REPUBLIC OF SOUTH AFRICA

IN THE TAX COURT OF SOUTH AFRICA
(HELD AT MEGAWATT PARK, JOHANNESBURG)

Case No.: **IT 45979**

(1)	REPORTABLE: YES / NO
(2)	OF INTEREST TO OTHER JUDGES: YES / NO
(3)	REVISED.
20 March 2024	.....
DATE	SIGNATURE

In the matter between:

TAXPAYER BOERDERY **Appellant**

and

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

J U D G M E N T

Delivered: This judgement was prepared and authored by the Judge whose name is reflected and is handed down electronically by circulation to the Parties/their legal representatives by email and by uploading it to the electronic file of this matter on CaseLines. The date for hand-down is deemed to be 20 March 2024.

WINDELL J

Introduction

[1] This is a statutory appeal by the taxpayer, Taxpayer Boerdery (Taxpayer) in terms of section 107 of the Tax Administration Act 28 of 2011 (the TAA), read with Rule 10 of the Tax Court Rules. Taxpayer, which at all relevant times conducted the trade of farming from which it derived income from the sale of fruit and vegetables, appeals against the additional assessments raised by the respondent, The Commissioner for the South African Revenue Service (SARS) in respect of the 2018 and 2019 years of assessment.[1]

[2] The dispute between the parties has its origin in two agreements concluded between Taxpayer, and an insurance company, Company XYZ Insurance Company Limited (Company XYZ) in 2018 and 2019 respectively. The "Multi-Peril Contingency Policy Contract" stipulated that annual premiums were required to obtain coverage for uncertain future events set out in the table of "Specifications". The premiums were allocated to a "Special Experience Account" (**"the experience account"**) and the bulk of the premiums were repaid to Taxpayer in the absence of any claims during the 12-month term. It is common cause that Taxpayer submitted no claims during the relevant periods.

[3] According to Taxpayer, the premiums paid constituted insurance expenses and were therefore deductible under section 11(*a*) of the Income Tax Act 58 of 1962 (Income Tax Act). This section permits deductions from income for expenses and losses that were "actually incurred in the production of the income", as long as they did not pertain to capital expenditures and losses.

[4] The annual premium in respect of the 2018 Policy was R35 000 037 (VAT inclusive) and the total annual aggregate limit of indemnity was recorded as R41.5 million. The annual premium in respect of the 2019 Policy was R35 391 732 (VAT inclusive), and the total annual aggregate limit of indemnity was R49.5 million. The appellant, however, only paid R1 987 943 as the balance comprised of a "roll-over premium".

[5] SARS disallowed the deduction of the premium for the 2018 year of assessment in the amount of R30 434 815. The only deduction that was allowed was for a fee that was charged by Company XYZ which it retained as payment which was not included in the experience account in the amount of R243 739. In the 2019 year of assessment Taxpayer claimed an amount of R2 332 976 in respect of premiums paid, but SARS disallowed the deduction of the premium in the amount of R1 987 943. The balance of the premium was allowed as a deduction from income derived by the appellant. SARS's main reason for disallowing the

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[1] The appellant submitted its income tax returns for the 2018 and 2019 years of assessment on 15 February 2019 and 26 November 2019.

premiums was that the annual premium that was paid was not expenditure but was simply another form of asset in the hands of Taxpayer.

[6] In addition, SARS imposed an understatement penalty (USP) of 10% on the disallowance of the insurance expense claimed in the 2018 year of assessment in terms of sections 222 and 223 of the TAA in the amount of R2 211 119.10. Interest was also levied in terms of section 89*quat* (2) of the Income Tax Act for the underpayment of provisional tax due to "the excessive deductions claimed" in the amount of R1 950 355.74.

[7] In terms of Rule 34 of the Tax Court Rules, the issues in dispute in a tax appeal are those contained in the statement of grounds of assessment (Rule 31 statement) read with the statement of grounds of appeal (Rule 32 statement) and the replying statement (Rule 33 statement). SARS did not file a Rule 33 statement. Following the pre-trial conference held between the parties, the issues in dispute have been refined. Although there is no consensus between the parties, I am satisfied that, except for the USPs and interest issues, the sole issue for determination in this appeal is whether the Company XYZ deposits in respect of premiums paid to it are deductible in terms of section 11(*a*) of the Income Tax Act.

[8] Determining this matter requires, in the first place, an interpretation of the contracts entered into by Taxpayer and Company XYZ (referred to as the Company XYZ contracts), and, in consideration of that analysis, a determination of whether the Company XYZ premiums qualify as deductible expenses under section 11(*a*) of the Income Tax Act.

Interpretation of the COMPANY XYZ contracts

[9] In the context of contract interpretation, it is imperative that any inquiry adhere to the currently established method of interpretation. This position was succinctly articulated by the Constitutional Court in *University of Johannesburg v Auckland Park Theological Seminary and Another*[2] as follows:

> "This approach to interpretation requires that 'from the outset one considers the context and the language together, with neither predominating over the other'. In Chisuse, although speaking in the context of statutory interpretation, this Court held that this 'now settled' approach to interpretation, is a 'unitary' exercise. This means that interpretation is to be approached holistically: simultaneously considering the text, context and purpose."
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> "The approach in Endumeni 'updated' the previous position, which was that context could be resorted to if there was ambiguity or lack of clarity in the text. The Supreme Court of Appeal has explicitly pointed out incases subsequent to Endumeni that context and purpose must be taken into account as a matter of course, whether or not the words used in the contract are

[2] *University of Johannesburg v Auckland Park Theological Seminary and Another* [2021] ZACC 13; 2021 (8) BCLR 807 (CC); 2021 (6) SA 1 (CC).

ambiguous. A court interpreting a contract has to, from the onset, consider the contract's factual matrix, its purpose, the circumstances leading up to its conclusion, and the knowledge at the time of those who negotiated and produced the contract." [3]

[10] Both Company XYZ contracts were for the calendar years 2018 and 2019, with respective durations of one year. The contractual provisions of the 2019 contract are identical to those of the 2018 contract, with only minor modifications. In its terms, the Company XYZ contracts identify and refer to itself as a "policy". It also refers to Company XYZ as "the Company" and to Taxpayer as the "Insured". The operative clause provides:

"OPERATIVE CLAUSE

… in consideration of, and conditional upon, the prior payment of the premium by or on behalf of the Insured and receipt thereof by or on behalf of the Company, the Company agrees to indemnify or compensate the Insured by payment or, at the option of the Company, by replacement, reinstatement or repair in respect of the defined events occurring during the Period of Insurance and as otherwise provided under the within Policy Sections, up to the sums insured, limits of indemnity, compensation and other amounts specified."

[11] Under "premium" the Company XYZ contracts provide that: "The Insured shall pay to the Company the premium indicated in the General Schedule payable at inception and/or renewal of the policy or as otherwise agreed." The table of "Specifications" reflect the "Total Annual Aggregate of Annual Limit of Indemnity" to be R41 500 000, comprised of the following: (a) Crop insurance R13 500 000 (b) Crop revenue shortfall R20 000 000 (c) Difference in Limits / Conditions – R3 000 000; and (d) Directors GPA cover R5 000 000. The "Total Annual Aggregate of Annual Limit of Indemnity" for 2019 was R49 500 000, with the additional R8 000 000 relating to "motor own damage", "business all risk" and "machinery breakdown".

[12] Of the several clauses in the Company XYZ contracts that lie at the heart of the appeal is Clause 6, entitled "SPECIAL EXPERIENCE ACCOUNT", which provides, in the relevant parts that –

"6. SPECIAL EXPERIENCE ACCOUNT

The Company shall maintain an experience account for the purpose of recording the results under this policy. The balance from time to time shall constitute the Special Experience Account. This Special Experience Account shall be operated as follows:

6.1. There shall be credited to the Special Experience Account:

6.1.1. the amount of premium actually received by the Company in respect of this policy from time to time, less Insurer's margin taken as per

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[3] Id at para 65-66.

Special Condition 2 and any other charges agreed with the Insured, attributable thereto;

6.1.2 all amounts received by the Company in respect of reinsurance, and attributable to this policy (including, but not limited to, reinsurance recoveries and reinsurance commission), from time to time;

6.1.3. notional interest on the funds invested calculated daily, compounded monthly in arrears at the average ABSA money market rate less 65 basis points.

6.2. There shall be debited to the Special Experience Account:

6.2.1. reinsurance premiums paid or due and owing by the Company from time to time in respect of this policy;

6.2.2. claims paid under this policy from time to time."

[13] Clause 6.1.1 above states that an Insurer's margin as per Special Condition 2 would be deducted from the amount of premium. Clause 2 describes the "Insurer's margin" as follows:

"INSURER'S MARGIN

The Insured agrees to the following debits against the Experience Account:

In respect of the Company (Insurer):

Insurer's margin: 2,25% of the premium received by the Company paid by, or on behalf of, the insured.

Investment Management Fee: 65 basis points of the funds invested in terms of Special Condition 6.1.3."

[14] Clause 7 is also of importance. It deals with "PREMIUM REFUND AND/OR PERFORMANCE BONUS CLAUSE" and provides as follows:

"Within 30 (thirty) days after termination/cancellation of this policy or on its renewal date (annual policies) or its review date (policies issued for periods other than 12 (twelve) months), the Company will declare and pay a Premium Refund and/or a Performance Bonus to the Insured if earned in terms hereof. The Refund will be calculated by taking any positive balance reflected in the Special Experience Account as the termination/cancellation or renewal or review date as the case may be. Any residual amounts at remaining after the finalisation and settlement of all outstanding claims will be refunded within 30 (thirty) days of such finalisation."

(Emphasis added)

[15] It is necessary to interpret the Company XYZ contracts in their entirety, taking into consideration all of their terms and the interrelation among their provisions. In essence the Company XYZ contracts state that Taxpayer will pay to Company XYZ an amount of

R35 million. Company XYZ will credit this amount to the experience account, which earns a return. Company XYZ will debit the experience account with a charge that is labelled the "insurer's margin" of 2,25%. Company XYZ will compensate Taxpayer on the occurrence of the defined events during the contract period. Any amount that Company XYZ pays to Taxpayer as a claim payment will be debited to the experience account. On expiry of the contract period, Company XYZ will refund Taxpayer the balance of the experience account. The balance of the experience account is also repayable to Taxpayer if it cancels the Company XYZ contracts, which it can do by giving 30 days' notice. In this way the balance of the experience account is always available to Taxpayer on notice.

[16] As a result, Taxpayer is able to invest pre-tax Rands and generate a return while simultaneously deducting the payment as an expense and benefiting from the tax advantages of the deduction. Moreover, it can retain access to its funds with mere notice.

The evidence

[17] Taxpayer called two witnesses: Mr One, a chartered accountant and Insurance Executive employed at Company XYZ and Mr Tone Taxpayer's auditor and director of Eastern Cape Accounting & Tax (ECAT). Several facts became evident throughout their testimony.

[18] Firstly, Mr One testified that Company XYZ intended to sell short-term insurance to Taxpayer and not investment policies. He suggested that the "investment management fee" was charged to Taxpayer as a fee for managing Company XYZ's investments. That can obviously not be the reason. In terms of the Company XYZ contracts, it is clear that Taxpayer is charged a fee for the management of its investment. Why would Taxpayer consent to pay a fee to Company XYZ to manage Company XYZ's investments? That would not be commercially sensible.

[19] It is furthermore unclear from Mr One's evidence what it was that Company XYZ was doing or providing in exchange for its 2.25%. During cross-examination it was put to Mr One that the 2.25% was in fact and in substance the premium that Company XYZ charged for the cover that was provided which is the difference between the limit of indemnity and the premium. It was in this context that Mr One was asked about premium rates being calculated as a percentage of the available cover. He was asked to agree that a premium rate of 85% was very high. Instead of conceding the obvious, Mr One was evasive and instead quibbled about the meaning of "very".

[20] Secondly, linked to Mr One's attempt at explaining why an investment management fee was charged is his artificial explanation of the phrase "notional interest" in clause 6.1.3. In accordance with the Company XYZ contracts "notional interest" shall be credited to the experience account on the funds invested "calculated daily, compounded monthly in arrears

at the average ABSA money market rate less 65 basis points". According to Mr One's testimony, it had been designated "notional interest" and not "interest" in the normal sense of the word, because Company XYZ had been advised that it could not pay "interest" because it does not have a banking license. It is not clear from his evidence why if the label is changed from "interest" to "notional interest" the substance changed. I agree with counsel for SARS, Mr White, that it only must be stated to be rejected. The "return" that was earned by Taxpayer on the balance of the experience account is expressed with reference to the average money market rate applicable to an ABSA money market account. This account accrues interest in the form of a percentage-based rate. What Company XYZ had agreed to do is pay Taxpayer a specified and determinable percentage return based on the balance of the experience account. Nothing, not even relabelling, can alter that.

[21] Thirdly, it is clear from the terms of the Company XYZ contracts that Taxpayer had the ability to terminate the Company XYZ contracts at any time with proper notice and demand repayment of the balance of the experience account. Although this may seem self-evident, Mr One suggested that this was in some way qualified, or contingent. But this is not what Clause 7 provides for. It clearly is not contingent and sets out Company XYZ's obligation to repay the balance of the experience account in the event of cancellation.

[22] Mr One then implied that Taxpayer, in exchange for repayment, had to agree not to claim against the policy. Nevertheless, this does not alter the fact that Taxpayer had the right to recoup the remaining balance on the experience account. The Company XYZ contracts are claims made contracts. That means that a claim is only payable when a claim is made. Had a claim been paid and the balance of the experience account reduced, Taxpayer would have been entitled to that payment. This does not mean that the experience account balance is not required to be calculated when Taxpayer cancels and requests repayment. The balance of the experience account can only be reduced by the management fee, the investment fee or claims. Company XYZ is therefore aware that in the event that Taxpayer cancels the contract without having filed a claim prior to that time, no claim will be paid thereafter. Given this, Mr One's assertion of claims and Taxpayer's waiver to refrain from making any claims are completely fictitious, as it would have been apparent to all whether or not a claim existed.

[23] Mr One contended that Taxpayer could not access the balance of the experience account and that claims would not be paid from the balance of the experience account by relying on the fact there is no separate bank account into which the balance of the experience account is placed. He emphasized that the experience account was not an account but a record of transactions. That point is an entirely artificial one. The issue is not one of a separate bank account but one of separate identification within Company XYZ's records and systems. The experience account was separately identifiable and Company XYZ was obliged to repay that balance to Taxpayer on cancellation.

[24] In any event, the conduct of the parties reveal that the balance of the experience account was repaid with interest at the end of the contract period: A "premium refund" of R30 million on 1 January 2019 on the expiry of the 2018 contract. And a "premium refund" of R32 million on 1 January 2020 on the expiry of the 2019 contract.

[25] Fourthly, Mr Tone prepared and submitted Taxpayer's return in which expenses of R30 million and R2 million paid to Company XYZ, were claimed as deductible expenditure. He testified that he did not actually consider the Company XYZ contracts, nor did he advise Taxpayer to claim the premium as a deduction. When asked if he knew who had advised Taxpayer to claim the deduction he referred to a "roadshow" that had been held by Company XYZ to sell its product to farmers. Mr Tone also referred to unspecified and untimed discussions he had with Company XYZ. In the absence of any evidence from the director of Taxpayer, it remains unclear who advised Taxpayer.

[26] Mr Tone agreed that if the experience account was to be recognised as an asset in Taxpayer's account then Taxpayer could not at the same time recognise the premium payment as an expense. He also explained why the accounting treatment of the premium in 2018 and 2019 was inconsistent. In 2018 Mr Tone recognised the repayment of the experience account from the previous Santam policy as taxable revenue, albeit that it was erroneously reported as an insurance claim payment and claimed a deduction for the premium paid to Company XYZ. But in 2019, and notwithstanding that Taxpayer had received repayment of the balance of the experience account and had then paid a further premium of R35 million to Company XYZ, Mr Tone did not recognise the repayment of the experience account as taxable income and did not raise an expense of R35 million for the premium that had been paid. He suggested he did this because of "netting off".

[27] However, his actions consisted of deferring tax on the 2019 repayment of the experience account, continuing to benefit from the tax deduction claimed on the R30 million paid in 2018, and concealing the interest earned by Taxpayer on the experience account. It is not suggested that Mr Tone did this intentionally, he had simply not considered the issues when he reviewed the financial statements.

[28] Mr Tone was asked whether he would have raised an asset if he had known what he knows now. In an effort to dispel the inference that an asset should have been acknowledged, he explained that the refund clause of the Company XYZ contracts utilized the word "if". When he was taken to the contracts the second paragraph of the refund clause was pointed out and Mr Tone then suggested that the balance of the experience account was not certain and there was some contingency to it. He attempted to argue that because the balance of experience account was only an indicative amount it was not an asset but a contingent asset. He, however, later conceded that given the realisation of the experience account balance in

January 2019 it could not be said to be merely indicative – therefore the asset could not be said to be contingent. Mr Tone agreed that if the experience account was to be recognised as an asset in Taxpayer's account then Taxpayer could not at the same time recognise the premium payment as an expense.

[29] Company XYZ provided Taxpayer with monthly statements which provided the fixed and determined balance of the experience account at the end of each month. This confirms that the balance in this account was certain.

[30] Fifthly, the 2018 policy was signed on 27 June 2018, but its effective date was 1 January 2018. Mr One said this difference in dates was because often terms still had to be agreed after there was agreement on the main terms. That explanation makes no sense – there is either an agreement or not. Why would an insured, as it were, waste 6 months of insurance by making the effective date six months earlier. Mr One's answer was that sometimes continuous insurance cover is required. But there is no evidence of that being required by Taxpayer. Continuous coverage is usually necessary for liability insurance (not asset insurance), which covers acts that result in claims made against an insured party. The insurance must be in effect at the time the act giving rise to the claim occurs, even if the claim is not made for some time or even years later when a different policy is in effect. This is referred to as the retroactive date which in the Company XYZ contracts is said to not be applicable.

[31] A "purchasing" of six months of insurance coverage in this instance would be a complete waste, given the absence of any reported claims. Taxpayer would have squandered R15 million of the R30 million premium in 2018. However, an alternative perspective arises if the R30 million is not, in fact, a premium, but rather funds transferred to Company XYZ for which it is obligated to reimburse Taxpayer upon request. When analysed from this perspective, Taxpayer would not squander a cent purchasing insurance for a six-month period in which it is certain there have been no claims. This fact gives rise to an "insensible or unbusinesslike result" or one that undermines the apparent purpose of the Company XYZ contracts.

[32] Finally, it is unclear why an insurer would refund the complete premium at the conclusion of the insurance period. That is completely uncommercial. If that were to be so an insurer would have assumed a risk for an entire year and would then simply return the whole premium because there was no claim. But, if the "premium" is in fact not a premium, but is money that Taxpayer has paid to Company XYZ, and on which it will earn a yield (interest), and which Company XYZ recognises it must repay to Taxpayer, then there is nothing uncommercial in the repayment of the whole "premium". Company XYZ would simply be repaying the money that was "deposited" with it.

Deductibility under section 11(*a*)

[33] As stated above, the main issue for determination on the merits is whether the Company XYZ deposits, referred to as the "annual premium" in the Company XYZ contracts, are deductible in terms of section 11(*a*) of the Income Tax Act. In terms of section 102(1) of the TAA, the onus of proving that the Company XYZ deposits are deductible in terms of section 11(*a*) is upon the taxpayer.

[34] Section 11(*a*) provides that:

> "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—
>
> (*a*) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature."

[35] In *Armgold/Harmony Freegold Joint Venture v Commissioner for the South African Revenue Services*,[4] the Supreme Court of Appeal (SCA)described the test for deductibility under section 11(*a*) as "the general deduction formula" which allows the deduction of expenditure and losses actually occurred in the production of income "provided such expenditure and losses are not of a capital nature".

[36] Accordingly, for any amount to qualify for deduction under section 11(*a*) it must satisfy the following requirements: (a) Expenditure; (b) Actually incurred; (c) In the production of income; (d) For purposes of trade; and (e) Not of a capital nature.

Expenditure

[37] The Income Tax Act does not define the term "expenditure". In *C: SARS v Labat Africa Ltd*,[5] the SCA grappled with the meaning of the term expenditure. It held:

> "[6] The question the court should have posed was whether the issuing of shares by a company amounts to 'expenditure', and not whether the undertaking to issue shares amounts to an obligation, which it obviously does. The terms 'obligation' or 'liability' and 'expenditure' are not synonyms. This is apparent from what was said by Botha JA in *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* 1975 (1) SA 665 (A) at 674D — E, namely that the expression 'any expenditure actually incurred' means 'all expenditure for which a liability has been incurred during the year, whether the liability has been discharged during that year or not'. […] In other words, the liability or obligation must be discharged by means of expenditure – timing is not the question.

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4 [2013] 1 All SA 253 (SCA).
5 (2011) 74 SATC 1 (SCA).

> [12] The term 'expenditure' is not defined in the Act and since it is an ordinary English word and, unless the context indicates otherwise, this meaning must be attributed to it. Its ordinary meaning refers to the action of spending funds; disbursement or consumption; and hence the amount of money spent. The Afrikaans text, in using the term 'onkoste', endorses this reading. In the context of the Act it would also include the disbursement of other assets with a monetary value. Expenditure, accordingly, requires a diminution (even if only temporary) or at the very least movement of assets of the person who expends. This does not mean that the taxpayer will, at the end of the day, be poorer because the value of the counter-performance may be the same or even more than the value expended. (Emphasis added.)
>
> …
>
> [14] Labat-Anderson assigned the trademark as consideration for the shares and the taxpayer did not 'expend' any money or assets in acquiring the trademark. As Goldblatt J said in ITC 1783 66 SATC 373, an allotment or issuing of shares does not in any way reduce the assets of the company although it may reduce the value of the shares held by its shareholders, and that it can therefore not qualify as an expenditure."

[38] In other words, expenditure means the action of expenditure, disbursement or consumption – hence money spent. Therefore, to constitute expenditure, money must have been permanently outlaid in exchange for something else other than money – purchase of goods or services; or an asset must have been permanently outlaid in exchange for a different type of an asset or service – in a barter transaction.

[39] Taxpayer expended the "annual premium" to acquire the rights in terms of the Company XYZ contracts. These rights included the rights that Taxpayer acquired in respect of the experience account and the refund of the amount recorded in this account, as specified in clauses 6 and 7. Save for the "insurer's margin' component, Taxpayer was not poorer by the "annual premium" it incurred. Since there was a movement in Taxpayer's assets (cash being exchanged for the rights in terms of the Company XYZ policy), it incurred expenditure equal to the "annual premium" despite there being no diminution in its overall assets.

Of a capital nature

[40] Section 11(*a*) prohibits deduction of expenditure that is "of a capital nature". The phrase "not of a capital nature" in respect of expenditure is likewise not defined in the Income Tax Act.

[41] "Revenue nature" is the antonym of "capital nature". A convenient summary of the test for determining whether expenditure is of a capital nature or revenue nature is to be found in the SCA judgment, of *BP Southern Africa (Pty) Ltd v C: SARS*,[6] where it was stated:

> "[7] As has occurred many times in the past, this court is required yet again to determine whether expenditure incurred by a taxpayer is either capital or revenue expenditure. By now the distinction is hopefully clear enough conceptually (see *Rand Mines (Mining & Services) Ltd v Commissioner for Inland Revenue* [1997] 1 All SA 279 (A) at 285 and the cases there cited). The purpose of expenditure is important and often decisive in assessing whether it is of a capital or revenue nature. Expenditure incurred for purposes of acquiring a capital asset of the business is capital expenditure whereas expenditure which is part of the cost incidental to the performance of the income-producing operations as distinct from the equipment of the income-producing machinery is revenue in nature (N*ew State Areas Ltd v Commissioner for Inland Revenue* 1946 AD 610 at 627). A distinction is thus drawn between expenditure made to acquire an income-producing concern (in respect of which the outlay is usually non-recurrent) and money spent. '… in working the concern for the present production of profit' (*Commissioner for Inland Revenue v George Forest Timber Co Ltd* 1924 AD 516 at 526-527)."

[42] Accordingly, the purpose for which the amount was paid is important and often decisive. A distinction must therefore be drawn between "income-producing concern' and "income-producing operation'.

[43] An income-generating concern is an asset or infrastructure used to generate income such as machinery used to manufacture trading stock, premises for hire, service contracts, contracts granting rights of use such as leases and loans. Accordingly, amounts paid to acquire or expand income-generating concerns are of a capital. An income-generating operation is an activity performed to produce income or incidental to the production of income such operating machinery to manufacture trading stock, repairs and maintenance of premises for hire, provision of services under a service contract.

[44] In *CIR v African Oxygen Ltd,*[7] the Appellate Court remarked that:

> "Generally speaking, money spent in creating or acquiring an income-producing concern, a source of profit or a capital asset, is capital expenditure, while the cost incidental to the performance of the income-producing operations is revenue expenditure. There are numerous examples of cases in which the expenditure was allocated to the one or the other of these categories and they are often of assistance, <u>but essentially the inquiry must be into the real nature of the particular transaction,</u> with due regard to this general distinction and such factors

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6 (2007) 69 SATC 79 (SCA).
7 1963 (1) SA 681 (A), 25 SATC 67.

> as have come to be accepted or have persuasive cogency as indications the one way or the other."

(Emphasis added)

[45] In exchange for payment of the "annual premium", Taxpayer obtained the right to a credit of the same amount which stood for its benefit in the experience account. The balance of the experience account was refundable at the end of the contract period and generated income in the form of interest. Irrespective of what the yield was called (notional or actual) Taxpayer's right to the experience account was an income-producing concern and therefore a capital asset. Because the "annual premium" was paid to acquire a capital asset, it is payment of a capital nature. For this reason, the "annual premium" does not qualify for deduction under section 11(*a*).

[46] Taxpayer bore the onus to prove that the payments made to Company XYZ were not of a capital nature. Taxpayer failed to demonstrate a sufficient link between its rights to the experience account and the performance of its income-earning operations. The appeal against the additional assessments raised by SARS in respect of the 2018 and 2019 years of assessment must therefore fail.

Penalties

[47] SARS imposed USPs at the rate of 10% on the additional tax liability arising from the disputed assessment.

[48] Section 222 of the TAA which imposes liability for USP provides as follows:

> "(1) In the event of an 'understatement' by a taxpayer, the taxpayer must pay, in addition to the 'tax' payable for the relevant tax period, the understatement penalty determined under subsection (2) unless the 'understatement' results from a bona fide inadvertent error."

[49] Section 102(2) of the TAA provides that the onus of proving the facts upon which SARS based the imposition of USP is borne by SARS.

[50] The facts upon which SARS based the imposition of USP is that the claiming of a non-deductible amount as a deduction resulted in substantial understatement by Taxpayer.

[51] The rate of 10% applies to standard case of substantial understatement in terms of section 223(1) of the TAA. This court has no reason to interfere in the imposition of the USP. Taxpayer thus remains liable for USPs of 10%.

Interest

[52] In terms of section 89*quat*(3), interest is payable on any underpayment of provisional tax unless SARS or this Court is satisfied that the underpayment was due to circumstances beyond the control of the taxpayer.

[53] The underpayment was not the result of any circumstances beyond Taxpayer's control; rather, it was the result of the company's aggressive tax position, which involved deducting non-deductible amounts.

[54] On this basis, Taxpayer remains liable for interest levied in terms of section 89*quat* (2) of the Income Tax Act.

Conclusion

[55] In the result the following order is made:

1. The appeal is dismissed.
2. The 2018 and 2019 additional assessments are confirmed.
3. The appellant to pay the costs of the appeal, including the costs of two counsel.

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L. WINDELL
JUDGE OF THE HIGH COURT
GAUTENG LOCAL DIVISION, JOHANNESBURG

I agree

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PROF. P. VAN DER ZWAN

I agree

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ADV. A.K. SITHOLE