

# TAX & EXCHANGE CONTROL ALERT

10 NOVEMBER 2022



CLIFFE DEKKER HOFMEYR

INCORPORATING  
KIETI LAW LLP, KENYA

## IN THIS ISSUE

### Check your mirrors: Sticking to original grounds of objection in SCA tax appeal proceedings

It's a long road to the Supreme Court of Appeal (SCA) for a taxpayer disputing an assessment – first they must lodge an objection, then an appeal to the tax court, and only then can they appear before the SCA, if leave to appeal is granted by the tax court. If leave to appeal directly to the SCA is not granted, an appeal to the High Court, heard by a full bench, will precede the SCA appeal.



FOR MORE  
INSIGHT INTO  
OUR EXPERTISE  
AND SERVICES

## Check your mirrors: Sticking to original grounds of objection in SCA tax appeal proceedings

It's a long road to the Supreme Court of Appeal (SCA) for a taxpayer disputing an assessment – first they must lodge an objection, then an appeal to the tax court, and only then can they appear before the SCA, if leave to appeal is granted by the tax court. If leave to appeal directly to the SCA is not granted, an appeal to the High Court, heard by a full bench, will precede the SCA appeal.

Although a taxpayer can obtain new insights on the road to the SCA through the benefit of hindsight, a taxpayer must by and large rely on the same grounds for disputing the assessment. The SCA made this clear in its recent decision in *Nesongozwi v Commissioner for SARS* (838/2021) [2022] ZASCA 138, handed down on 24 October 2022.

### FACTS

The taxpayer in *Nesongozwi* was the sole director of Umthombo Resources (Pty) Ltd (Umthombo), a company which held coal prospecting and mining rights. Umthombo had entered into a consultancy agreement with Sumo Coal (Pty) Ltd (Sumo) whereby Umthombo would prospect for coal and enter into a joint venture with Sumo to mine any coal deposits found.

Umthombo's sole shareholder was the Nesongozwi Mining Corporation (Pty) Ltd (NMC), and in turn the taxpayer was the sole shareholder of NMC.

In August 2008, NMC sold 50% of its shares in Umthombo to a third party for a price of R150 million. In October 2009, the taxpayer sold his shares in NMC (which still held a 50% interest in Umthombo) to the Nesongozwi Family Trust (Trust) for R547,275, in terms of a verbal agreement. This price was reasoned on the basis that NMC was a holding entity, its only income being dividends paid by Umthombo, and, to date, Umthombo had not declared any dividends or engaged in any mining operations.

The South African Revenue Service (SARS) disagreed with the value attributed to the NMC shares by the taxpayer and raised an additional assessment wherein it imposed capital gains tax and donations tax on the taxpayer, in the amount of approximately R48 million.



## Check your mirrors: Sticking to original grounds of objection in SCA tax appeal proceedings

CONTINUED

The taxpayer objected against this additional assessment on the basis that SARS had not reduced the value of the NMC shares due to the value of the underlying Umthombo shares being impaired by the potential joint venture between Umthombo and Sumo. When SARS disallowed the objection, the taxpayer appealed to the tax court. The tax court ordered that an altered assessment be issued in terms of section 129(2) of the Tax Administration Act 28 of 2011 (TAA), which still left the taxpayer with a substantial additional tax liability. The taxpayer then appealed the tax court decision to the full bench of the High Court.

However, a day before the appeal was to be heard by the full bench, the taxpayer gave notice of his intention to file an amended notice of appeal to include two further grounds, being (i) that the valuation method applied by SARS when valuing the NMC shares was incorrect and (ii) that

SARS' characterisation of Umthombo's mineral resources was incorrect. The full court disallowed the amendment in respect of the first issue but allowed it in respect of the second issue.

After the full bench dismissed the taxpayer's appeal, the taxpayer appealed to the SCA, and again relied on these two additional grounds of appeal.

The SCA indicated that prior to considering the merits of the appeal, it had to decide whether these additional grounds were properly before the SCA as grounds of appeal. This was because of the SCA's judgment in prior cases, such as *Lion Match Company (Pty) Ltd v Commissioner for the South African Revenue Service* [2018] ZASCA 36 (see our [Tax and Exchange Control Alert](#) of 13 April 2018), where it was held that because the tax court is a creature of statute, its jurisdiction, powers and the scope of any right to appeal its decisions are defined in the TAA.

### THE RELEVANT LEGAL PRINCIPLES

In its judgment, the SCA summarised the provisions of the TAA and the dispute resolution rules promulgated in terms of section 103 of the TAA (Rules), dealing with the process for objection and appeal. The SCA referred to section 129 of the TAA, dealing with the powers of the tax court, including its power to alter an assessment, as the tax court ordered. It also dealt with the provisions of the TAA dealing with appeals against a tax court judgment, namely section 133, which deals with the appeal to the High Court or SCA and section 134, which deals with the process to be followed in pursuing the appeal, including documents that need to be filed.

However, it appears that the main provision on which it relied in deciding the issue of the additional grounds raised in the High Court and SCA appeals, was Rule 10 of the Rules, which deals with the filing of a notice of appeal, including concomitant grounds of appeal, to the tax court.

## Check your mirrors: Sticking to original grounds of objection in SCA tax appeal proceedings

CONTINUED

Rule 10(2) states that:

*"a notice of appeal must:*

- (a) be made in the prescribed form;*
- (b) if a SARS electronic filing service is used, specify an address at which the appellant will accept delivery of documents when the SARS electronic filing service is no longer available for the further progress of the appeal;*
- (c) specify in detail:*
  - i. in respect of which grounds of the [taxpayer's objection] the taxpayer is appealing;*
  - ii. the grounds for disputing the basis of [SARS'] decision to disallow the [taxpayer's objection]; and*
  - iii. any new ground on which the taxpayer is appealing ..."*

Rule 10(3) expressly prohibits a taxpayer from appealing *"on a ground that constitutes a new objection against a part or amount of the disputed assessment not objected to under Rule 7 [in the taxpayer's objection]"*.

The principle in Rule 10(3) is repeated in Rule 32 of the Rules, which states that in its statement of ground of appeal (which would be filed after SARS' Rule 31 statement of grounds of assessment), the taxpayer is prohibited from relying on *"a ground of appeal that constitutes a new ground of objection against a part or amount of the disputed assessment not objected to under Rule 7 [in the taxpayer's objection]"*.

### SCA DECISION

Pursuant to the above, the SCA found that in his initial objection lodged with SARS, the taxpayer objected on the basis that *"SARS used incorrect valuations for its assessments"* as it

had failed to reduce the value of the NMC shares due to the value of the underlying Umthombo shares being impaired by the potential joint venture between Umthombo and Sumo. The taxpayer again relied on this exact ground when lodging his notice of appeal under Rule 10 with the tax court.

When the taxpayer appealed to the full bench of the High Court, the SCA found that he initially appealed on the same ground. In fact, in his notice of appeal, *"the taxpayer made it clear that the valuation of Umthombo's shareholding was not in issue"*. However, once leave to appeal had been granted, the taxpayer sought to change this, at the last-minute challenging both the valuation methodology of the NMC shares and the characterisation of Umthombo's mineral resources. The SCA also made reference to the expert evidence that was led during the tax court hearing, from which it was clear that

## Check your mirrors: Sticking to original grounds of objection in SCA tax appeal proceedings

CONTINUED

the valuation methodology was not in dispute. The SCA also noted the High Court's finding that on the issue of the joint venture impairing the value of the Umthombo shares, the issue was that the joint venture had not yet been formed, at the time that the taxpayer sold the NMC shares. Therefore, it could not be taken into account to determine the value of NMC's Umthombo shares and in turn, the taxpayer's NMC shares at the time they were sold.

In relation to the characterisation of mineral resources issue raised by the taxpayer for the first time in the High Court appeal and again in the SCA appeal, the SCA found that the issue was appealable in terms of the principle in *Matla Coal Ltd v Commissioner for Inland Revenue* [1987] (1) SA 108 (A). In *Matla Coal*, it was held that a court should not be unduly technical or rigid in its approach to a taxpayer's objection and notice of appeal and should focus on the "substance of the objection" within the context of the particular facts of the case.

However, in respect of the additional ground of appeal regarding the valuation method, the SCA held that this could not be raised as:

- it was not an issue before the tax court or the High Court, as it was first raised in the heads of argument filed in the High Court appeal;
- it was common cause that the valuation method used was the correct one; and
- even if the issue was appealable, the taxpayer would have had to establish a misdirection on the part of the High Court in the exercise of its discretion to disallow the amendment of the notice of appeal. The taxpayer did not do this.

Pursuant to the above, the SCA dismissed the taxpayer's appeal. It concluded that the reasoning of the tax court and High Court was firmly grounded in the credible evidence of SARS' expert witnesses and could not be faulted.

## TAKE-AWAYS AND OBSERVATIONS

### *The taxpayer's approach*

After going through an objection and three appeals, the taxpayer in Nesongozwi ran out of the proverbial road and found himself on two last-minute rocky grounds of appeal. The judgment illustrates the importance of a taxpayer formulating comprehensive grounds of objection and appeal from the beginning of the dispute resolution process. Obtaining professional advice early on, ideally at an early stage of the dispute resolution process and at least before lodging the objection, can go a long way to ensuring that the best possible outcome is achieved, particularly if further appeals are contemplated.

### *Matla Coal principle*

The SCA's reliance on the principle in *Matla Coal* as the basis for considering the additional ground of characterisation of mineral resources, should be welcomed. The principle promotes the focus on the substance

## Check your mirrors: Sticking to original grounds of objection in SCA tax appeal proceedings

CONTINUED

of the objection as opposed to taking an overly technical approach that results in the disallowance of an appeal on purely technical grounds. While not explicitly stated by the court, it thus appears that if a taxpayer makes an argument or raises a ground of appeal that is different from its grounds of objection, at the initial appeal stage or later, the taxpayer could potentially argue that the ground of appeal must be considered, on the basis that it does not deviate from the substance of the initial objection. However, the most prudent approach is still to draft comprehensive grounds of objection and appeal, pursuant to obtaining professional advice early in the life of the dispute.

### *Donations tax and capital gains tax consequences*

Considering that the SCA upheld the High Court and tax court decisions, the taxpayer remains liable to pay the additional tax, interest and penalties, as per the tax court finding.

While it is unfortunate that the SCA did not analyse this issue further, the judgment illustrates that on a set of facts, a transaction can give rise to both capital gains tax and donations tax consequences. While it is not stated in the judgment whether the taxpayer's initial valuation was based on expert advice, it would have likely been better for the taxpayer to conclude a written agreement between himself and the Trust for the NMC share sale. Furthermore, before entering into the agreement, it would have likely been best for the taxpayer to obtain a proper valuation and understand the tax risk, specifically the adverse capital gains tax and donations tax consequences that could ensue, as a result of SARS questioning the tax treatment and valuation, which ultimately happened in this case.

**NICHOLAS CARROLL AND  
LOUIS BOTHA**



## OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa and Kenya, please contact:



### Emil Brincker

Practice Head & Director:  
Tax & Exchange Control  
T +27 (0)11 562 1063  
E [emil.brincker@cdhlegal.com](mailto:emil.brincker@cdhlegal.com)



### Sammy Ndolo

Managing Partner | Kenya  
T +254 731 086 649  
+254 204 409 918  
+254 710 560 114  
E [sammy.ndolo@cdhlegal.com](mailto:sammy.ndolo@cdhlegal.com)



### Lance Collop

Director:  
Tax & Exchange Control  
T +27 (0)21 481 6343  
E [lance.collop@cdhlegal.com](mailto:lance.collop@cdhlegal.com)



### Mark Linington

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1667  
E [mark.linington@cdhlegal.com](mailto:mark.linington@cdhlegal.com)



### Gerhard Badenhorst

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1870  
E [gerhard.badenhorst@cdhlegal.com](mailto:gerhard.badenhorst@cdhlegal.com)



### Jerome Brink

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1484  
E [jerome.brink@cdhlegal.com](mailto:jerome.brink@cdhlegal.com)



### Petr Erasmus

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1450  
E [petr.erasmus@cdhlegal.com](mailto:petr.erasmus@cdhlegal.com)



### Dries Hoek

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1425  
E [dries.hoek@cdhlegal.com](mailto:dries.hoek@cdhlegal.com)



### Alex Kanyi

Partner | Kenya  
T +254 731 086 649  
+254 204 409 918  
+254 710 560 114  
E [alex.kanyi@cdhlegal.com](mailto:alex.kanyi@cdhlegal.com)



### Heinrich Louw

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1187  
E [heinrich.louw@cdhlegal.com](mailto:heinrich.louw@cdhlegal.com)



### Howmera Parak

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1467  
E [howmera.parak@cdhlegal.com](mailto:howmera.parak@cdhlegal.com)



### Stephan Spamer

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1294  
E [stephan.spamer@cdhlegal.com](mailto:stephan.spamer@cdhlegal.com)



### Tersia van Schalkwyk

Tax Consultant:  
Tax & Exchange Control  
T +27 (0)21 481 6404  
E [tersia.vanschalkwyk@cdhlegal.com](mailto:tersia.vanschalkwyk@cdhlegal.com)



### Louis Botha

Senior Associate:  
Tax & Exchange Control  
T +27 (0)11 562 1408  
E [louis.botha@cdhlegal.com](mailto:louis.botha@cdhlegal.com)



### Varusha Moodaley

Senior Associate:  
Tax & Exchange Control  
T +27 (0)21 481 6392  
E [varusha.moodaley@cdhlegal.com](mailto:varusha.moodaley@cdhlegal.com)



### Tsanga Mukumba

Associate:  
Tax & Exchange Control  
T +27 (0)11 562 1136  
E [tsanga.mukumba@cdhlegal.com](mailto:tsanga.mukumba@cdhlegal.com)

**BBBEE STATUS:** LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

**PLEASE NOTE**

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

**JOHANNESBURG**

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.

Dx 154 Randburg and Dx 42 Johannesburg.

T +27 (0)11 562 1000 F +27 (0)11 562 1111 E [jhb@cdhlegal.com](mailto:jhb@cdhlegal.com)

**CAPE TOWN**

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.

T +27 (0)21 481 6300 F +27 (0)21 481 6388 E [ctn@cdhlegal.com](mailto:ctn@cdhlegal.com)

**NAIROBI**

Merchant Square, 3<sup>rd</sup> floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.

T +254 731 086 649 | +254 204 409 918 | +254 710 560 114

E [cdhkenya@cdhlegal.com](mailto:cdhkenya@cdhlegal.com)

**STELLENBOSCH**

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.

T +27 (0)21 481 6400 E [cdhstellenbosch@cdhlegal.com](mailto:cdhstellenbosch@cdhlegal.com)

©2022 11707/NOV