IN THE TAX COURT OF SOUTH AFRICA

HELD AT PORT ELIZABEH

Case No.: IT13726

In the matter between:

MR. A Appellant

and

THE COMMISSIONER FOR THE

SOUTH AFRICAN REVENUE SERVICE Respondent

JUDGMENT

REVELAS J:

[1] The appellant had been the Chief Executive Officer of XYZ (Pty) Ltd ("XYZ") for just over sixteen years, when his employment with XYZ

came to an end in 2012. The appellant also traded as a cattle farmer under the name Mr. A, trading as A Company.

[2] In his submitted income tax return for 2012, the appellant claimed farming expenses amount of R1 781 604.00 to be deducted. The amount claimed was for expenses incurred in respect of bush clearing, cattle rails, fencing and irrigation. The appellant submitted that these expenses were incurred for purposes of trade, and are of an expense nature, as the respondent contended and such expenses ought to have been be allowed as deductions in terms of paragraph 12(1) of the Income Tax Act, No. 58 of 1962, as amended ("the ITA"). This claim was disallowed by the respondent.

[3] The other sum of money that became a subject of dispute is the severance package paid out to the appellant by his erstwhile employer when he resigned. When the appellant's services at XYZ came to an end, XYZ paid him the amount of R7 066 530.00 as an amount equal to a severance package calculated in accordance with XYZ's retrenchment policies. It was described as a "lump sum payment for separation package" in his Income Tax return for 2012.

[4] The year of assessment with regard to the aforesaid amounts is 2012. An additional assessment was issued on 31 January 2013.

[5] On the basis that the appellant did not satisfy the requirements of section 11(*a*) read with section 23(*g*) of the ITA, the claim was disallowed. The respondent did not accept that the lump sum payment paid by XYZ to him was as a result of a retrenchment and therefor was not taxable as a retrenchment benefit, and was taxed as "other" income.

[6] On 24 and 26 April 2013 respectively, a letter of objection and a notice of objection to the assessment was submitted by the appellant subsequently the appellant was notified that certain farming expenses he had claimed were disallowed as deductions, and that the farming financial statements were not uploaded with other supporting documents but were uploaded with the objection.

[7] On 7 October 2013 and 27 November 2014 (his objections being rejected), the appellant filed the present appeal against the abovementioned two assessments or rulings of the respondent. The late filing of the February 2014 appeal was condoned in March 2014.

[8] On 25 May 2017 the Registrar of the Tax Court was notified that the parties would argue only the following:

(i) As a point *in limine*, whether the audit conducted prior to the additional assessment is valid, and whether the subsequent additional assessment is valid, and

(ii) Whether the lump sum payment received by the appellant at the termination of his employment was a "severance benefit" as defined in the ITA.

[9] The issue pertaining to the claim for the deductions of farming expenditure against the appellant's income would stand over for argument at a later stage.

[10] The year of assessment by the respondent and the subject matter of this appeal is 2012. An additional assessment was issued on 27 March 2013, after the appellant admitted some returns.

[11] The amount of R7 066 530.00 was taxed as "other income" under code 4214 on the additional assessment. The appellant contends that it was a lump sum payment and thus could not be taxed as normal taxable income as the respondent had done. The appellant submits that the amount of R7 066 530.00 ought to have been taxed according to the tax table for retirement and retrenchment lump sums. These questions raise the crux of what has to be determined in this appeal, namely whether the appellant was retrenched or not.

[12] The Respondent alleges in its Rule 31 statement, "Grounds of Assessment" and its opposition to the appeal, that it conducted a personal income tax audit on the appellant during January 2013. Its investigations showed that (i) the payment received by the appellant

was incorrectly declared as a “lump sum payment” for a “separation package” in the appellant’s income tax return for 2012.

[13] The respondent contends that it was not a severance benefit as contemplated in the ITA, because the appellant was relieved of his duties in terms of clause 14.2 of his employment contract with XYZ which deals with severance payments pursuant to a dismissal. Accordingly the appellant argues, the sum paid out to him constitutes taxable income in his tax return. In addition, the respondent stated that the appellant failed to provide sufficient proof of the retrenchment in the form of supporting documentation and an IRP5 form in particular. It had requested that appellant on 6 May 2013 to furnish his IRP5 certificate.

[14] The appellant explained that he was unable to obtain an IRP certificate from XYZ since there was a dispute regarding his retrenchment of which he advised the respondent in writing.

[15] A further request for supporting information was made by the respondent on 17 July 2013. Thereafter the respondent simply advised the appellant that his objection was disallowed since no reply was received to its queries of 6 May 2013 and 17 July 2013. The present appeal was then lodged.

[16] The aforesaid is essentially what is in dispute before the parties. The parties agreed that the only question to be determined in this appeal is the one relating to the taxation of the lump sum payment paid by the appellant's employer (XYZ) upon the termination of the appellant's employment relationship.

[17] The appellant also raised a point *in limine*, namely whether the audit conducted prior to the issuing of the additional assessment is valid and whether the subsequent additional assessment is therefore valid. If the assessment is found to be invalid, the matter will be disposed of on that basis alone.

In Limine:

[18] The appellant states that the respondent's reference to a personal audit that was conducted in respect of himself in the respondent's Rule 31 "Statement of Grounds of Assessment", is the first word he has heard of such an audit.

[19] The respondent's reliance on a procedurally flawed audit conducted without the appellant's knowledge as a new ground of assessment in its Rule 31 statement is impermissible. In the unreported case of *Sasol Oil (Pty) Ltd v CSARS,*[1] the court precluded the respondent from introducing a new ground of assessment in

[1] GNP Case No. 17583/2012

similar circumstances against the appellant, as being contrary to the principle of legality.

[20] An additional assessment is administrative action as contemplated in section 33 of the Constitution, which protects the right to administrative action that is lawful reasonable and fair. The section also provides that everyone whose rights have been adversely affected by administrative action has the right to be given written reasons. Therefore an assessment, that is procedurally flawed for a lack or failure to give reasons, offends the principle of legality and set out in *Albutt v Centre for the Study of Violence and Reconciliation,*[2] *Wessels v Minister of Justice and Constitutional Development.*[3]

[21] Section 40 and 42 of the Tax Administration Act, No. 28 of 2011 (the "TAA") clearly give effect to and echo the administrative justice provisions set out in section 33 of the Constitution. They read as follows:

> *"40.* ***Selection for inspection, verification or audit.****—SARS may select a person for inspection, verification or audit on the basis of any consideration relevant for the proper administration of a tax Act, including on a random or a risk assessment basis.*
>
> *42.* ***Keeping taxpayer informed.****—(1) A SARS official involved in or responsible for an audit under this Part must, in the form and in*

[2] 2010 (3) SA 293 (CC) at para [49] et seq
[3] 2010 (1) SA 128 at para 141 (GNP)

the manner as may be prescribed by the Commissioner by public notice, provide the taxpayer with a report indication the stage of completion of the audit.

(2) Upon conclusion of the audit or a criminal investigation, and where—

(a) the audit or investigation was inconclusive, SARS must inform the taxpayer accordingly within 21 business days; or

(b) the audit identified potential adjustments of a material nature, SARS must within 21 business days, or the further period that may be required based on the complexities of the audit, provide the taxpayer with a document containing the outcome of the audit, including the grounds for the proposed assessment or decision referred to in section 104(2).

(3) Upon receipt of the document described in subsection (2)(b), the taxpayer must within 21 business days of delivery of the document, or the further period requested by the taxpayer that may be allowed by SARS based on the complexities of the audit, respond in writing to the facts and conclusions set out in the document.

(4) The taxpayer may waive the right to receive the document.

(5) Subsections (1) and (2) (b) do not apply if a senior SARS official has a reasonable belief that compliance with those subsections

would impede or prejudice the purpose, progress or outcome of the audit.

(6) SARS may under the circumstances described in subsection (5) issue the assessment or make the decision referred to in section 104 (2) resulting from the audit and the grounds of the assessment must be provided to the taxpayer within 21 business days of the assessment or the decision referred to in section 104(2), or the further period that may be required based on the complexities of the audit."

[22] The respondent's breach of the legality principle is further compounded by its failure to comply with section 42(1) of the TAA which requires the SARS official responsible for the audit to provide the taxpayer with a report indicating the stage of completion of the audit. The appellant was not kept informed regarding the status of the audit. In addition the papers do not reveal any written conclusions or findings as would be required at the end of an audit. It was also pointed out that the respondent also did not discover any audit file for 2012. It was also required that a financial inspection had to precede any additional assessment. None of this occurred.

[23] The outcome of the audit was not conveyed to the appellant either. In this regard section 42(2)(*b*) of the TAA was flouted by the respondent. Accordingly the appellant was deprived of the opportunity

to respond to any of the issues raised, particularly the question of the circumstances surrounding his resignation and the nature of the lump sum paid to him.

Lump Sum:

[24] A 'severance benefit' is defined in the Income Tax Act, 58 of 1962 ("the ITA") as *"any amount (other than a lump sum benefit an amount contemplated in paragraph (d) (ii) or (iii) of the definition of 'gross income')*[4] *received by or accrued to a person by way of a lump sum from or by arrangement with the person's employer or an associated institution in relation to that employer in respect of the relinquishment, termination, loss, repudiation, cancellation or variation of the person's office or employment or of the person's appointment (or right or claim to be appointed) to any office of employment, if—*

> *(a) such a person has attained the age of 55;*
>
> *(b) such relinquishment, termination, loss, repudiation, or variation is due to the person becoming permanently incapable of holding the person's office or employment due to sickness, accident, injury, or incapacity through infirmness of mind or body;*

[4] With regard to payments of awards associated with the cessation of employment relationships, in terms of insurance contracts, and or policies in certain circumstances.

or such termination or loss is due to—

(i) the person's employer having ceased to carry on or intending to cease carrying on the trade in respect of which the person was employed or appointed; or

(ii) the person having become redundant in consequence of a general reduction in personnel or a reduction in personnel of a particular class by the person's employer

unless, where the person's employer is a company, the person at any time held more than five percent of the issued shares on members' interest in the company…."

[25] " 'Gross income', in relation to any year or period of assessment means—

(i) in the case of any resident, the total amount in cash or otherwise, received by or accrued to or in favour of such a resident; or

(ii) in the case of any person other than a resident the total amount, in cash or otherwise, received by or accrued by to or in favour of such person form a source within the republic

during such year or period of assessment, excluding receipts or accruals of a capital nature, but including without in any way limiting the scope of this definition such amounts (whether of a capital nature or not) so received or accrued …"

[26] If the appellant was afforded the opportunity to explain his position, he could have informed the respondent that his services came to an end during a retrenchment process as contemplated in paragraph (*b*)(ii) of the definition, when XYZ terminated the services of a substantial amount of its employees, i.e. 31% of its work force.

[27] The respondent submitted that the appellant was not retrenched, but that his services were terminated through a dismissal in terms of clause 14.1 of the employment contract with XYZ. Clause 14.1 relates to dismissals of employees for *inter alia* materially failing to perform their duties, in which case no severance package is paid out to an employee. In this regard the respondent relied on a letter by XYZ to the appellant which reads as follows:

> *"Dear Mr. A*
>
> *It is with sadness, but with respect that I have to advise you that the Board of Directors would like to ask you to stand down as Chief Executive Officer of the Company.*
>
> *It is the opinion of the Board that the expenses have not been contained and as a consequence the Company will not be able to meet the expectations of its shareholders, consequently a change in leadership is appropriate at this time.*
>
> *Let me assure you that we recognize and respect your passion, your energy and your operational capabilities, and in no way question your integrity and commitment.*

> *Your exit strategy can be discussed with me and the terms would be in line with your Agreement of Employment as introduced earlier this year.*
>
> *You have done much to develop the XYZ Group in your time with the company and I know your legacy will be remembered and appreciated."*

[28] The respondent's reliance on the letter is rather selective. The letter together with the type of severance or "separation package" in actual fact paid to the appellant, indicates that the appellant's services were terminated as part of a retrenchment exercise or it was least treated as such by XYZ, in that the package paid to the appellant was equal to a package calculated in the course of a retrenchment, and in accordance with clause 14.2 of the relevant contract of employment. If the audit by the respondent had been conducted with due regard to section 40, 41 and 42 of the TAA, the outcome of the audit may have been very different.

[29] The same considerations apply to the farming expenses that were disallowed. A properly conducted audit would almost certainly have produced a different result. Since the issue of the farming expenses claim stood over by agreement and was not argued, the merits of that claim requires no further consideration. The invalid audit renders such a discrimination moot in any event.

[30] The respondent's non-compliance with sections 40 and 42 of the TAA clearly offends both the Constitution and the principle of legality. Accordingly, the respondent's decision to conduct an additional assessment without notice, must be set aside as it does not comply with the peremptory prescripts of the applicable legislation and it is also constitutionally unsound. In the circumstances, the assessment is found to be invalid.

[31] The entire assessment must therefore be set aside.

Order:

1. The appeal is upheld.
2. The respondent's entire 2012 additional assessment in respect of the appellant is hereby set aside.
3. The interest calculated in respect of the assessment is hereby remitted.
4. The respondent is to pay the appellant's costs of the appeal.

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E REVELAS

Judge of the High Court

I Agree:

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A BAGE

Assessor