the newly-enacted sub-s 270(6)(d) of the TA Act, the onus to establish the extent of the additional tax rested upon the Commissioner. He submitted that this had been conceded in the pre-trial arrangements by the Commissioner. As the Commissioner bore the onus it should also bear the duty to begin.

In the short judgment which I gave on the points in limine, I directed that in accordance with Rule 22 of the Rules of the Tax Court, the normal practice was that the appellant should begin, and I saw no reason to depart from that.

(d) Constitutionality : Mr *X* submitted that the provisions of the VAT Act relating to additional tax were unconstitutional. During argument he conceded that he

would have to follow the correct procedure in challenging any provisions of the VAT Act on the grounds of constitutionality, and that those procedures had not been adopted here. In addition this Court has no jurisdiction to declare any provision of an Act unconstitutional. In this regard I have considered the judgment of Southwood J in *ITC 1806 68 SATC 117*. I am in agreement with the reasons and conclusions in that matter. This point *in limine*, accordingly, was also dismissed.

[12] The only witness for the appellant was Mr Y whose evidence may be summarised as follows:

(a) the appellant was started by his father, in 1986, who ran it until he fell ill in 2005;

(b) up until 2005 his father was the only member of the appellant;

(c) as Mr Y's mother fell ill during 1981, he joined his father working in the appellant as a sales person. Mr Y, who was then 18 years of age, was responsible only for marketing and actual selling and his father took care of purchases and the administration of the appellant;

(d) at that stage the business ran as a retail business and Mr Y would issue cash sale slips for buyers who requested a receipt;

(e) the business continued to operate as a retail business. During 1995 Mr Y left the appellant as a result of having been traumatised in a robbery at the business premises. He went to work for S Company as a sales representative, selling garments. All administrative aspects were dealt with by

S Company, and Mr Y simply worked from prices reflected on a schedule, which he gave to his clients. He had no knowledge of the breakdown of the prices although he dealt with large customers such as E Company and other big stores. All queries with regard to prices were dealt with by his superiors. Mr Y was unaware whether S Company was registered for VAT;

(f) Mr Y's father fell ill during 2005, and Mr Y was compelled to return to the business of the appellant to assist him. At that stage the business was being operated as a wholesale business involving fewer but bigger clients;

(g) Mr Y did not dispute that the appellant had been registered for VAT from 1991 until 2000, and during that period had rendered returns pursuant to its obligations as an entity registered for value added tax;

(h) when he returned to the business Mr Y eventually took over the running of the business completely during 2006 and ran it until the Commissioner required an audit of the business in 2010. After first having been telephoned by a member of the Commissioner's staff, who indicated to him that he was acting in contravention of the provisions of the VAT Act, Mr Y stopped the operation of the appellant. An accounting officer was hired who compiled the appellant's accounts for the 2007, 2008, 2009 and 2010 tax years. The accounting officer also compiled output and input statements for the computation of VAT for those tax years;

(i) it was not disputed by Mr Y in evidence that no income tax returns or VAT returns had been submitted to the Commissioner by the appellant between 2001 and 2010. He did not deny that as far as the Commissioner was

concerned the appellant had been deregistered and no longer carried on business during that period;

(j) only one accountant had worked for the appellant prior to 2006, Ms T, apparently a firm of chartered accountants who had dealt with the accounts and tax requirements of the appellant until 2000. No accounting officer had existed between 2000 and 2010, and the tax returns which were compiled for the 2007 to 2010 tax years had been compiled after an audit had been requested by the Commissioner;

(k) with regard to his knowledge of the tax requirements of the appellant, Mr Y stated that he had charged VAT on items sold by the appellant simply because the appellant had paid VAT on the items which it had purchased. He saw this as the way the system operated and did not understand the need for the payment over to the Commissioner of the VAT which was collected by the appellant.

[13] Unfortunately, Mr Y did not impress the court as a good witness. His evidence was both vague and contradictory. A trial bundle was used throughout the hearing which consisted of various documents. The parties agreed in a Rule 37 conference that the documents in the bundle were what they purported to be, and would be admissible without formal proof or production of the originals. Mr *X,* however, initially indicated that although the appellant accepted the form of the appellant's invoices which were contained at pages 1 to 4 of the trial bundle, it was not admitted that they were documents originally emanating from the appellant. I indicated some difficulty with this approach to Mr *X* during the trial, because Mr Y

admitted that he had personally completed the tax invoices in manuscript. Those tax invoices, in Mr Y's own hand, recorded the quantity of items sold, a description of those items, the unit price, the resulting sales price (being the quantity multiplied by the price per unit) and then the addition of what is recorded in each case as '14% VAT'. Each tax invoice contained the heading 'TAX INVOICE' as well as a VAT number.

[14] Mr Y's explanation was that he had no idea why the words 'TAX INVOICE' appeared at the top right-hand side of each invoice and did not know the purpose or meaning of the VAT number reflected on each invoice immediately next to the appellant's registration number.

[15] Mr Y stated that the selling price of any item had been computed by him after taking the purchase price, including VAT, and adding eight to ten percent on each item. To that would be added the fourteen percent VAT.

[16] Mr Y indicated that he had adopted this process because they had ascertained that their markup should be between eight and ten percent. The markup would fluctuate depending on whether debulking or transportation costs were required to be included. The example was put to Mr Y that if he purchased an item for R100 and paid VAT on it the total cost price would be R114. If he added ten percent to this the selling price would be R125,40.

[17] It was pointed out to him that if he marked up goods on that basis, and then added fourteen percent, which he did not pay over to the Commissioner, the net result was that his markup would in fact be something of the order of 25%. At this stage Mr Y's evidence became extremely vague and he indicated that he would calculate the selling price (cost price plus VAT, plus 8 – 10%) and work backwards from the result in order to ascertain the unit price of the items sold. This explanation is also illogical because if the resultant VAT had been paid over to the Commissioner, his business would have run at a loss – (i.e. R100 + R14 = R114 + (say 10%) + R125,40 – then 'reverse calculating' to provide VAT the net selling price would be R110,00).

[18] The example was put to Mr Y by the court of someone having to purchase a television set, and of the fact that VAT would be required to be paid for such a purchase. He said he understood how that worked and he understood that the VAT collected was for the Commissioner. He still, however, remained confused as to why he should have paid over the VAT charged by him on his invoices to the Commissioner.

[19] Mr Y stated in cross-examination that he was not aware that not every business was a registered VAT vendor and said that he had absolutely no knowledge of how the business had operated prior to his becoming involved in it again in the latter part of 2005/2006. He admitted that he had paid income tax as an employee of S Company. At the end of each tax year of his employment by S Company he had been given a document reflecting his earnings which he had

delivered to the Commissioner. He denied, however, having ever received any tax returns either in his personal capacity or on behalf of the appellant. He conceded in cross-examination that he knew that he had to submit tax returns as a tax payer in his personal capacity. He said that he had only ever registered as a tax payer when he had joined S Company in 1996. His father had strictly controlled the running of the business and had taken care of all the aspects of the business. Mr Y did, however, concede that he had been running the business alone from 2006, and had not declared either the appellant's income or the VAT paid by it. He also admitted that he had not paid personal income tax from 2006 until the audit was conducted in 2010. Mr Y maintained that he had never intended to evade the payment of tax and evidence of that was to be found in the fact that he had paid VAT on the purchases which the appellant had made. It seemed entirely lost upon him that that was something over which he had no control.

[20] Mr Y maintained in cross-examination that he was unaware exactly when he had become a member of the appellant. He said he had signed whatever documents his father had asked him to sign and did not question him. He stated, however, that he had collected records of purchases and sales for the appellant and that he had not been aware that he was required to account to the Commissioner for the profits of the appellant. He maintained that he had continued to deal with his personal income tax reflecting his drawings from the appellant. He conceded however, that he had only started to do this once the audit had been raised by the Commissioner in 2010. From that day he had ceased to operate the business of the appellant.

[21] Even in re-examination, Mr Y stated that although he understood VAT being reflected on invoices as a form of tax, he did not realise that it was money being collected for the Commissioner. He had been told by his father to reflect 14% VAT on the invoices and that is what he had continued to do.

[22] Although Mr Y stated that he accepted that the appellant was responsible for the debts incurred to the Commissioner, and in that regard accepted the assessment and the 10% penalty as well as the interest, the appellant had no assets, and neither the appellant nor he were in any position to make any repayments to the Commissioner. This was despite the fact that he had regarded the income of the appellant as his own and that he lived in a house which was owned by him and worth approximately R1,2M. Mr Y also conceded that the appellant's deposits for the 2007 to 2010 tax years had totalled R5,197million.

[23] That was the case for the appellant.

[24] The only witness for the Commissioner was Mr V, the auditor employed by the Commissioner who dealt with the case against the appellant. He stated that the business intelligence unit of SARS had identified the case against the appellant because of input credits and deductions claimed by another company, which was the subject of an audit by the Commissioner. Investigations revealed that the appellant was de-registered but trading and had not submitted any returns. The appellant had

been de-registered since 2000 and although it was reflected as dormant, he was unable to say why it had been reflected in that way in the records of the Commissioner. No returns were submitted from 2000 until the audit had finalised in 2011.

[25] Mr V stated that the assessment of the appellant's VAT for the relevant years had been compiled on schedules submitted by Mr Y. He said that Mr Y had been fully compliant in assisting the Commissioner's staff in the investigation. However, using the documents submitted by the appellant, different figures had been arrived at, compared to those submitted by the appellant's accountant. Various invoices had not been present on the schedules delivered and various amounts had been disallowed as input taxes. Eventually an assessment letter had been issued and the Commissioner's figures had been accepted, with the exception of the additional tax of 200% which had been levied by the penalty committee.

[26] Under cross-examination Mr V conceded that the de-registration of the appellant as a VAT vendor may have taken place without the knowledge of the appellant, and because the minimum turn-over level for registration as a value added taxpayer had not been met. He conceded that under the present TA Act, the appellant would be treated as a 'standard case' with a maximum penalty applicable of 150% for additional tax.

[27] Mr V stated that his initial view had differed from the penalty committee, in that he did not believe that the maximum penalty of 200% should be implemented because Mr Y had fully co-operated and given him an enormous amount of information during the investigation.

[28] In re-examination Mr V also confirmed that the statement on the annual financial statements, submitted by the appellant's accountant, that the appellant did not have a bank account, was incorrect. He stated that the annual financial statements submitted were not representative and neither the revenue, nor expenses had been correctly reflected.

[29] That was the case for the Commissioner.

[30] In assessing the evidence of Mr Y, the court is unable to accept his contention that he was unaware of the true role of value added tax. In the example given regarding the purchase of a television set by a consumer, he readily understood that the VAT added to such a purchase would be paid over to the Commissioner. He was, however, unable to distinguish between this example and the liability of the appellant in this case to pay over the VAT which it had added to each of the invoices.

[31] Mr Y is 52 years of age and completed his matric. Whilst he may not have undergone any tertiary education, that in my view did not in any way prevent him

from understanding and knowing what he was doing when he wrote '14% VAT' on each tax invoice which he completed. The fact that he was using stationery which had been compiled by his father does not assist him. His understanding of the phrases 'output tax' and 'input tax' and his ability to calculate and determine the differences between cost price and selling price indicate that he was astute in matters of business. He was aware of the implications of taxation, because he had dealt with the Commissioner as an employee of S Company and had understood the need for submitting his IRP5 to the Commissioner each year.

[32] Mr *X* submitted that Mr Y had only ever been a sales person and had not run a large corporation. If he had no knowledge of the regulation of VAT as he said, that was relevant to his alleged intention to evade the payment of VAT.

[33] Given Mr Y's knowledge of the concepts of selling price and cost price in a business, we were unable to understand his confusion when it came to the imposition of VAT. Mr Y could not have really believed that the appellant's markup was only eight to ten percent. Over the four years he must have understood that the appellant's income figures were demonstrating something completely different. This is because if he had taken a cost price including VAT and marked it up by eight to ten percent and then charged VAT which he retained, he would very quickly have understood that his turnover was more of the order of twenty-five percent rather than eight to ten percent. It is not something which any trader could have failed to understand.

[34] If on the other hand Mr Y had simply taken the cost price including VAT and marked it up between eight to ten percent, and then worked backwards to determine the VAT and the unit price for sale purposes, he would have operated at a loss, and very soon realised this. The truth is that he operated a business with large turnover figures for four years. Had he been operating the business at a loss, Mr Y would have very soon appreciated this and been unable to continue for over four years.

[35] Ultimately the court cannot rely upon the suggestion by Mr Y that his ignorance of the obligation of the appellant to account for the value added tax which it received, is acceptable. He clearly understood that the money which he was recovering was not his and should have been paid over to the Commissioner. His belief that he was simply setting off the VAT which he had paid when purchasing the items makes no sense whatsoever. A moment's reflection on that suggestion would have demonstrated clearly that that could not be so. To contend as he did, he must have believed that he was entitled to make a profit on the VAT which he paid, and however small that profit may have been, that suggestion is untenable.

[36] In all the circumstances the question of the onus is largely irrelevant because whichever party bore the onus, it had been established before us that Mr Y knew he was obliged to pay over the VAT which he collected over the years on behalf of the appellant and deliberately chose not to do so. Insofar as it may have been necessary to do, the Commissioner has discharged the onus.

[37] In a letter dated the 9th February 2012 the appellant's advisor wrote a letter to the Commissioner including the following :

'Our client was not aware of the VAT registration that was applicable to the close corporation merely continued using the stationery that was available (sic). There was no inherent intent upon the vendor to levy VAT and misunderstanding as to the law applicable as it was his understanding that should turnover be below R1 million no VAT is accountable by the institution.'

[38] When questioned on this statement during his evidence, Mr Y stated that prior to the audit being instituted by the Commissioner, he had had no idea there was any threshold whatsoever applicable to the accountability to render VAT. How it could be suggested that there was 'no inherent intent upon the vendor to levy VAT' when the invoices in his own hand levied VAT as a separate item, is inexplicable.

[39] In all the circumstances the appellant acted in a manner which clearly indicated that he sought to evade the payment of VAT in contravention of s 60 of the VAT Act.

[40] With regard to the quantum of the penalty applicable we are mindful of the benefits which have accrued to the appellant and indeed, Mr Y, and his indication to the court that he has made no effort whatsoever to make payments of any of the amounts due by the appellant. His case is simply that neither he, nor the appellant have assets which can be liquidated to effect payment. When questioned as to why

he had discontinued the operation of the appellant immediately upon being advised of the impending audit, Mr Y simply stated that he had been informed that he had been dealing on an incorrect basis, and did not wish to do so in the future.

[41] In my view, the fact that the appellant may be wholly unable to discharge its indebtedness to the Commissioner should not be the end of the matter. There are various avenues which can be pursued by the Commissioner, as alluded to by Mr *X*, in order to recover the taxes due from Mr Y himself. As Mr *X* pointed out, the actions of the appellant were essentially those of Mr Y. We take into account as mitigating factors all the matters raised by Mr Y in evidence concerning his personal circumstances and those of his family. Those factors do not, however, detract from the fact that money was recovered from debtors on the representation that it would be in due course paid over to the Commissioner, and that the paying over was never done.

[42] We accept that it is necessary that in levying additional tax the court should be mindful of the message which is sent out to other taxpayers who may similarly be disinclined to render to the Commissioner what is due. We have considered the factors relevant to the imposition of additional taxes as set out by Mullins J in *ITC 1430 SATC 50- 51* as including the punishment of the taxpayer, the deterrent effect on the taxpayer himself and the deterrent effect on other taxpayers.

[43] We also have had regard to the amended provisions under the TA Act, which would have rendered the appellant liable for payment of additional tax in an amount of 150% of the assessment. Although those sections are not applicable to the present case they provide some guidance as to the intention of the legislature with regard to the future treatment of persons seeking to evade the payment of VAT.

[44] What is also significant is the fact that VAT is a self-assessing tax, the collection of which relies in the first instance upon the integrity of the taxpayer. The Commissioner operates largely on the basis of the co-operation of the taxpayer in correctly declaring the output taxes levied by him, and in providing an accurate reflection of the expenses which may be offset against that and then paying the balance over to the Commissioner.

[45] In all the circumstances we are of the view that the appellant should have been levied additional tax of 100% of the assessed amount due and not paid. Given the circumstances of this case it would be just and equitable were each party to be ordered to pay their own costs of the hearing because the appellant only contested the 200% additional tax, and he has been largely successful in doing so. I accordingly make the following order :

(a) the appeal succeeds.

(b) the decision of the penalty committee is set aside and replaced with the following :

‘The appellant is directed to pay additional tax in terms of s 60 of the Value Added Tax Act, 1991 of 100% - i.e. R379 614.

(c) each party is directed to pay their own costs of the hearing.

_____

Judge Graham Lopes

President

_____

Absolom Phiri

Commercial Member

_____

Goolam Gani

Accounting Member