REPORTABLE

IN THE TAX COURT – PRETORIA

CASE NO : 11961

DATE : …….

BEFORE:

The Honourable Mr Justice W R C Prinsloo	President
Mr R Parbhoo	Accountant Member
Mr N A Matlala	Commercial Member

In the matter between:

A Appellant

and

THE COMMISSIONER FOR THE

SOUTH AFRICAN REVENUE SERVICE Respondent

(Heard at Pretoria on 23 February 2007)

JUDGMENT

PRINSLOO, J

[1] This appeal came before us on the 23 of February 2007. Mr Marais (SC) appeared for the Appellant and Mr Stevens for the Respondent. Judgment was reserved at the conclusion of the proceedings.

[2] In April 2002, the Appellant rendered an income tax return to the Respondent in respect of the year of assessment ended 31 December 2001 **("the 2001 year of assessment").** At that stage the Appellant's financial year ran until the 31st of December.

[3] In the 2001 return the following amounts, *inter alia*, were included as **"gross income"** of the Appellant:

(i) an amount of R19 019 422-22, in respect of which Appellant invoiced A during the 2001 year of assessment;

(ii) an amount of R11 876 660-40, which amount, plus VAT, was paid by A to the Appellant on the 8th January 2002.

This was after the end of the 2001 year of assessment.

[4] Thereafter the Appellant's entitlement to the aforementioned amounts was disputed by A. The dispute culminated in an arbitration.

The arbitration:

[5] On 28 January 2000 the Appellant, and A entered into a written Agreement in terms of which the Appellant agreed to provide A with Financial Risk Management Services in consideration for the payment of specified Performance Related Fees **("the Agreement").**

[6] As already pointed out, disputes arose between the Appellant and A with regard to whether the Appellant was entitled to certain payments in terms of the Agreement and also whether A was entitled to the refund of certain payments which it had made to the Appellant.

[7] For purposes of this judgment, only two of the claims which featured during the arbitration proceedings are relevant.

[8] The first claim relates essentially to benefits allegedly derived by A as a result of the introduction of an Electronic Cash Sweeping System by the Appellant for A. The Appellant contended that with effect from 1 November 1999 it rendered so-called Liquidity Risk Management **("LRM")** services to A, that such services created benefits for A, and that it was entitled to a fee in respect of such benefits, calculated in accordance with the provisions of the Agreement.

The claim was referred to during the arbitration as the "**LRM Claim".** The same name will be applied in this Judgment.

A denied the Appellant's contentions.

[9] During the 2001 year of assessment the Appellant invoiced A for the LRM Claim which it contended it had against A. The invoice was for some R19m (in round figures).

[10] Because A contested the claim, it was never paid.

[11] The remaining claim had to do with a General Insurance Fund, and is known as the **"GIF"** claim. The claim was not represented by actual cash. The Appellant arranged for a Contingency Insurance Policy to replace the GIF. The Appellant alleged that it brought about a benefit for A by initiating the introduction of this Contingency Insurance Policy. In the 2001 year of assessment the Appellant invoiced A for a fee of R13 539 392-40, (inclusive of VAT) in respect of an alleged saving which it contended was brought about for A.

[12] As I already pointed out, A in fact paid this amount to the Appellant early in January 2002. The amount appears to have fluctuated between (in round figures) R11m and (in round figures) some R13m. I assume that the VAT factor has something to do with that. Nothing turns on this.

[13] In the arbitration, A reclaimed the aforementioned sum in what became known as **"the GIF Counterclaim"** on the grounds that it was paid erroneously and without A having been liable to do so.

[14] The Arbitrator made his award on 28 July 2004. The result did not favour the Appellant.

[15] The result, briefly speaking, was as follows:

(i) The Appellant did not prove that it was entitled to the amount of the LRM Claim. This claim was dismissed;

(ii) The Appellant was not entitled to the amount of the GIF Claim, and the Counterclaim of A was upheld and it was declared that the latter was entitled to repayment.

The Issues:

[16] The issues for decision before us were the following:

(i) In regard to the LRM Claim:

(a) whether there was an accrual to the Appellant, as contemplated in the definition of **"gross income"** in Section 1 of the Income Tax Act, Act 58 of 1962 **("the Act")** in the 2001 year of assessment;

(b) if so, whether it had been established what amount so accrued to the Appellant during the 2001 year of assessment;

(ii) In regard to the GIF Counterclaim, whether the amount of some R11m had **"accrued to"** the Appellant, as contemplated in the aforementioned definition, during the 2001 year of assessment;

(iii) Whether the negative findings against the Appellant by the Arbitrator had any effect on the possible accrual of the amounts in the 2001 year of assessment.

[17] Before us, there was some debate as to whether or not the question of the amount (ground (ii) supra) was identified as one of the issues for decision.

It was raised by the Appellant, and it was also argued that it attracts an onus for the Respondent to discharge. It only comes into play in the event of a finding that there was in fact an accrual.

It is clear that this point was already raised by the Appellant in the Notice of Objection dated May 2005. Already in that letter, the Appellant suggested to the Respondent that with regard to the question as to whether **"an amount"** has accrued to the Taxpayer, the onus is on the Commissioner (Respondent) to prove this. As authority for this proposition, the Appellant relies on, *inter alia*, ***CIR v Butcher Brothers (Pty) Ltd 1945 Ad 301 at 322.***

The Evidence:

[18] The Appellant and the Respondent agreed upon a Statement of Facts, contained in Volume III of the Dossier.

[19] Some salient facts, not already mentioned in this Judgment, agreed upon by the parties in this document, are the following:

(i) the Income Tax Return of the Appellant for the 2001 year of assessment was dated 22 April 2002 and received by the South African Revenue Service on 30 April 2002;

(ii) the Financial Statements were accompanied by, *inter alia*, a report of the independent auditors, Ernst and Young;

(iii) with regard to the two amounts under debate, which where declared as gross income by the Appellant, SARS assessed the Appellant on a taxable income of some R30m (round figures) on 3 June 2002. The due date was 1 July 2002 and the **"second date"** was 31 July 2002;

(iv) the Appellant approached SARS on 9 May 2005 with a request to condone the late filing of its Notice of Objection to the assessment issued in respect of the 2001 year of assessment. This request was granted on 18 May 2005.

(v) the findings of the Arbitrator contained in his award, insofar as they relate to findings of fact, are correct and a complete finding of the facts.

(vi) the Arbitration Award is binding on the parties thereto and accordingly all findings of the Arbitrator, whether relating to the facts or to the law, are binding on the parties to the Arbitration.

The Onus:

[20] Mr Marais, on behalf of the Appellant, contended that the factual findings of the Arbitrator provide a sufficient factual basis upon which the relevant legal principles, on which the Appellant relies, are to be applied. In my view, this submission is correct.

[21] It is for the Court to establish what the law is and to apply the law to the facts.

[22] Mr Marais also argued that, in the present matter, the fact that Section 82 of the Act places a burden of proof on the Taxpayer (Appellant) is **"quite irrelevant".** This could be an over simplification. Nevertheless, where the findings of the Arbitrator have become common cause, the Section 82 onus inasmuch as it still plays a role in this case, must become easier to discharge. This is so, because of the Arbitrator's finding that the Appellant was not entitled to payment of either of the two amounts. As will be seen, infra, certain legal arguments still flow from this state of affairs.

[23] Finally, as to onus, I have already referred to the Appellant's argument that the onus is on the Respondent to prove the accrual of an amount to the Appellant. The findings of the Arbitrator on this aspect will be referred to briefly hereunder.

Provisions and Principles Pertaining to "Gross Income":

[24] The general part of the definition of **"Gross Income"** with effect from 1 January 2001, as it appears in Section 1 of the Act, reads as follows:

> **"'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 resident; …"**

[25] In the present case, the critical phrase appears to be **"the total amount … accrued to "the taxpayer".**

[26] In ***CIR v Peoples' Stores 1990 (2) SA 353 (A) at 365 A - B*** it was held that what is required for an accrual in terms of the definition of **"gross income"**, is that the person concerned must have become entitled to the amount in question, or to a right capable of being valued in money (emphasis added).

[27] In ***Cactus Investments (Pty) Ltd v CIR [1999] 1 All SA 345 (SCA) at 348 E,*** it was added that the entitlement should be unconditional.

[28] It follows, in my view, that to establish whether a person is entitled to an amount, the relevant legal principles are to be applied. The subjective belief of the person that he is entitled to the amount appears not to be the test.

[29] The question as to whether or not the Appellant became entitled to the amounts in question (emphasis added) can, in my view, be answered by the findings of the Arbitrator, which are common cause.

[30] As to the LRM Claim, the Arbitrator said the following:

> **"My conclusion is that the claimant has failed to prove what the position would have been if it had not (delivered certain services) under the LRM and, therefore, failed to prove the benefit derived by the defendant from such system or the amount of the fee to which it became entitled by introducing such system. Therefore, the LRM claim must fail".**

[31] As to the GIF counterclaim, the Arbitrator said the following:

> **"It follows that the very basis of the fee charged by the claimant for the GIF, namely that if the defendant had not changed to the contingency insurance it would have been obliged to and would in fact have borrowed an amount of R337 976 864,50 … is fundamentally flawed. Therefore, the claimant was not entitled to the GIF fee."**

The Arbitrator found that all of the requirements for unjust enrichment or the *condictio indebiti* had been met, and concluded:

> **"It follows, therefore, that the defendant is entitled to repayment of the GIF fee of R13 539 392.26".**

The Effect of the Arbitrator's Findings:

[32] In view of what the Arbitrator found, supra, and because the correctness of his findings of fact are common cause, Mr Marais made the following submissions:

(i) The Appellant was never entitled to the amount of R19m (round figures) in respect of the LRM Claim;

(ii) In any event, if there was an entitlement to some amount, this amount had not been proved by the Respondent, who bears the onus in this regard.

On this point, it is fair to add that the Arbitrator, in the course of his Judgment, did say that the Appellant had rendered some of the LRM services and was entitled to payment, but he concluded that the amount involved had not been proved.

I already referred, supra, to ***CIR v Butcher Brothers (Pty) Ltd 1945 AD 301 at 322***, where the following was said:

> **"The assessment in dispute, made by the Commissioner … can only be allowed to stand if some 'amount' accrued to or was received by the company in the tax year ended 30th June, 1935, by virtue of its rights under the building clauses in the lease, and it is essential for the Commissioner, in order to support his**

assessment, to show that some 'amount' has accrued to or been received by the company by virtue of such rights."

(iii) The Appellant was never entitled to the amount of R11m (round figures) in respect of the GIF Claim and was obliged to return this payment to A, as the Appellant had been unjustly enriched;

(iv) The findings of the Arbitrator, which are agreed to have been correct, confirmed what was throughout the legal position. Put differently, this legal position also prevailed during and as at the end of the 2001 year of assessment.

[33] These submissions flow from the Appellant's argument, not conceded by the Respondent, that the determination by the Arbitrator did not have the effect of a novation of the Appellant's rights flowing from the contract but rather served to confirm and reinforce those rights and obligations which had existed all along.

[34] If this were found to be the position, the Appellant's argument that there was no accrual of the relevant amounts during the 2001 year of assessment would be fortified:

I have already referred to the definition of **"gross income"** which encompasses the accrual of an amount in favour of the resident. I have also referred to the meaning of **"accrued to"** as defined by the Appellate Division

in ***CIR v Peoples' Stores*** ; supra and ***Cactus Investments (Pty) Ltd v CRI,*** supra.

Was there a Novation?

[35] In support of the argument that the determination of the Arbitrator did not serve as a novation of the Appellant's rights and obligations flowing from the contract (which formed the basis of the Arbitration) the following submissions were made by Mr Marais:

(i) In Section 1 of the Arbitration Act, 42 of 1965, **"arbitration proceedings"** is defined as "**proceedings conducted … for the settlement … of a dispute";**

(ii) In ***Total Support Management (Pty) Ltd and Another v Diversified Health Systems (SA) (Pty) Ltd and Another*** ***2002 (4) SA 661 (SCA)***, the following remarks were made at 673 G - I:

> **"… arbitration is a process by which the rights of the parties are determined in an impartial manner in respect of a dispute between parties which is formulated at the time that the arbitrator is appointed"**; and

> **"The hallmark of arbitration is that it is adjudication, flowing from the consent of the parties to the arbitration agreement … as arbitration is a form of private adjudication, the function of an arbitrator is not administrative but judicial in nature".**

(iii) In ***Trust Bank of Africa v Dhooma*** *1970 (3) SA 304 (N) at 310* ***A – C***, the following was stated:

> **"It does seem to me to be a somewhat artificial view of the position to regard a judgment as, in all circumstances, having the effect of a novation. In some cases, of course, it does have precisely that effect, where, for example, a plaintiff obtains a judgment for cancellation of a contract and for damages. Thus, in this case, had the judgment been one declaring the contract between the parties to have been at an end, with an order that the defendant return the vehicle to the plaintiff and pay the defendant a sum of money, it could quite realistically be said that the judgment wholly replaced and thus novated the contractual rights and liabilities of the parties *inter se*. But in a case like the present, where the only purpose of the judgment is to enable the plaintiff to enforce certain rights, by means of execution if need be, without in any way affecting other rights arising out of the contract, it seems more realistic to regard the judgment not as novating the former, but as strengthening or reinforcing them. The right of action will have been replaced by a right to execute, but the enforceable right remains the same."**

(iv) In ***Swadif (Pty) Ltd v Dyke NO*** *1978 (1) SA 928 (A),* ***TRENGOVE AJA*** (as he then was) analysed this question by referring, *inter alia*, to the Roman-Dutch authorities and the South African authorities and text book writers:

At 944 E-F, the Learned Judge comes to the conclusion that the views expressed in ***Trust Bank of Africa Limited v Dhooma,***, supra, in the *dictum* quoted above, are correct, and in accordance with the views of the Roman-Dutch writers, namely to regard a judgment enforcing rights arising from a contract not as novating the obligation, but rather as strengthening or reinforcing it.

(v) In ***Standard Bank of South Africa Limited v Oneanate Investments (Pty) Ltd*** (in liquidation) ***1998 (1) SA 811 (SCA)*** the ***Swadif (Pty) Ltd***-judgment was quoted with approval and the following was said at 834 A:

"… a judgment does not in a real sense novate the debt".

[36] In his enthusiastic address on behalf of the Respondent, Mr Stevens advanced the opposite argument:

(i) He argued that the arbitration constituted a factor or event independent from, and unconnected with and extraneous to the contractual arrangement. He submitted that the arbitration was something in the nature of a *novus actus interveniens*, which could not in fact or in law affect the turn of events which happened before the arbitration was agreed to and at a stage when both the Appellant and the Respondent had closed the book on the 2001 year of assessment.

In support of this argument, I was referred to ***Tuck v CIR*** ***1988 (3) SA 819(A)*** and ***CIR v Shell Southern Africa Pension Fund*** ***1984(1) SA 672 (A)***. No specific passages from these judgments were referred to. I, with respect, when looking at these judgments, could not find direct support for the argument advanced by Mr Stevens in this regard;

(ii) It was further submitted that when the Appellant and A officially agreed to resign their differences to a process of arbitration, they naturally brought their previous agreement to an end.

This submission appears to fly in the face of the conclusions arrived at in ***Swadif (Pty) Ltd*** , supra and in ***Trust Bank of Africa Ltd v Dhooma***, supra..

Mr Stevens referred me to the well known authors, ***A J Kerr: The Principles of the Law of Contract 6th Ed, pp 541 et seq***; and ***L R Caney: A Treatise on the Law relating to Novation, 2nd Ed, pp 3 – 4, 67, 69***.

In my debate with him, Mr Stevens, if I understood him correctly, indicated that these Learned Authors did not differ from the principles laid down in ***Swadif (Pty) Ltd*** and ***Trust Bank of Africa Ltd v Dhooma***.

(iii) It was further argued that the relevant assessment was issued when the **"previous"** agreement between the parties was still valid and according to certified and approved financial statements of the Appellant at the time. This assessment, so it was argued, would normally have become prescribed in terms of the provisions of Sections 81(2), read with 81(5), of the Act, within a period of 30 days after the date of the assessment.

It was argued that under these circumstances the action by the Appellant to request (and be granted) condonation for the late filing of a Notice of Objection to the assessment are irrelevant as far as the adjudication of this appeal is concerned;

(iv) It was argued that each year of assessment has to be considered on its own. The amounts in dispute were correctly included by the Appellant for purposes of the 2001 year of assessment. At that time the relevant debts were due to the Appellant, i.e. they **"belonged to"** or were **"owing"** to the Appellant. The debt became bad during the 2004 year of assessment when the Arbitrator made his determination.

(v) Against this background, so the argument went, the Appellant should have requested the Commissioner for the allowance of the amounts as a bad debt in terms of the provisions of Section 11 (i) of the Act.

This section reads as follows:

> **"For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived –**
>
> **(i) the amount of any debts due to the taxpayer which have during the year of assessment become bad, provided such amount is included in the current year of assessment or was included in previous years of assessment in the taxpayer's income".**

(vi) It is for this reason that Mr Stevens argued that the Appellant should have followed the Section 11(i) route during the year of assessment ended 31 December 2004, which is the year when the Arbitrator made his determination.

[37] I cannot accept these submissions by Mr Stevens. In my opinion, the debts were never **"due"** as intended by the provisions of Section 11(i). This much was held by the Arbitrator. Moreover, the **"debts"** also could not have **"become bad**" in view of the finding by the Arbitrator. The latter expressly found that the debts never existed so that there is nothing to become **"bad"**. In my view, the alternative Section 11 (i) route suggested cannot be applied.

[38] I find myself in respectful agreement with the dicta in ***Trust Bank and Swadif***; the very essence of the arbitration was an analysis of the contract and the pronouncement of the rights and obligations flowing therefrom. Certain disputes arose between the Appellant and A with regard to certain aspects of

the contract. Those defined disputes were referred to arbitration. The rights and obligations of the contracting parties relevant to those disputes were pronounced upon. In the process, the rights of the parties were confirmed and reinforced. Those rights and obligations existed all along. A novation did not result from this process.

Could the Appellant rely on its own omission as a basis for objecting to an assessment?

[39] It appears from the Agreed Statement of Facts prepared by both parties and forming part of the record before us during the hearing that:

(i) In the 2001 year of assessment the Appellant returned as income, and was assessed on, the amount of some R30m (round figures) comprising the LRM Claim and the GIF Claim;

(ii) The assessment was initially accepted by the Appellant. The assessment took place in June and July 2002. The relevant tax was paid by the Appellant;

(iii) On the 9th of May 2005 the Appellant approached SARS with a request to condone the late filing of its Notice of Objection to the assessment issued in respect of the 2001 year of assessment;

(iv) SARS complied with this request on 18 May 2005.

[40] On the 23rd of May 2005 the Appellant lodged a Section 81 objection to the assessment relating to the 2001 year of assessment. This objection, of course, was made possible by the condonation aforementioned. Part of the Notice of Objection reads as follows:

> "**In terms of the provisions of Section 81 of the Income Tax Act No 58 of 1962 ("the Act"), read with the rules promulgated in terms of Section 107A of the Act, we hereby lodge objection against your refusal to reduce the company's 2001 income tax assessment by excluding the amounts of R19 019 443, 00 and R11 876 650, 00, as requested in Werksmans' letter dated 5 April 2005, read with their letter dated 11 November 2004."**

[41] It is obvious that when the Appellant included the R30m (in round figures) as income in respect of the 2001 year of assessment, it still had confidence in the validity of the two claims invoiced for the account for A.

[42] As pointed out, supra, the independent auditors also certified the relevant claim details as correct.

[43] Three years later, in 2004, the Arbitrator dismissed the claims and even ordered a refund of the second claim which had already been paid.

[44] I have already found that this determination by the Arbitrator served to confirm and reinforce the rights and obligations flowing from the contract between the Appellant and A, which rights and obligations had existed all along. This was also the position during the 2001 year of assessment.

[45] The determination of the Arbitrator is acknowledged by both parties to be correct. It follows that the Appellant erred when declaring the R30m (round figures) as income.

[46] Accordingly, there was no accrual as intended by the definition of **"gross income"** in Section 1 of the Act. The legal position has been analyzed on the authority of ***CIR v Peoples' Store***, supra, and ***Cactus Investments (Pty) Ltd v CIR***, supra.

[47] The mistaken impression under which the Appellant had labored became apparent through the 2004 determination of the Arbitrator. As a direct result of the mistake, the income declared for the 2001 year of assessment was over inflated, and the assessment which was paid was excessive.

[48] It follows that the Appellant paid more tax than was due to the *fiscus*.

[49] In income Tax Case No 1785 (Natal Tax Court) held in November 2004, the Taxpayer's taxable income had also been determined on an erroneous basis. The error resulted from foreign exchange fluctuations.

[50] The question then arose whether the Taxpayer, having itself to blame for the omission or mistake, could object to the assessment as **"an aggrieved Taxpayer"** within the meaning of Section 81 (1) of the Act.

[51] The case was reported as Income Tax Case number 1785 in ***South African Tax Cases Volume 67, 2005 page 98***. In dealing with the question set out above, the Learned Judge said the following at 102 G to 103 C:

> **"Can the appellants be heard to complain that any right of theirs has been infringed by the circumstance that their assessments do not take account of certain losses, qualifying for deduction from their taxable incomes, in the years between 1992 and 1996? It seems to me that, while they could probably not invoke the provisions of s 102 at this stage in order to seek 'a refund of tax overpaid', they can be said to be entitled to contend that the foreign exchange losses apparently sustained in each of those years should properly have been set off against the amounts which have become payable in respect of the revised assessments.**
>
> **As Mr *Wallis*, for the appellants, stressed, the fundamental object of tax legislation is to exact from each citizen his due. What is 'due' is, in each case (questions of penalty aside), strictly prescribed by statute and the amount of the taxpayer's taxable income must, in the process of assessment, be accurately determined preparatory to the calculation of the amount which he (or she) is required to hand over to the *fiscus*.**
>
> **In that light, it is clear that a taxpayer whose taxable income has been determined on an erroneous basis is always 'aggrieved' even if the source of error is entirely attributable to him. Of course, where the error results in an over-assessment of taxable income, the taxpayer would ordinarily avail himself of the statutory *condictio indebiti* provided by s 102 (available to him at any time within three years of the date of assessment) rather than lodging**

> **an objection in terms of s 81 (which would have to be done within 30 days or within an extended period allowed by the Commissioner at his discretion). Accordingly it is perhaps not surprising that there is a dearth of authority as to whether a taxpayer can rely on his own mistake as a basis for an objection in terms of s 81. In my view he can do so".**

[52] I find myself in respectful agreement with this reasoning. I fail to see how this Court can approve an overpayment of tax on a presumed income of R30m which was, in fact, never earned, and will never be received.

[53] The Section 81 objection was lodged within the extended period allowed by the Respondent. In my view, the relief sought ought to be granted.

[54] Inasmuch as it can be stated that the Appellant had an onus to prove its case within the ambit of Section 82 of the Act, I hold that such onus was properly discharged.

[55] Inasmuch as significance may be attached to the Arbitrator's finding that some services were rendered with regard to the LRM Claim, but that he was unable to determine the amount involved, I hold that the Respondent failed to discharge its onus flowing from this state of affairs as described earlier in this judgment.

[56] As to costs, both Counsel, correctly in my view, adopted the attitude that the Respondent's opposition to the appeal was not unreasonable. Consequently, I am not inclined to make a costs order against either of the parties.

[57] To the extent that this appeal involves a matter of law only (which appears, substantially, to be the case) this judgment and the order made is my own.

To the extent that issues of fact had to be considered and decided in this Appeal, the Learned Members of the Court, whose signatures are appended for that limited purpose, endorse the unanimous finding of the Court.

[58] In the result, I make the following order:

(i) The appeal against the income tax assessment for the 2001 year of assessment is upheld;

(ii) It is directed that the two relevant amounts of R19 019 422, 22 and R11 876 660, 40 be excluded from the assessment.

_____

W R C PRINSLOO
PRESIDENT

This judgment should be reported:	**YES / NO**

I Agree:

_____

R PARBHOO
Accountant Member

I Agree:

_____

N A MATLALA
Commercial Member

Mr P J J Marais (SC), instructed by Werkmans Attorneys, Sandton, appeared on behalf of the Appellant.

Mr G Stevens represented the Commissioner for the South African Revenue Service.