

**IN THE TAX COURT OF SOUTH AFRICA**  
**(HELD IN CAPE TOWN)**

Case No.: **ITI 13772**

In the matter between:

**ABC HOLDINGS (PTY) LTD**

Appellant

and

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

Respondent

Date of judgment: 4 November 2016

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**JUDGMENT**

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**BOQWANA J**

**Introduction**

[1] The issue for consideration in this case is whether the appellant is entitled to claim a deductible allowance for such future expenditure in terms of s 24C of the Income Tax Act 58 of 1962 ('the Income Tax Act') for its 2011 year of assessment.

[2] The appellant claimed an amount of R9 354 458.00 as a deductible allowance for its 2011 year of assessment. The respondent conducted an audit on the appellant during January 2014 and notified the appellant that the s 24C allowance was incorrectly claimed by the appellant because the provisions of this section were not applicable to the amount of income received by the appellant in that year and the appellant was therefore liable to pay tax in the amount of R2 619 248.00 ('the tax'). It levied an understatement penalty of R261 924.80 ( $R2\,619\,248 \times 10\%$ ) ('the penalty') in terms of s 222 of the Tax Administration Act 28 of 2011 ('Tax Administration Act')

[3] On 3 April 2014, the appellant filed a notice of objection which was disallowed in May 2014. The respondent maintained that the s 24C allowance had been incorrectly claimed and that the tax and penalty were payable. The appellant appeals against the respondent's disallowance of its objection.

## **Background Facts**

[4] The appellant is a private company conducting business of managing and administrating retirement villages and their frail care centres. During 2006 it acquired four retirement villages and their frail care centres through an amalgamation transaction from the developers of the retirement villagers. Monthly levies are payable to the Body Corporate by residents who own units in the village. The appellant is a party to a deed of sale in terms of which units in the village are sold and transferred from an existing resident owner ('the seller') to a new owner ('the purchaser'). It earns profit when a sale is concluded. According to the appellant, it also becomes contractually obliged to incur future expenditure on behalf of the purchaser.

[5] In order to purchase or sell a unit in the village, a party has to conclude a standard form written contract of sale ('standard form contract'). The parties to the contract are the seller (the resident owner), the purchaser (the new owner) and the appellant. The important terms and conditions of the standard form contract are as follows:

### **'15. LEVY**

It is recorded that the cost of the following will be paid for from the levy to be charged to and be payable by, the Purchaser: Notwithstanding anything to the contrary contained in previous documents or in the Rules. It is recorded that the following terms, forming part of the Sectional Title Levy ordinary payable by the Purchaser, will be paid by ABC HOLDINGS (PTY) LTD, directly to the Body Corporate Levy Fund as a subsidy on behalf of the Purchaser, provided that the Purchaser pays the levy, as agreed in terms of clause 16 hereof, which levy will be charged by ABC HOLDINGS (PTY) LTD to and be payable by, the Purchaser

- 15.1.1. Insurance on all building structures;
- 15.1.2. maintenance of the ground, the community centre and the exterior of the buildings;
- 15.1.3. 24-hour security;
- 15.1.4. payment of common electricity and water;
- 15.1.5. management of accounts, investments and cash;
- 15.1.6. reception facilities;
- 15.1.7. provision of administrative staff as required for the efficient management of X Entity;
- 15.1.8. primary health care consisting of nursing staff of the Health Care Centre attending to application of medications, dressing, injections, monitor tests

and caring on residents reasonably requiring assistance, advice or reassurance. Where more intensive nursing attention is needed, residents will be transferred to the Health Care Unit, in this regard the decision of ABC Holdings (Pty) Ltd or its duly appointed representative will be final.

- 15.1.9. provision of a transport service for which a mileage charge will be levied for use:

## **16. THE LEVY**

...

- 16.5. The levy will be paid by the Purchaser to the Body Corporate Levy Fund retrospectively as from the date of transfer and thereafter monthly advance in the manner determined and advised by the Body Corporate Levy Fund from time to time;
- 16.6. Inasmuch as this agreement imposes rights, obligations and liabilities on ABC Holdings (Pty) Ltd, the sold company is to that extent a party to this Agreement. The signature of the duly authorised representative of the company therefore hereby binds the company to this Agreement as far as the provisions hereby relate to it.

## **17. RESALE**

The Purchaser shall be entitled at any time after the purchase of the Units to sell same, subject however to the following restrictions and conditions

- 17.1. ABC Holdings (Pty) Ltd shall endeavour to sell the Unit on behalf of the Seller and in the event of a sale being effected, no Estate Agent's commission would be charged. However if the Seller engages the services of his own Estate Agent, he shall be solely responsible for any Estate Agent's commission, (as described in clause 6 of the Schedule) which shall be payable from the Seller's share of the selling price.
- 17.2. On the death of the last surviving nominated occupant the unit must be sold
- 17.3. Such sale shall be subject to the written consent of ABC Holdings (Pty) Ltd
- 17.4. Any sale shall only be effected at the true current market value of the Unit (evidenced, if necessary by the valuation of an independent valuer) failing which ABC Holdings (Pty) Ltd shall be entitled to withhold the consent required in terms of 17.3. ABC Holdings (Pty) Ltd – shall be entitled to enforce Clause 70 of the Regulations (Sectional Title Act 95 of 1986).
- 17.5. The consent of ABC Holdings (Pty) Ltd – to any resale will only be given on receipt by ABC Holdings (Pty) Ltd –of a written undertaking for payment of all

amounts owed to ABC Holdings (Pty) Ltd – and/or the Body Corporate from any cause whatsoever and in addition for payment to ABC Holdings (Pty) Ltd of an amount equivalent to **40% (FORTY PER CENT)** of the enhancement in the value of the Unit as evidenced by the sale price, or should such sale price not be market related, the market value of the Unit as determined by an independent valuer appointed by ABC Holdings (Pty) Ltd whichever may be higher.

17.6. The enhancement payable under 17.5 above shall be calculated by deducting the original purchase price from the selling price on re-sale,

17.6.1. against registration of transfer of the re-sale –

17.6.2. the Seller shall receive the original purchase price plus **60% (SIXTY PER CENT)** of the enhancement (less any amounts owed to ABC Holdings (Pty) Ltd or the Body Corporate, plus any owed by ABC Holdings (Pty) Ltd or the Body Corporate);

17.6.3. ABC Holdings (Pty) Ltd shall receive **40% (FORTY PER CENT)** of the enhancement (less any amounts owed to the Seller, plus any amounts owed by the Seller).

17.7. Payment of the amounts to be paid under 17.6 above shall be made against registration of transfer of the Unit from the Seller to his Purchaser.

...

17.10. All re-sales shall be effected in terms of a Standard Deed of Sale Agreement embodying the terms and conditions contained herein, or such other terms and conditions as ABC Holdings (Pty) Ltd may determine.

17.11. Such Standard Deed of Sale Agreement shall in particular contain –

17.11.1. an undertaking by the new Purchaser to abide by the terms and conditions of the Standard Deed of Sale Agreement, the Rules and such House Rules as may be applicable from time to time;

17.11.2. an undertaking by the Seller to pay to ABC Holdings (Pty) Ltd from the proceeds of the sale the amounts owed and payable in terms of clauses 17.5 and 17.6 hereof and to impose, in such re-sale agreement, an identical condition imposing such obligations upon his purchaser.

17.12. The Seller shall be obliged to deliver to ABC Holdings (Pty) Ltd a copy of the duly signed Deed of Sale within 4 (FOUR) days of such sale being effected; in the event of this failing to be done, or having been done, it being found that

such Deed of Sale does not contain the specific undertakings referred to in clause 17.7, 17.11.1 and 17.11.2, ABC Holdings (Pty) Ltd shall be entitled to withhold its consent to the re-sale until such time that the omission have been remedied to the satisfaction of ABC Holdings (Pty) Ltd .’

[6] The terms of the standard contract make it a condition that the contract of sale between the seller and the purchaser (‘the second contract’) shall be effected on the same terms and conditions as the standard form contract in terms of which the seller originally purchased the unit (‘the first contract’).

[7] Furthermore, upon the sale of the unit by the seller, the seller is liable to pay the appellant an amount equivalent to 40% of the enhancement value of the unit (‘the enhancement’).

### **Respondent’s reasons for disallowing the appellant’s claim**

[8] The respondent disallowed the appellant’s s24C claim and its subsequent objection on the grounds that:

- 8.1 The enhancement accrues to the appellant in terms of the first contract because it is an obligation which the resident owner has to discharge if the unit is ever sold, and the amount paid by him and not by the new owner.
- 8.2 No future expenditure has to be incurred by the appellant which relates to the enhancement income received by the appellant when the unit is sold because the resident owner has departed and all obligations of both the resident owner and the appellant have been discharged.
- 8.3 The enhancement income therefore is not income against which future expenditure will be incurred as contemplated in s 24C.
- 8.4 Section 24C is therefore not applicable and the appellant is not entitled to claim a s 24C allowance against the enhancement.

### **The relevant provision**

[9] Section 24C reads as follows:

**‘24C. Allowance in respect of future expenditure on contracts.** - (1) For the purposes of this section, “**future expenditure**” in relation to any year of assessment means an amount of expenditure which the Commissioner is satisfied will be incurred after the end of such year –

- (a) in such manner that such amount will be allowed as a deduction from income in a subsequent year of assessment; or

- (b) in respect of the acquisition any asset in respect of which any deduction will be admissible under the provisions of this Act.
- (2) If the income of any taxpayer in any year assessment includes or consists of an amount received by or accrued to him in terms of any contract and the Commissioner is satisfied that such amount will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under such contract, there shall be deducted in the determination of the taxpayer's taxable income for such year such allowance (not exceeding the said amount) as the Commissioner may determine, in respect of so much of such future expenditure as in his opinion relates to the said amount.
- (3) The amount any allowance deducted under subsection (2) in any year of assessment shall be deemed to be income received by or accrued to the taxpayer in the following year of assessment.' (Underlined for emphasis)

[10] In terms of the SARS Interpretation Note No: 78, arising from this provision is that income for a particular year of assessment includes or consists of an amount received or accrued under a contract. The Commissioner must be satisfied that all or part of that amount will be used to finance expenditure which will be incurred by the taxpayer in a subsequent year of assessment performing the obligations under the contract. Expenditure must either be expenditure which will be allowed as a deduction from income when incurred in a subsequent year of assessment or is expenditure which will be incurred in a subsequent year of assessment on the acquisition of an asset for which any deduction will be allowed under the Act (i.e. future expenditure.)

### **Appellant's contentions**

[11] The appellant contends that the reasoning of the respondent that the enhancement constitutes income to the appellant in terms of the first contract because it obliges the resident owner ('seller') to pay the enhancement to the appellant if the unit is ever sold is flawed for the following reasons:

11.1 As a matter of law gross income cannot accrue to or be received by a taxpayer (whether in terms of s24C or otherwise) unless "**total amount**" thereof has been determined. Therefore, although the provisions of the first contract do record the appellant's right to be paid and enhancement upon the sale of the unit, the amount of enhancement:

- (a) cannot be calculated until the selling price becomes known subsequent to the conclusion of the second contract;

- (b) only accrues to the appellant as income in the year of assessment in which the second contract is concluded;
- (c) only becomes payable to the appellant upon transfer of the unit pursuant to the second contract; and
- (d) is only received by the appellant when paid by the subsequent to the resident owner transferring the unit to the purchaser in terms of the second contract.

11.2 In paragraph 16.3 of its Rule 31 statement, the respondent in fact contradicts its assertion that the enhancement constitutes income which accrues to the appellant in terms of the first contract, because it unequivocally states that *'[T]he enhancement income received by the Appellant income which accrues to the appellant in terms of the deed of sale at the date at which the resident disposes the...unit'* which disposal can only be in terms of the second contract.

11.3 Therefore, it is in terms of the second contract in the tax year in which it is concluded that the enhancement accrues to or received by the appellant as “**an amount**” of income in terms of s24C.

11.4 In the circumstances, the enhancement could never have accrued to the appellant in terms of the first contract.

11.5 Furthermore, on the date of the conclusion of the second contract, the amount of the enhancement accrues in favour of the appellant as income and the appellant becomes contractually obliged to pay the levy subsidy on behalf of the new owner subsequent to transfer of the unit pursuant to the contract.

11.6 Therefore, the levy subsidy which the appellant becomes liable to pay in terms of the second contract constitutes future expenditure of the kind described in s24C which it incurs in the performance of its obligations “**under such contract**”.

11.7 Equally, it is not in dispute that the appellant utilises part of the enhancement income derived from the second contract to pay for the levy subsidy in terms thereof.

11.8 In light of that, the respondent is incorrect when it asserts that no future expenditure has to be incurred by the appellant which relates to the enhancement income “**received**” by when the unit is sold. The enhancement income is only received by the appellant on or after the date on which the unit is

transferred to the new owner by the resident owner in terms of the second contract, from which date, the appellant also becomes liable to pay the levy subsidy.

11.9 Accordingly, the resident owner's departure and termination of the reciprocal obligations between him and the appellant under the first contract has nothing to do with the appellant's claim in terms of s24C in that the enhancement income to be used to pay the future subsidy levy is only "**received**" by the appellant subsequent to the resident owner passing transfer to the new owner in terms of the second contract with all the obligations under the first contract terminating on that date.

11.10 The enhancement derived from the conclusion of the second contract is gross income which can be utilised by the appellant in whole or part to pay for the future levy expenditure which is incurred by it in terms of the contract as contemplated in s24C. Section 24C is therefore applicable and the appellant's claim in terms of that section should accordingly be allowed.

[12] As to the penalty levied, the appellant submit that if it was entitled to the s 24C allowance then it could never have made a 'substantial understatement' of the kind alleged and is therefore not liable for the penalty. In the alternative, in the event the appeal is refused, then the appellant seeks an order that it be excused from paying the penalty on the basis that the alleged understatement was as a result of a *bona fide* inadvertent error of the kind contemplated in s 222(1) of the Tax Administration Act, and that it acted on the strength of the tax advice it received and that its s24C claims were previously allowed by the respondent. It therefore had reason to believe that the basis upon which it claimed the allowances was correct and accepted by the respondent. There was accordingly nothing preventing it from claiming such allowances in subsequent years of assessment, such as 2011.

### **Discussion**

[13] Section 24C was introduced as a measure to relieve a taxpayer who had received an advance payment in terms of a contract and who will incur expenditure under that contract in future. It was to deal with a situation where an anomaly would arise when income is received in one year and expenditure occurs or is incurred in the subsequent year. Absent s24C, the income would be fully taxable in the year received without any deduction for future expenditure. The section seeks to place the taxpayer in the same position as he or she would have been had the income earned and expenditure incurred occurred in the same tax year.

[14] As the first requirement, in terms of s24C, the income of the taxpayer in a particular year of assessment must include an amount received by or accrued in terms of any contract. Secondly, the commissioner must be satisfied that such amount will be utilised in whole, or in part to finance future expenditure which would be incurred by the taxpayer in the performance of his or her obligations under such contract. Thirdly, such expenditure must be expenditure that would be allowed as a deduction from income when incurred in a subsequent year of assessment.

[15] There are two contracts under consideration in this matter. The first contract is one between the original seller and first purchaser ('Owner 1/ resident owner') and the second contract is between the resident owner, subsequent purchaser and the appellant ('the purchaser/new owner').

[16] In terms of the second agreement the resident owner sells his /her ownership of a unit to the purchaser. The appellant performs certain administration and related services for the purchaser against payment of a levy, which is paid monthly in advance by the purchaser to the appellant. The second agreement as is the first contract, contains an undertaking by the purchaser to pay enhancement income to the appellant when he or she (the purchaser) sells the unit in the future with the inclusion of the terms and conditions or the related clause in a future agreement in respect of sale. These two agreements are incorporated in one deed of sale for purposes of tax despite them being two separate agreements.

[17] Mr Y who appeared for the appellant submitted that whilst the first contract provides for the occasion or the opportunity for the result to be produced, i.e. a unit must be sold for the enhancement value to be payable, it is the second contract that actually produces the result or that positively contributes to the production of the result in that the appellant can never receive the enhancement amount until another deed of sale is concluded. This is because until there is a purchase price in terms of the second contract, there can never be an enhancement value. Furthermore, it is in terms of the second contract that levies are expended by the appellant on behalf of the purchaser and that occurs only after the income has been received. To support this argument Mr Y referred to a decision of *Tuck v Commissioner for Inland Revenue* 1988 (3) SA 819 (A) at 831 F-G where Corbett JA stated the following:

‘...Indeed generally in law you seek the fact that actually produces the result or positively contributes to its production and not a fact that provides the occasion or opportunity for the results to be produced.’

[18] This case turns on the interpretation of s24C in relation to the two agreements. In *Commissioner for the South African Revenue Service v Bosch and Another* 2015 (2) SA 174

(SCA) at para 9 the Court in considering interpretation of s 8A(1)(a) of the Income Tax Act, the issue being whether two taxpayers exercised a right to acquire the shares, within the meaning of that expression in s 8A(1)(a), when they exercised the options, or whether they only did so when the time for payment and delivery arrived, held that:

‘[9] That involves the proper construction of the section in accordance with ordinary principles of statutory construction. The words of the section provide the starting point and are considered in the light of their context, the apparent purpose of the provision and any relevant background material[4]. There may be rare cases where words used in a statute or contract are only capable of bearing a single meaning, but outside of that situation it is pointless to speak of a statutory provision or a clause in a contract as having a plain meaning. One meaning may strike the reader as syntactically and grammatically more plausible than another, but, as soon as more than one possible meaning is available, the determination of the provision’s proper meaning will depend as much on context, purpose and background as on dictionary definitions or what Schreiner JA referred to as ‘excessive peering at the language to be interpreted without sufficient attention to the historical contextual scene [5]’.

[4] *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 18; *Bothma-Batho Transport (Edms) Bpk v S Bothma & Seun Transport (Edms) Bpk* 2014 (2) SA 494 (SCA) paras 10-12.

[5] *Jaga v Dönges NO and Another; Bhana v Dönges NO and Another* 1950 (4) SA 653 (A) at 664 G – H.]. (Underlined for emphasis)

[19] From the wording of the section it is clear that the contract being evaluated must contain both income and the obligation of future expenses. It expresses thus, ‘...[i]f the income ... consists of any amount received by or accrued to him in terms of any contract and the Commissioner is satisfied that such amounts will be utilised in whole or in part to finance future expenditure which will be incurred by the taxpayer in the performance of his obligations under such contract.’

[20] Mr Y submitted that the words ‘*in terms of any contract*’ must be interpreted to include the plural, which he suggests is the most sensible approach to the section. He referred to a number of authorities dealing with interpretation of legislation seeking to persuade the court that the legislature never required that s 24C would always refer to ‘one contract.’ It could in his view refer to more than one contract as in this case. Whether or not the words ‘any contract’ or ‘such contract’ must be viewed in singular or plural is not the real issue. ‘Any contract or ‘such contract’ should be viewed within the context, purpose and background of the section. That section was introduced into the Income Tax Act for the

benefit of building contractors, in particular those who in a contract would be paid certain amounts in advanced whilst the builder's obligation to carry work out in terms of the contract will give rise to future expenditure which would only be incurred in the later tax year. (See *Income Tax Case No 1697 63 SATC 146*)

[21] The court does not find it necessary to deal with the analysis of the authorities referred to on the plural meaning issue, because even if Mr Y were correct that any contract could mean more than one contracts, the bulk of his argument was devoted on persuading the court that the two agreements in question should be viewed as one or as intertwined. This presupposes a realisation that in order for the appellant to come home on the requirements of s 24C it must show that the first and second contracts are, within the context of s 24C, inextricably linked so as to be interpreted as a whole.

[22] This is because it has been held that both income and future expenditure must be from the same contract. Thus, there must be a link between the 40% enhancement value and the obligation that the appellant is to discharge for the payment of the levies. This point was illustrated in *Income Tax Case No 1697 63 SATC 146* at 158 where the court observed that for allowance to be available in terms of s 24C, '*it must be in terms of the very contract in respect of which the income is received that the future expenditure is payable.*'

[23] According to Mr Y one could not look at one contract without the other as the two agreements imposed the same rights and obligations. To show the link between the income and the obligation the terms of the contracts must be viewed together. The clauses which impose the rights and obligation on the appellant are clauses 15 and 17. Clause 17 entitles the appellant to the enhancement value and clause 15 obliges payment of the levy by the appellant.

[24] Mr Y highlights the fact that the enhancement value is arrived at by subtracting the purchase price of the second contract from the first contract's as an important link. In his view, the second contract further gives rise to the future obligation of levies that are incurred and having to be paid on a monthly basis. According to him, the first contract simply gives a personal right when concluded but that right only turns into income which is taxable, when the second contract is concluded because that is when it accrues, or is received. The appellant only ever earns income when the unit is sold.

[25] It is common cause that the right to claim the enhancement income emanates from the first contract between the appellant and the seller. The calculation is deferred until the seller sells the unit. The party making payment of the enhancement value once the unit is sold is the seller, upon payment of the purchase price and not the purchaser and that obligation is in

terms of the first contract and that is an important issue. The purchaser never makes payment of income to the appellant when the unit is sold to him or her by the seller. He or she only does so in future when he or she sells the unit again.

[26] It seems that the only connection that arises between the two agreements is that the conclusion of the second contract merely activates the application of clause 17 in the first contract in terms of which the 40% enhancement value is payable by the seller who made that undertaking to the appellant. The mere conclusion of the second contract which has an effect of triggering a consequence in the first contract cannot mean without more that the two agreements are inextricably linked.

[27] Mr Y referred to the decision of *Cash Converters Southern Africa v Rosebud WP Franchise* 2002 (5) SA 494 (SCA). Whilst he distinguished the conclusion in this case on the basis that the debate was different, (in that case the issue was whether cancellation of one contract necessarily led to the cancellation of the other) he contended that that case was relevant because it found that the two agreements were linked. The link being between a sale agreement which served as a basis for the conclusion of the franchise agreement and vice versa. Apart from the fact that in *Cash Converters* the agreements were concluded on the same day, by the same parties, that case does not support the proposition the appellant is putting forward in anyway. At para 61 of that judgment, Brand JA (with whose judgment Y JA and Navsa concurred) held as follows:

‘I agree with both Navsa JA and Lewis AJA that the two contracts cannot be one indivisible transaction, as contended for by Rosebud. There are two separate contracts and, although interlinked, they represented two separate transactions. Once this is accepted, the notion that termination of the franchise agreement (‘the franchise’) automatically leads to the termination of the sale, can only be founded, is accepted by Lewis AJA, on a tacit or implied term.’

[28] The alleged interlinkage in *Cash Converters* did not go as far as leading to the conclusion that the two agreements should be regarded as one indivisible transaction as the respondent sought to suggest in that case.

[29] The link sought to be drawn in this case does not even go as far as the situation in *Cash Converters*, the sale of the unit by the seller is not depended on any clause in the first contract. The two agreements are concluded independently of each other with different sellers and purchasers, who may not know of each other’s existence or who are not all in the picture at the conclusion of each of the contracts. The claim that the appellant has for payment of the enhancement value is between it and the seller and does not involve the purchaser. Similarly, if and when the purchaser sells the unit and becomes a seller of that unit, he or she would be

obliged to pay the appellant the enhancement value as the seller of the unit and that would not involve the purchaser of the unit. He or she would have had his or her levies subsidised by the appellant at the time he or she was the resident of the unit.

[30] Furthermore and crucially, the expenditure cannot follow the receipt of income, it must precede it. The appellant contracts with current owner to subsidise the current owner's levies. Its reward for doing that would be an entitlement to 40% of the proceeds when the current owner sells the unit one day. It follows logically, that the sequence in this case, if the appellant's proposition were to be accepted, would mean that expenditure (i.e. payment of levies on behalf of current owner) is incurred before the income is being incurred (i.e. at the sale of the unit) which conceptually does not accord with the object of s24C which contemplates receipt of income before the actual expenditure. Because payment of levies would have been for the benefit of the resident ('that is the seller') as an obligation in terms of the contract between the appellant and the seller, (i.e. the first contract).

[31] Therefore, even if there was any link between the two agreements, the link must fulfil the requirements of s 24C i.e. the relationship between the income received and obligation to finance future expenditure. The only link that can be shown in this case is the triggering of the payment of the enhancement value undertaken in the first contract, at the sale of the unit and nothing more.

[32] In conclusion on this issue, it must be accepted that even though the second contract serves as a trigger for the realisation of the undertakings in clause 17 of the first contract, the argument cannot be stretched to the level that the two agreements are so intertwined so as to be viewed as the *any* or *such* contract contemplated by s 24C, taking into account the context of that section. '*Such future expenses*' in the second contract have no bearing to '*such income*' as it does not arise from *such contract* as is required by s24C. Furthermore, the obligation must be imposed against *such income*. The appellant receives payment of income from the seller as per the first contract with him or her, having subsidised levies for the seller during the duration of that contract. When the unit is sold, the purchaser makes no payment in respect of that sale to the appellant, in terms of which future expenditure that he might incur. There being no payment made by the purchaser to the appellant, s 24C allowance cannot be claimed.

[33] That point was stressed by Blignault J in *Income Tax case no 1667 61 SATC 439* at para 13 where he held that '*It is a clear requirement of s24C (2) that the expenditure must be incurred by the taxpayer in the performance of his obligations in terms of the same contract as the contract under which the income was received by him or accrued to him.*'

[34] No payment is made by the purchaser in advance when he or she concludes the second contract and acquiring the unit. Thus, it cannot be said that the expenditure incurred by the appellant is in the performance of its obligations in terms of the same contract from which the income was received.

[35] There is neither clause in the second agreement or the first agreement for that matter, nor evidence to suggest that other parties to the agreement (s) are aware that payment of the 40% enhancement value by the seller to the appellant would be utilised to settle any possible future expenditure that the appellant might have to incur in terms of its contractual obligations with the purchaser in relation to the levy. Whilst, Mr Y proficiently took the court through various clauses of the contracts and authorities to show the link between the two contracts, on close analysis of the said agreements, it is difficult to find the link sought to be drawn.

[36] For these reasons, the court has to find that the appellant was not entitled to deduct allowance in terms of s 24C of the Income Tax Act.

### **Penalty**

[37] As regards the understatement penalty imposed on the tax payer in terms of s 222 of the Tax Administration Act, the appellant submitted that it could never have made a substantial understatement of the kind alleged, if however the appeal is refused, it should be excused from paying the penalty on the basis that the alleged understatement was as a result of a *bona fide* inadvertent error of the kind contemplated in s 222(1). It submits that it acted on the strength of the tax advice it received; and that in years preceding the 2011 assessment it claimed allowance in terms of s24C which was allowed. It therefore had every reason to believe that the claims were correct and accepted by the respondent and that there was nothing precluding it from claiming in subsequent years such as 2011.

[38] Having perused the papers, it appears that the appellant was assisted by Mr E of LL Accountants and also obtained a tax opinion from Professor T which was given in a letter dated 5 March 2014. This opinion was attached to the notice of objection. Prof T concluded, inter alia, that *'the 40% profit share is earned in terms of the resale agreement, which means that it can be taken into account in determining the section 24C allowance that the appellant is entitled to.'*

[39] Not much was submitted by the appellant during argument as to why such conduct should be treated as one that would fit the definition of a *'bona fide* inadvertent error.'<sup>7</sup> The second respondent did not assist the court on this point either.

[40] On the issue of previous claims being allowed, no evidence was given to show that indeed the respondent allowed these kinds of deductions in the past. One searched in vain for the evidence or the facts from the papers. Mr G who appeared for the respondent stated that there was no proof that these claims were ever allowed until such time the audit was done. Mr Y simply stated that facts were common cause as per agreed pre-trial minutes without directing the court to the relevant allegations in the papers. In the absence of evidence or facts the court has difficulty in accepting this submission.

[41] The issue that remains is whether acting on the strength of the tax opinion of Prof T constitutes ‘a *bona fide* inadvertent error’ warranting the court to remit the penalty.

[42] In terms of the statement opposing grounds of appeal, it is alleged that the behaviour of the appellant was selected per s 223(1)(i) as that of substantial understatement and is considered to be a standard case.

[43] Section 222 (1) provides that where there has been an understatement, the taxpayer must pay the understatement penalty determined unless the understatement results from a *bona fide* inadvertent error. In terms of s 221 an ‘*understatement*’ means any prejudice to SARS in respect of a tax period as a result of a default in rendering a return, an omission from a return, an incorrect statement in a return, or a failure to pay the correct amount of tax where no return is required. The use of ‘must’ denotes that once the requirements have been met, the penalty must be imposed. There is no definition of a *bona fide* inadvertent error.

[44] According to the Oxford Dictionary the origin of the word ‘*bona fide*’ is Latin and literally means ‘with good faith’. The word is also defined as ‘genuine’; ‘real’; ‘without intention to deceive’. ‘Inadvertent’ is defined as ‘not resulting from’ or ‘achieved through deliberate planning’. The Merriam-Webster online dictionary gives the following as some of the synonyms for the word inadvertent: ‘accidental’ ‘unintentional’, ‘unintended’, ‘unpremeditated’, ‘unplanned’ and ‘unwitting’. Error is defined by the Oxford Dictionary as ‘a mistake’. It also gives the following synonyms: ‘the state or condition of being wrong in conduct or judgement’.

[45] 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.

[46] Section 223 (3) states that SARS must remit a ‘penalty’ imposed for a ‘*substantial understatement*’ if SARS is satisfied that the taxpayer -

- (a) made full disclosure of the arrangement, as defined in section 34, that gave rise to the prejudice to SARS or the fiscus by no later than the date that the relevant return was due; and
- (b) was in possession of an opinion by an independent registered tax practitioner that –
  - (i) was issued by no later than the date that the relevant return was due;
  - (ii) was based upon full disclosure of the specific facts and circumstances of the arrangement and, in the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance provisions of a tax Act, this requirement cannot be met unless the taxpayer is able to demonstrate that all of the steps in or parts of the arrangement were fully disclosed to the tax practitioner, whether or not the taxpayer was a direct party to the steps or parts in question; and
  - (iii) confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court.’

[47] In *Commissioner for South African Revenue Services v Foskor* [2010] 3 All SA 594 (SCA), at paras 48 to 51 the Supreme Court of Appeal (‘SCA’) remitted the interest that SARS had imposed. This was done on the basis that *Foskor* had taken legal advice upon which it had based its position and regulated its business affairs and the Commissioner for South African Revenue Services had remained passive for some considerable time.

[48] In the present matter, there is no doubt that the appellant acted in good faith with no intention to deceive, the question is whether it made a mistake by relying on the advice of the tax experts. While in our assessment, the wording in s 24C is simple, the complexity may have been created by the tax opinion given to the appellant that caused it to believe that two contracts were inextricably linked and could be interpreted as ‘any contract’ or ‘such contract’ within the meaning of s24C. Prof T went as far as interpreting the law referring to case law on interpretation of contracts, some of which was relied on by the appellant’s counsel in his argument holding, inter alia, that circumstances prevailing at the time of the conclusion of the agreement should be taken into account. This could have given an impression that this position would more than likely be upheld in court. It can be argued that Prof T’s opinion went beyond giving a tax opinion on what s 24C meant. He possibly also strayed into offering a legal opinion. Whilst a line may sometimes be fine, the court is

doubtful that such was the case in the present matter. Having said that, there is merit in excusing the appellant for its reliance on Prof T's opinion on the basis of it being lay on issues of tax and the law.

### **Costs**

[49] As to costs, s 130(1) of the Tax Administration Act provides that:

'The tax court may, in dealing with an appeal under this Chapter and on application by an aggrieved party, grant an order for costs in favour of the party, if –

- (a) the SARS grounds of assessment or 'decision' are held to be unreasonable;
- (b) the 'appellant's grounds of appeal are held to be unreasonable;
- (c) the tax board's decision is substantially confirmed;
- (d) .....
- (e) ..... ' (Underlined for emphasis)

[50] The court has a discretion to award costs in favour of the aggrieved party and on application by that party if either the grounds for assessment or appeal, whichever is applicable are held to be unreasonable. The respondent did not apply for a finding that the appellant's grounds of appeal were unreasonable. Submissions made by the respondent's upon the court's enquiry also did not deal with the question of whether the grounds of appeal were unreasonable. For those reasons, no order is made on the aspect of costs.

[51] In the result, the following order is made:

1. The appeal is dismissed with no order as to costs.
2. On the imposition of the understatement penalty for the 2011 year of assessment, the appeal is upheld, and the said penalty is hereby remitted.

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**BOQWANA J**

**President**