REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT PRETORIA, GAUTENG)

Case No.: **IT 45673**

(1) REPORTABLE: YES / **NO**

(2) OF INTEREST TO OTHER JUDGES: YES / **NO**

(3) REVISED.

17 July 2024
DATE

SIGNATURE

In the matter between:

TRUST TAXPAYER **Appellant**

and

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **Respondent**

J U D G M E N T

KEKANA, J

[1] This is an appeal by the taxpayer against the decision by the Respondent, the Commissioner of South African Revenue Services (the Commissioner or SARS). The appeal arises after the objection raised by the taxpayer was partially allowed as per the "notice of objection partially allowed" dated 16 September 2020 resulting in reduced assessments for 2007 to 2016.

[2] The partially allowed objection resulted in the Commissioner:

2.1 adjusting the Trust's taxable income by the inclusion of an amount of R97 007 315.00 in terms of the definition of "gross income" in section 1 of the Income Tax Act 58 of 1962 (ITA);

2.2 disallowing the inclusion by the Trust of an amount of R29 773 041 which is alleged to be the purchase price for the acquisition of a usufruct from RMB into the base cost calculation for capital gains tax purposes in terms of paragraph 20(1)(*a*) of the Eighth Schedule to the ITA ("the Eighth Schedule") when the Trust disposed of a commercial property comprising sections 4 and 5 of the UC Building ("the UC Building" or "the property") to Investec in the 2016 year of assessment;

2.3 levying 10% understatement penalties (USP) in terms of section 222(1) read with section 223 of the Tax Administration Act 28 of 2011 ("TAA") in the relevant years of assessment on the basis that there was a "substantial understatement", constituting a "standard case";

2.4 levying an underestimation of provisional tax penalty in respect of the 2015 year of assessment in terms of paragraph 20(1) of the Fourth Schedule to the ITA; and

2.5 levying interest in terms of section 89*quat(2)* of the ITA

Facts

[3] The appellant's version as regards facts can be summarised as follows:

3.1 That what was sold by Phemelo and acquired by the Trust was the bare dominium over the property (UC Building);

3.2 That prior to the Sale of Property Agreement, Phemelo had sold the usufructuary rights in the property to ZMS, with a cession of the rental income to First Rand Bank (FRB);

3.3 Since the usufructuary rights had already been stripped from the property when it was sold to the Trust, the rental income generated by the property accrued to ZMS, and was taxable in the hands of ZMS;

3.4 The usufruct in respect of the letting enterprise was held by ZMS and that the rental income in the form of promissory notes that were issued by ZMS to Phemelo, were ceded to FRB by Phemelo.

[4] SARS's contention to the appellant's version can be summarised as follows:

4.1 That a usufruct is a real right, the transfer of which must be registered with the Deeds Registry and no such registration took place.

4.2 That no usufructuary right was ceded to ZMS or FRB.

4.3 That the Trust purchased the property and took assignment of Phemelo's rights and obligations under the Head Lease, excluding Phemelo's rights in the promissory notes.

4.4 That the Trust was a landlord in the web of agreements signed and was always the recipient of the rental income generated out of the Head lease.

Issues in dispute

[5] The Appellant dispute the income tax consequences of certain agreements concluded in respect of the UC Building. Before this Honourable Court the Appellant raised four grounds of appeal namely that:

5.1 the Trust is not liable for additional income tax on rental income as it was not earned or did not accrue to it;

5.2 the Trust is not liable for additional income tax on the valid capital cost disregarded by SARS in the determination of the base cost of the disposed asset; meaning that the amount of R29 773 041 should have been included in the base cost of the asset when disposed to Investec in 2016.

5.3 the Trust is not liable for understatement penalties; and

5.4 the Trust is not liable for section 89*quat(2)* interest.

[6] Before this Honourable Court the Appellant opted not to call any witnesses nor introduce any evidence except for its head of arguments. While the Appellant opted not to adduce any evidence or call any witness, it must be noted that in terms of section 102(1) of the TAA, the burden of proof that an amount is not liable to tax is on the taxpayer, to be discharged on a balance of probabilities.[1] The Respondent called one witness to testify, Ms Zanear, who was at the time when the taxpayer was audited, an audit specialist at SARS and a numerous documents were placed into evidence in support of the Respondent's case.

[7] In her testimony Ms Zanear took the Court through the processes followed by SARS both as regards the facts found and how the audit was conducted and how various tax laws were applied to the entire scheme. These included:

7.1 the audit of the trust, its scheme and the findings resulting in the Commissioner's additional assessment on the income;

7.2 the engagement between the audit team and RMB as regards the rental income and the alleged cessation of usufruct and the subsequent acquisition of the usufruct by the trust;

7.3 how and why the R29 773 041 was disallowed from being included into the base costs on the disposal of the asset to Investec in 2016;

7.4 how understatement penalties were computed; and

7.5 how interests were levied under section 89*quat(2)*.

[8] At the hearing four lever-arc files containing documents of more than 1 400 pages ("the Bundle") was introduced by the Respondent. The probative value of the Bundle was agreed by the parties in the usual terms namely that: unless the evidence to the contrary has been led the documents are what they purported to be without admission as to the truths of the contents.

[9] As regards the additional income raised by the Commissioner, the Appellant argues that the trust only held bare dominium on the asset and that the usufruct was ceded to ZMS. ZMS is the taxpayer to which the rentals accrued to and must therefore include the rental in their gross income. That to prove that the usufruct was ceded to RMB it was later acquired by the trust in 2016 at an amount of 29 million rand. The Appellant further argues that there was no contract in terms of a lease or invoice with the trust as such the trust neither enjoyed the

---

1 *CIR v Middleman* 1991 (1) SA 200 (C) at 202B.

use of the asset nor the concomitant rental income. Also, that since the trust only held the bare dominium the rental income accrued to the holder of the usufruct, namely, ZMS.

[10] To prove that the Appellant was the recipient of the rental income, the Respondent was able to place into evidence numerous lease agreements signed by the trust as landlord with multiple tenants, some of the lease agreements were concluded in the year 2012. The tenants according to these lease agreements were National Intelligence Agency, Department of Public Works, Bankmed to mention but a few.

[11] The Respondent was also able to place into evidence a correspondence between SARS and RMB. This document was a response from RMB to SARS and same was shared with the Appellant and no objection was raised by the Appellant and it was admitted by both parties as part of the evidence. This correspondence was a response by RMB emanating from an enquiry by SARS regarding the rental income, the usufruct allegedly ceded to RMB, and the 29 million rand paid by the trust to RMB in 2016. In its response RMB was able to state that:

- it never received any rental income;
- that the trust did not cede any usufruct to RMB;
- that in January 2016 RMB sold its remaining rights to Promissory Notes (PN) that were not yet due and payable to the Trust Taxpayer for an amount of 29 million.

[12] The Respondent was able to prove that there was no usufruct ceded to ZMS or RMB. That the R29 773 041 paid by the trust to RMB was not incurred in the acquisition or maintenance of a right “usufruct” as alleged by the Appellant. The Respondent was able to place into evidence a list of lease agreements between the trust and several tenants in which the trust was according to the terms of all these lease agreements the landlord and was the recipient of the rental income.

[13] The Respondent was able to also prove and place into evidence the annual financial statements of the trust which showed that the trust did receive rental income from all these lease agreements the trust entered into with the various tenants.

[14] The Respondent was also able to place into evidence the insurance that the Trust took for the protection of the rental income to mitigate the risk against the loss of rental income. This insurance was taken in 2007 with the entity SA Eagle policy in which the Trust is insured against a loss of rental income and it insured the property for R131 million (the same property the Trust alleges to only have a bare dominium of R200 000.

[15] I'm convinced that there was no usufruct ceded to any other entity not ZMS and certainly not FRB/RMB. The trust always had all rights and enjoyed the use of the asset. The Trust entered into lease agreements in its capacity as the landlord and received the rental income as declared in its annual financial statements. The Appellant's version cannot succeed as it failed to adduce evidence to support the cessation of a usufruct or because it is a personal servitude, the registration thereof with the Deeds Registry as required by the law.[2]. The Trust failed to discharge the onus resting on it of proving on a preponderance of probability that the additional assessments raised by SARS, were wrong. As such I'm fully convinced that the Commissioner was correct in raising the additional assessment.

[16] I now will focus my attention to the disallowed inclusion or the exclusion of the R29 773 041 from the calculation of the base cost when the asset was disposed to Investec in 2016. While this ground of appeal by the Appellant may appear to be independent as a second ground of appeal, it is not independent in that there is a close connection between this (second) ground of appeal and the first ground.

[17] The two are innately linked to the issue I consider central to the whole dispute, that of the usufruct allegedly ceded by the Trust. If the answer to the ceded usufruct is in affirmative, it will then mean that the Commissioner would have erred in raising the additional income and conversely the amount incurred in acquiring the usufruct from RMB should then be included in the base cost of the asset when disposed to Investec in 2016. If no usufruct was ceded, then that conclusion also affects the answer to the second ground, meaning that the 29 million rand should be excluded from the calculation of the base cost of the asset when disposed.

[18] The appellant argues that the amount of R29 773 041 was paid to RMB by the Trust to acquire the usufruct. That RMB had purchased the right to receive the rentals for the period. That, without the acquisition of these rights from RMB the trust could not have sold the investment property. The evidence and findings made in paragraph 11 above become relevant to this second ground of appeal. The Respondent was able to prove that there was no usufruct ceded to RMB and that the 29 million rand paid was not for the acquisition of any usufruct.

[19] The issue of whether there was a usufruct ceded has been clarified in the correspondence from RMB to SARS. The Appellant did not challenge the originality nor the authenticity of these correspondence from RMB. I'm of the view that if no usufruct was ceded to RMB, no usufruct was acquired by the payment of R29 million to RMB consequently the 29 million rand cannot be included nor added into the base cost of the asset sold to Investec. The Commissioner was correct in disallowing the inclusion of R29 773 041 into the base cost

---

2 Section 65(1) of the Deeds Registries Act, 47 of 1937 ('Deeds Act').

when the asset was disposed to Investec in 2016. This amount was not incurred in establishing, maintaining or defending title or right to an asset.[3]

[20] I now will deal with the understatement penalty the Commissioner assessed. The Commissioner assessed an understatement penalty at a rate of 10%. The Appellant argues that there was no understatement in that the rental income did not accrue to the trust and also that the trust is not liable for additional income tax on the valid capital cost disregarded by SARS in the determination of the base cost of the disposed asset.

[21] The Appellant argues that between the tax years of 2007 - 2016 there was no "understatement", as defined in section 221 of the TAA because no income accrued to the trust. That since there was no tax to pay by the trust there can be no understatement penalty to be levied.

[22] The Appellant argues that the "understatement" if any resulted from a "*bona fide* inadvertent error" The Appellant in advancing its argument of a "*bona fide* inadvertent error" relies on the case of *ITI 13772* where it was held at para 45 that:

> "It follows from the above that the bona fide inadvertent error has to be an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive."

[23] The Appellant further argues that in completing and submitting its returns for the 2007 - 2016 years of assessment, the trust acted with the reasonable and bona fide belief that it had calculated its tax liability correctly. That if it is found that the taxpayer has understated its income in the years of assessment, it has just erred and done so in good faith and unintentionally, as such SARS may not impose an understatement penalty at all.

[24] While I agree with the authority referred to by the Appellant, I'm however, of the view that the use of this authority by the Appellant to advance its argument is a misnomer, and completely misplaced. It is an ironic paradox and a contradiction in terms for the Appellant to belief that while there existed evidence that proved that there was no usufruct ceded by the Trust, with evidence of lease agreements entered into between the Trust and multiple tenants which showed that the trust was the landlord receiving the rental income, with evidence of rental income declared in the annual financial statements of the Trust throughout the affected years of assessment, and with the Trust taking up insurance to mitigate against the risk of the loss of the said rental income, which evidence has and remains unchallenged, the Appellant still believes that the non-declaration of the income by the Trust was an innocent, unintentional mistake.

---

[3] Paragraph 20 of the Eight Schedule.

[25] Unfortunately, this argument by the Appellant is ill conceived, without any legal foundation and not persuasive. Boqwana J defines a "*bona fide* inadvertent error" as an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive.[4] I find no innocent mistake here but rather a planned scheme, an arrangement with intention to deceive.

[26] Any taxpayer relies on its annual financial statements when completing and submitting tax returns to confirm the revenue generated for the year. The trust was aware of its annual financial statements; this is the information it receives from its own auditors. The trust was always aware that it had not ceded any usufruct, that all rental income from all its tenants was received and accrued to it hence it was declared in all its annual financial statements. Also, the Trust as beneficial owners of the rental income, understanding the risk assumed had to mitigate against it by taking insurance to protect the loss of the said rental income if it had no rights over the income.

[27] The Respondent argues that the rate of 10% may apply to an understatement which arises out of "substantial understatement". An "understatement" is defined in section 221 of the TAA to mean:

> "any prejudice to SARS or the fiscus as a result of—
>
> (*a*) failure to submit a return required under a tax Act or by the Commissioner;
>
> (*b*) an omission from a return;
>
> (*c*) an incorrect statement in a return;
>
> (*d*) if no return is required, the failure to pay the correct amount of 'tax'; or
>
> (*e*) an 'impermissible avoidance arrangement'."

[28] The onus of establishing the facts upon which the penalty was imposed lies with the Commissioner[5]. The Commissioner through its witness, Ms Zanear, whose testimony was uncontested, was able to proof the following:

28.1 that the trust did not declare the rental income under the head lease. Meaning the provisions of section 221(b) and (c) of the TAA referred to above are satisfied. The sub-provisions are interpreted disjunctively and not conjunctively meaning that the satisfaction of one will be sufficient for the Commissioner to prove that there was an understatement;

---

4 *ITC 1890* 79 SATC 62 (2016) 45.

5 Section 102(2) TAA.

28.2 that the impact thereof exceeds 5% of the total amount of tax otherwise payable; and

28.3 that it is not necessary for the Commissioner to demonstrate the reasons for considering this a "standard case". A "standard case" being a default position and that once a "substantial understatement" has been shown, 10% is the minimum penalty to be imposed.[6]

[29] I'm satisfied that the Commissioner was able to establish the facts upon which the penalty was imposed, and the rate it applied. The rate applied was the correct rate considering that this was a standard case where 10% is the minimum penalty the Commissioner can impose.

[30] As regards interests, they are imposed by the Commissioner in terms of section 89*quat(2)* if the "normal tax" payable by a taxpayer in respect of its taxable income exceeds the credit amount in relation to such year. The Appellant's argument is that the normal tax payable by the Trust in respect of its taxable income for its 2007-2016 years of assessment did not exceed "the credit amount in relation to such year", as contemplated in section 89*quat(2)*. The Appellant goes on to argue that if contrary to Trusts contentions section 89*quat(2)* did apply, the Commissioner should have exercised the discretion conferred on him in terms of section 89*quat(3)* to direct that such interest shall not be paid by the Trust.

[31] Section 89*quat(3)* of the Income Tax Act, the relevant provision reads as follows:

> "Where the Commissioner having regard to the circumstances of the case, is satisfied that any amount has been included in the taxpayer's taxable income or that any deduction, allowance, disregarding or exclusion claimed by the taxpayer has not been allowed, and the taxpayer has on reasonable grounds contended that such amount should not have been included or that such deduction allowance, disregarding or exclusion should have been allowed, the Commissioner may, subject to the provisions of section 103(6) direct that interest shall not be paid by the taxpayer on so much of the said normal tax as is attributable to the inclusion of such amount or the disallowance of such deduction, allowance, disregarding or exclusion."

[32] The provisions of section 89*quat(3)* are under the circumstances not applicable as the Appellant has failed to prove that the amount included in the Trust's taxable income should not have been included, consequently there is no basis to remit the section 89*quat* interest imposed by SARS. Having concluded above that the Trust was and remains liable for the income tax for the disputed years of assessment, the Trust is liable for the interests charged. While the Commissioner can exercise its discretion to remit the interest in whole or in part if he is satisfied that the interest payable in terms of subsection (2) were as a result of

---

6 Section 223 TAA.

circumstances beyond the control of the taxpayer, one is compelled to repeat some reasons advanced in paragraph 24 above to conclude on the aspect of whether the discretion by the Commissioner is applicable or not. The taxpayer was always aware of the following:

32.1 that no usufruct was ceded by the Trust;

32.2 that Trust entered into lease agreements with multiple tenants as a landlord receiving the rental income;

32.3 that the rental income for affected years of assessment was declared in the annual financial statements; and

32.4 that it took insurance to mitigate against the risk of the loss of the said rental income.

[33] I can conclude that the Appellant had always had control of what was happening with the Trust, its finances, including the security for the income. As such the non-declaration of the taxable income cannot be said to be beyond the taxpayer's control.

[34] As regards costs for the appeal, counsel for the Respondent argued that the awarding of costs in tax proceedings differ from any other legal proceedings where costs usually follow the suit. That as regards tax matters, it is only in very exceptional circumstances that the court will award costs against the party. Costs will only be awarded against a party if the Court is satisfied that the grounds relied upon by that party are unreasonable[7]. I'm of the firm belief that the Appellant had no merits to initiate nor lodge an appeal. The Appellant had no facts or law to rely on in the furtherance of its appeal to pursue this matter and bringing it before this court. The appeal to this Court (the Tax Court) was, particularly after the Commissioner had partially allowed its objection, a very frivolous step which was unreasonable, and lamentable.

[35] In the circumstances the following order is made:

1. That appeal by the taxpayer is dismissed.

2. The additional assessments, including the understatement penalties and interest assessments, is upheld.

---

7 Section 130(1) (a) of the Tax Administration Act.

3. That the appellant shall pay the cost of this appeal on the scale of attorney and client including the employment of the two counsels.

ND Kekana

Acting Judge of the Pretoria High Court

Mr Eric Mphumbude (Accountant Member)

Ms Sebueng Mthembu (Commercial Member)

Hearing: 27 to 31 May 2024

Judgment: 17 July 2024