

Tax Court vs High Court: Differing opinions on tax matter

The Tax Administration Act, 2011 (TAA) enables the South African Revenue Service (Sars) to impose an understatement penalty where the conduct of a taxpayer has either resulted in prejudice to Sars or the fiscus.

By Ursula Diale-Ali and Jana Krause^{9 Oct 2023}



Image source: Nataliya Vaitkevich from [Pexels](#)

According to the Sars Guide to Understatement Penalties (Guide), the purpose of penalties under the TAA is to deter undesirable taxpayer behaviour, such as non-compliance and tax evasion. The exception to the imposition of understatement penalties is if the taxpayer has made a "bona fide inadvertent error", which is a concept not defined in the TAA.

Where legislation is silent on the definition of legal concepts, the ordinary dictionary meaning must be considered. In previous case law, the concept of "bona fide inadvertent error" was broken down. It was acknowledged that the *English Oxford Living Dictionaries* define "error" as "a mistake" and "inadvertent" "not resulting from or achieved through deliberate planning", and according to the dictionary "bona fide" means "genuine" and "real". Ultimately, it was held that a bona fide inadvertent error is an innocent misstatement by the taxpayer while acting in good faith and without the intention to deceive, which results in an understatement.

Once it is determined that a taxpayer's behaviour constitutes an understatement, Sars must identify the appropriate behaviour with respect to which understatement penalties are levied.

Background

In *Lance Dickson Construction CC v Commissioner for the South African Revenue Service*, the High Court had to determine whether the Tax Court's confirmation of Sars' decision to levy understatement penalties was correct. For unsubstantiated reasons, the High Court set aside the decision of the Tax Court.

and ordered Sars to lift the understatement penalty. By so doing, the High Court may have missed an opportunity to delve into the substance of the matter, as the court merely reiterated the views of the Tax Court.

During the 2017 year of assessment (2017 YOA), the taxpayer, Lance Dickson Construction CC (LDC), transferred immovable property, which was to be subdivided into 72 erven, to Kwali Mark Construction CC (KMC), a related party. The immovable property was transferred to KMC for the amount of R25.2m, which was not payable immediately.

In terms of the written sale agreement, KMC was to pay LDC the amount of R350,000 for each erf on-sold to the ultimate purchaser, and the capital gains tax (CGT) arising in the hands of LDC upon the initial sale would be paid upon the on-sale of each erf by KMC and receipt of the proceeds by LDC.



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As the erven were not on-sold during the 2017 YOA and LDC did not "receive" any proceeds, LDC did not declare the proceeds from the sale to KMC in its 2017 tax return and further did not pay any CGT arising from the sale, although the transfer to KMC was registered at the Deeds Office during the 2017 YOA. This occurred even though it was clear from the ITA and common knowledge to persons conducting a business that tax is imposed on the earlier of accrual or receipt.

As a registered VAT vendor, LDC correctly charged output VAT on the sale of the immovable property to KMC and declared this in their VAT return for the relevant period. During the tax reconciliation process, Sars identified the discrepancy between LDC's VAT declaration and income tax declaration and picked out the omission of the proceeds from the 2017 income tax return.

Consequently, Sars imposed an understatement penalty of 25% on the basis that LDC did not take reasonable care in completing its tax return, i.e. behaviour (ii) in the understatement penalty percentage table.

Considerations under the Income Tax Act

The Tax Court dealt with the substance of the matter and considered the provisions dealing with the time of disposal of assets.

In terms of paragraph 13(1)(a)(ii) of the 8th Schedule to the Income Tax Act (ITA), the time of disposal of an asset where there is a change of ownership from one person to another is, in the case of an agreement that is not subject to a suspensive condition, the date on which the agreement is concluded. Effectively, this would be the date of accrual of the proceeds for CGT purposes.

In the Tax Court, Sars successfully pleaded that the contractual clause delaying the payment of the purchase price and CGT liability constituted a suspensive time clause and not a suspensive condition as contemplated in paragraph 13(1)(a)(ii). Therefore, the immovable property was determined to have been disposed of on the date that the sale agreement between the parties was concluded, a date falling under the 2017 YOA.

As a result, LDC could not rely on the exception provided for in paragraph 13(1)(a)(ii) to escape its liability pay CGT in the 2017 YOA.

To understand the Tax Court's conclusion, it is important to distinguish between the concepts "suspensive time clause" and "suspensive condition", as it is easy to mistake one for the other.

Suspensive time clause and suspensive condition

A suspensive condition is a condition that, if not fulfilled, renders the contract null and void. A good example is when a seller and purchaser conclude an agreement for the purchase and sale of immovable property the condition that the buyer obtains a mortgage bond. If the condition is not fulfilled, the agreement falls away as the purchaser would not have the funds to acquire the property.

On the other hand, a suspensive time clause suspends the operation of rights or obligations under a contract until a predetermined event occurs.

In the LDC case, the contentious clause likely constituted a suspensive time clause as it did not impose a condition that, if not fulfilled, would result in the agreement between the parties being invalidated. The clause simply sought to delay payment by KMC of the purchase price and payment by LDC of the CGT.



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Although the parties may have intended to achieve a suspensive condition, the clause was crafted in its wording more similarly to a suspensive time clause, and in our view, the decision of the Tax Court should have been accepted.

Importance of wording

This case demonstrates the importance of contractual drafting so that the intentions of the contracting parties reflect clearly in the wording of contracts. The lawful desired outcomes of the parties may not be achieved with poorly worded contractual terms.

Taxpayers must also exercise great diligence regarding the nature of clauses they include in their agreements, as they may still be liable for CGT if a clause other than a suspensive condition is included in the agreement.

Sars took this as an opportunity to remind taxpayers that they have a legal obligation to declare their taxes the YOAs in which they dispose of an asset. This is also contained in section 26A of the ITA, which requires that a person's taxable capital gains for a YOA be included in that person's taxable income for that YOA.

Whether there was an understatement and determination of appropriate behaviour

The Tax Court determined that there was indeed an understatement on the basis that LDC did not apply reasonable care in completing its tax return and the "bona fide inadvertent error" exception was not a question before the courts. The Tax Court applied the reasonable person test and considered the fact that LDC was not a first-time seller of immovable property and was aware of the tax implications arising from

the sale of immovable property.

In the Tax Court, LDC argued that there was no understatement as there was no loss to Sars or the fiscus considering that CGT would have in any event been paid in subsequent YOAs upon the on-transfer of the individual even by KMC. This argument failed as the court accepted that Sars is given an annual target by the National Treasury to collect certain amounts of taxes and in order for the target to be reached, every c counts.

Sars' witness convinced the Tax Court that a failure to disclose a sale with a value of R25.2m by a taxpayee would impact Sars negatively and affect the government's ability to fulfil its constitutional obligations to South African citizens.

Increase of understatement penalty

It transpired in the Tax Court proceedings that Sars sought to have the imposed understatement penalty increased to 50% in terms of section 129(3) of the TAA, which empowers the Tax Court to increase a Sars understatement penalty. Although the Tax Court allowed the parties to file supplementary heads of argument, it concluded that it could not increase the penalty with reference to the Supreme Court of Appeal (SCA) decision in *Purlish Holdings v The Commissioner for the South African Revenue Service* (26 February 2019), wherein it was held that the Tax Court could increase the penalty where "the issue has been properly raised for adjudication before that court".

Further, Rule 34 of the TAA Rules confines the issues in a Tax Court appeal to those issues contained in the parties' submissions (ie. Rules 31, 32, 33 statements). Aggrieved by the decision of the Tax Court to confirm the imposition of the understatement penalty, LDC appealed to the High Court.

The High Court focused on Sars' initial request to increase the understatement penalty and questioned the Sars' witness about how behaviour (ii) was identified as the most appropriate behaviour in respect of which the understatement penalty was imposed. Seemingly disappointed by the witness' response, the High Court raised the point that Sars could have imposed understatement penalties on the basis of behaviour (iii) ie. on reasonable grounds for tax position taken, which attracts a minimum penalty of 50%.



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The witness' agreement with this point appears to have constituted sufficient evidence for the High Court to conclude that Sars did not discharge the onus to justify its imposition of the penalty based on behaviour (ii). Furthermore, the High Court went on to explain why the Tax Court had misread the *Purlish* case, as "there is no debate that the Tax Court has the power to increase an understatement penalty [in terms of] s 129(3) of the TAA [which] expressly provides so" (own emphasis).

It is our respectful view that the Tax Court did not misread the *Purlish* case, but accepted and abided by the SCA's decision, which effectively means that the issue regarding the increase of the penalty was not properly brought before the court as it was not contained in the parties' submissions and, as a result, could not be entertained by the court. We doubt, from the wording of the Tax Court decision regarding this issue that the Tax Court ever doubted its powers in terms of section 129(3).

Failure to look at substantive facts

We believe the manner in which the High Court reached its conclusion is questionable and fails to show substantive reasoning. The court heavily critiqued the decision of the Tax Court because of the concession made by the Sars' witness that a penalty of 50% could have been imposed instead, based on behaviour (i

This concession undoubtedly prejudiced Sars' arguments against LDC but could not, at least in our view, completely release LDC of its tax obligations and the penalty imposed. Sars was successful before the Tax Court in proving the presence of an understatement. This meant that LDC was liable for understatement penalties given its omission in the 2017 income tax return and that should have been the end of the story.

The High Court's direction that Sars lift the understatement penalty is basically permitting LDC and KMC to contract out of section 26A of the ITA and paragraph 13(1)(a)(ii) of the 8th Schedule, which are clear on the tax treatment of asset disposals where the agreement is not subject to a suspensive condition.

By granting LDC's appeal, the High Court is condoning undesired behaviour by taxpayers, which is the primary issue that understatement penalties seek to tackle, and unfortunately, the decision of the High Court has already been accepted by many as it does not favour Sars.

It may be unfounded to completely fault the court, considering the inherent complexity of tax matters. This case is a clear indication that the High Court should consider inviting tax specialists to sit in on tax-related matters, especially given the binding nature of High Court judgments, whereas Tax Court judgments are merely persuasive. This case has important implications for taxpayers, Sars, the courts and tax practitioners alike.

ABOUT THE AUTHOR

Ursula Dale-Ali, Associate, and Jana Krause, Tax Counsel, Tax Practice, Baker McKenzie Johannesburg

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