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TAX & EXCHANGE CONTROL ALERT

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A punter, a futures trader and a tax problem: Tax Court judgment on the taxation of unexplained deposits in a bank account

It is safe to say that in most legal disputes, proof is everything. Where a taxpayer embarks on entrepreneurial activities and these activities involve payment of amounts into and out of a bank account held in his own name, the ability to prove what the amounts relate to is even more important. This, in a nutshell, is what the Tax Court's judgment in *Mr X v The Commissioner for the South African Revenue Service* (Case No IT13178) (reported on the SARS website), is all about. As discussed below, the court ultimately decided the matter in SARS' favour due to Mr X (Taxpayer) not being present at the proceedings, but there are a number of important things that one can learn from this matter.



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A punter, a futures trader and a tax problem: Tax Court judgment on the taxation of unexplained deposits in a bank account

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It is safe to say that in most legal disputes, proof is everything. Where a taxpayer embarks on entrepreneurial activities and these activities involve payment of amounts into and out of a bank account held in his own name, the ability to prove what the amounts relate to is even more important. This, in a nutshell, is what the Tax Court's judgment in *Mr X v The Commissioner for the South African Revenue Service* (Case No IT13178) handed down on 31 March 2021 (as yet unreported), is all about. As discussed below, the court ultimately decided the matter in SARS' favour due to Mr X (Taxpayer) not being present at the proceedings, but there are a number of important things that one can learn from this matter.

Facts

Taxpayer's business activities and imposition of additional tax

- The Taxpayer appealed against the additional assessments raised in respect of the Taxpayer's 2005-2007 tax years.
- The Taxpayer is a businessman who earned his living from two parallel business ventures, namely bookmaking and equity futures trading.
- The bookmaking business entailed accepting and placing horseracing bets from private individuals and the public (the punters). If the bets placed with the Taxpayer win, he is obliged to pay out the winnings to the relevant punters and to mitigate his exposure to risks from winning bets, the Taxpayer places hedging bets with other bookmakers.
- To monitor the betting transactions, the Taxpayer maintained a spreadsheet on a daily basis. The Taxpayer alleged that during the 2005-2007 tax years, the settling of bets made by the Taxpayer, was done verbally on a mutually agreed figure on a weekly basis. In other words, no settling statements or statements of account were issued.
- Following a tax audit and an analysis of deposits made to his bank account, SARS found that the Taxpayer underdeclared income from his bookmaking business during the 2005-2007 tax years. The underdeclared amount for each year was between R3,8 and R4,81 million.
- In respect of the Taxpayer's equity futures trading business, the Taxpayer operated an account with Z Securities (Pty) Ltd (Z Securities), which is a stock brokerage firm and a member of the South African Futures Exchange (SAFEX).
- An analysis of the Taxpayer's bank statements for the futures trading account, reflected undeclared profits for the 2005-2007 tax years, varying between R219,000 and R950,000, in each tax year.
- The Taxpayer also failed to declare interest that accrued to him from the funds held with Z Securities and from a call account held with Y Bank.
- SARS imposed interest in terms of section 89*quat* of the Income Tax Act 58 of 1962 (Act) and additional tax, at the rate of 100%, on top of the tax owing in respect of the income that was allegedly not declared correctly (interest, bookmaking and equity futures trading income referred to above).

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When the matter was due to be heard on 4-5 February 2021, the Taxpayer's attorneys of record withdrew and the proceedings took place in the Taxpayer's absence.

Taxpayer partially successful on objection and appeal proceedings

- At the hearing of the matter, Ms M, a SARS official, explained that the Taxpayer's objection against the additional assessments was allowed partly. SARS conceded that the proceeds in the futures trading account were capital in nature and imposed capital gains tax on the profits made for the 2005-2007 tax years.
- SARS also allowed those deductions proved by the Taxpayer and invited the Taxpayer to explain the unexplained deposits.
- SARS also considered extenuating circumstances and reduced the additional tax rate to 50%, instead of the original rate of 100% that was used. The Taxpayer appealed against those parts of his objection that were not allowed.
- The Taxpayer requested a postponement of the appeal proceedings before the Tax Court on numerous occasions, with the aim of trying to settle the matter.

- The Taxpayer's last application for postponement was made on 24 November 2020 and when the Tax Court granted that application, it indicated that no further postponements would be granted.
- When the matter was due to be heard on 4-5 February 2021, the Taxpayer's attorneys of record withdrew and the proceedings took place in the Taxpayer's absence. The withdrawal was only communicated to the Tax Court on the first day of proceedings.

Issues for determination

The Tax Court had to decide on the following issues, amongst others:

- Whether SARS was entitled to issue additional assessments as a result of the unexplained receipts and deposits in the Taxpayer's bank account on the basis that they formed part of his "gross income" (as defined in section 1 of the Act) derived from his bookmaking business and equity futures trading business.

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Due to the proceedings taking place in the Taxpayer's absence, the Tax Court did not have any evidence to consider, save for what was submitted by SARS during the hearing.

- Whether the interest income that accrued to the Taxpayer, formed part of the Taxpayer's gross income.
- Whether the Taxpayer produced sufficient evidence to satisfy SARS that the additional tax imposed under section 76(2) of the Act (which applied at the time of the Taxpayer's under declaration) should be remitted.
- Whether the Taxpayer successfully contended that the amounts in dispute should not have been declared in his income tax returns to justify the remittal of interest under section 89quat(3) of the Act.

Judgment

Due to the proceedings taking place in the Taxpayer's absence, the Tax Court did not have any evidence to consider, save for what was submitted by SARS during the hearing. It discussed the provisions in the Act that were applicable to decide the issues for determination and considered SARS' argument as to whether the court should grant default judgment in terms of rule 44(7) of the rules promulgated under the Tax Administration Act 28 of 2011 (TAA) (Tax Court Rules).

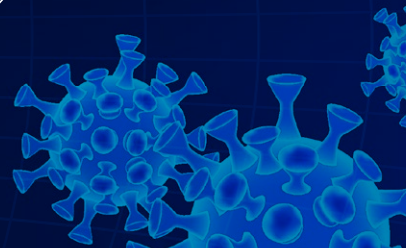
Rule 44(7) states the following:

- If a party or a person authorised to appear on the party's behalf fails to appear before the tax court at the time and place appointed for the hearing of the appeal, the tax court may decide the appeal under section 129(2) upon—
 - the request of the party that does appear; and
 - proof that the prescribed notice of the sitting of the tax court has been delivered to the absent party or absent party's representative, unless a question of law arises, in which case the tax court may call upon the party that does appear for argument.

The court noted that the submission in terms of rule 44(7) was well grounded as it was submitted to the court that the Taxpayer failed to provide instructions to his attorneys in preparation for the appeal, after the last postponement was granted in November 2020.

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The Tax court queried SARS as to how it arrived at its calculations and after considering SARS' submissions, it granted judgment against the Taxpayer in default, as provided for in terms of rule 44(7) of the Tax Court Rules.

In coming to its decision in the matter, the court considered the following:

- The Taxpayer must prove that amounts are deductible, with reference to section 11(a) of the Act and section 102 of the TAA. The latter provision states that the Taxpayer bears the burden of proof on whether an amount is deductible.
- In terms of section 76(2) of the Act (which applied at the time of the contravention), SARS may remit the additional tax imposed under section 76(1), but only if SARS is of the opinion that there were extenuating circumstances and that the Taxpayer did not do anything with the intent to avoid tax.
- In terms of section 89quat(3) of the Act, interest imposed may be remitted if the Taxpayer has on reasonable grounds contended that an amount should not have been included in taxable income or should have qualified for deduction.

The Tax Court queried SARS as to how it arrived at its calculations and after considering SARS' submissions, it granted judgment against the Taxpayer in default, as provided for in terms of rule 44(7) of the Tax Court Rules.

Comment

The judgment illustrates the following important principles that should also be kept in mind by taxpayers:

Firstly, taxpayers always bear the burden of proving that an amount should be subject to tax or that it should qualify for deduction. There are only a few instances mentioned in the TAA where SARS bears the burden of proof. A taxpayer should therefore ensure

that they have the necessary evidence (documentary or otherwise) that proves why they treated an amount in a certain way for tax purposes. If a taxpayer receives income or pays business expenses from his personal bank account, it is therefore crucial to have supporting documentation for information contained in the bank statement, so that it is clear what pertains to business (and is subject to tax) and what isn't.

Secondly, taxpayers should, as far as possible avoid a tax dispute from being drawn out unnecessarily. In the current matter, one does not know all the reasons why it took 10 years before the matter reached the Tax Court, but it appears to be at least partly due to the Taxpayer's requests for postponement. Aside from late payment interest that is charged on the unpaid tax, additional tax and interest, a witness' ability to recall an event and provide cogent evidence can be adversely affected by such a long delay.

Thirdly, when taxpayers make settlement proposals, they should be made strategically and whilst appreciating the relevant settlement provisions in the TAA that must be taken into account. For example, the TAA states that if certain facts are present, SARS will not agree to settling a dispute.

Finally, the judgment is also a reminder for persons engaged in cryptocurrency trading to ensure that they keep sufficient proof of all income derived and expenses incurred in the course of trading, especially if they use their personal accounts for this purpose. Any trading related income received into a person's bank account, including any cryptocurrency that accrues to the person by virtue of receipt into their digital wallets, could be subject to tax, if it accrued to them or was received in the course of trading.

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