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TAX & EXCHANGE CONTROL **ALERT**

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International insights into judicial treatment of taxpayers claiming work-related expenses

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The deduction of an individual's work-related expenses for tax purposes was considered in the recent Australian judgment of *Munkayilar and Commissioner of Taxation (Taxation)* [2021] AATA 1839 (22 June 2021), which was delivered by the Taxation and Commercial Division of the Australian Administrative Appeals Tribunal. In particular, the tribunal reflected on whether the taxpayer had met the requirements under Australian tax law to claim the relevant expenses as a deduction and whether an administrative penalty ought to be imposed to the extent that such expenses did not qualify for deduction.

Facts

In his 2018 tax return, the taxpayer claimed, as a tax deduction, work-related expenses amounting to AUS$15,492. The expenses claimed by the taxpayer included:

- clothing expenses (the cost of laundry and shoes);
- self-education expenses (the cost of course fees, a study loan and depreciation on a computer, as well as travel expenses incurred pursuant to his self-education); and
- other expenses (the cost associated with the use of his cell phone and the cost of specialised hand cream necessary for his occupation as a social worker).

On 3 June 2019, the Australian Commissioner of Taxation notified the taxpayer that an audit was being conducted in respect of the work-related expenses that he had claimed in his 2018 tax return. To this end, the commissioner requested that the taxpayer provide supporting documentation in order to substantiate the work-related expenses that had been claimed as deductions.

The taxpayer's tax agent responded to this request by informing the commissioner that the taxpayer was unable to find the receipts and other documents on which the claims were based, and further that the deductions that were claimed in respect of the self-education course fees had been incorrectly claimed on the basis of incorrect information provided by the taxpayer. The taxpayer then submitted a voluntary disclosure form which sought to reduce the work-related expenses claimed by the taxpayer for the 2018 year.

In the subsequent finalisation of audit letter and amended assessment that was issued by the commissioner, the taxpayer's work-related expenses claim was disallowed in full and an administrative penalty of 50% on the shortfall amount was imposed. The administrative penalty was imposed on the basis that the taxpayer had made false or misleading statements in his tax return as a result of the taxpayer and his agent's recklessness in preparing the 2018 tax return.

The taxpayer first lodged an objection to the amended assessment, which was unsuccessful, following which he lodged an application to the tribunal for a review of the commissioner's decision to disallow the objection.

During the tribunal proceedings, the taxpayer was able to provide only a copy of his bank statements (on which he had made handwritten notes describing what the relevant amounts were spent on) as documentation supporting his deduction claims.

Judgment

In terms of Australian tax law, losses and expenses which are actually incurred in the course of gaining or producing assessable income are deductible, unless those losses or expenses are capital, domestic or

International insights into judicial treatment of taxpayers claiming work-related expenses...*continued*

The taxpayer had been unable to provide the necessary written evidence that the expenses had actually been incurred.

private in nature. Work-related expenses may only be claimed if they are deductible in terms of a legislative provision contained in Australian tax law, and if they can be substantiated by written evidence. To this end, if a taxpayer cannot comply with a request to provide written evidence of the expense, then that expense cannot be allowed as a deduction.

In determining whether the commissioner's additional assessments had been incorrect or excessive, the tribunal considered each type of expense that was claimed by the taxpayer and ultimately identified three fundamental issues with the taxpayer's claim for deductions.

The first significant issue was that some of the expenses that he had claimed were not actually incurred or paid by him. While giving evidence, the taxpayer conceded that he had not actually paid any amounts towards his course fees (which were covered by the government) or his study loan during the 2018 year of assessment. As no amounts were expended by the taxpayer in respect of these items, the tribunal found that the taxpayer had not been entitled to a deduction of the amounts that had been claimed (but not paid) and the tribunal therefore upheld the commissioner's amended assessment in this regard.

The second issue that the tribunal highlighted was that the taxpayer had been unable to establish a sufficient link between some of the expenses incurred and the production of his assessable income. In this regard, the tribunal considered the taxpayer's travel expenses and the depreciation claim in respect of his computer. The taxpayer's overall inability to demonstrate a close enough link between the expenses and his income-producing activities, and more particularly his inability to show precisely how he calculated the particular amounts of the expenses that actually pertained to his income producing activities, led the tribunal to find that he had not been entitled to claim the travel and computer expenses.

The last issue that the tribunal focused on was that the taxpayer had been unable to provide the necessary written evidence that the expenses had actually been incurred. It was the taxpayer's submission that he previously had receipts and other documents that would have substantiated his claims, but that he had subsequently lost them and had made little to no effort to obtain replacement documents. In respect of the bank statements that the taxpayer had produced, the tribunal noted that the written descriptions included thereon did not indicate exactly what items were purchased or how these purchases were incurred in the production of the taxpayer's assessable income. As there were no other documents before the tribunal that could substantiate the taxpayer's claims, it was held that the expenses could not be claimed as a deduction.

On the issue of the administrative penalty, the tribunal found that the taxpayer had not discharged his obligation to show that he had taken reasonable care in preparing his 2018 tax return. It was held that a reasonable person in the same circumstances would have exercised greater care and would have made reasonable inquiries into the correctness of the tax position before lodging their tax return. In coming to this finding, the tribunal took into account the taxpayer's circumstances, including his knowledge, education, experience and skill. The

International insights into judicial treatment of taxpayers claiming work-related expenses...*continued*

In a media statement issued on 2 July 2021, the South African Revenue Service advised taxpayers to carefully consider any claims in respect of home office expenditure as these claims are likely to be selected for verification or audit.

amount of the penalty imposed by the commissioner was, however, reduced by the tribunal on the basis that the taxpayer had made a *"genuine attempt to meet his tax obligations and made an effort to do the right thing despite recklessly including false and misleading statements in his tax return"*. This finding was made in large part due to the voluntary disclosure that the taxpayer had made.

Ultimately, the tribunal accepted the commissioner's amended assessment and reduced (but did not fully remit) the administrative penalty that had been imposed.

Comment

There are significant differences between the types of expenses that may be claimed by individuals in terms of South African tax law and in terms of Australian tax law. However, the principles laid down by the tribunal in this case are noteworthy for those South African individuals, and more particularly South African employees, who are considering claiming deductions in respect of the expenses that they have incurred pursuant to their employment.

In our Tax & Exchange Control Alert published on 20 May 2021, the types of deductions that may be claimed by employees, and the requirements that must be met in order to claim them, were discussed in detail. To the extent that individuals in South Africa intend on claiming these types of deductions, they should be aware that the onus to prove that they are entitled to the deductions rests on them and the following fundamental principles that were highlighted by the tribunal should be borne in mind:

- The expenses that are claimed as deductions must have been expenses that were actually incurred by the individual in the relevant year of assessment.
- There must be a connection between the expenses that are claimed and the employment functions carried out by that individual (in a South African context one would consider whether the *"close connection"* requirement laid down in the *PE Tramway* case was met).
- It is critically important that documentary evidence of the expenses incurred be retained by the individual. To this end, individuals must be able to show that the expenses were incurred and must be able to demonstrate how they calculated the relevant deductions.

In a media statement issued on 2 July 2021, the South African Revenue Service advised taxpayers to carefully consider any claims in respect of home office expenditure as these claims are likely to be selected for verification or audit. In the event of verification or audit, the taxpayer will need to provide the necessary proof that they are entitled to the deductions. To the extent that taxpayers are not legally entitled to claim the deductions, they may face penalties.

Louise Kotze

What to consider when seeking to amend an appeal in Tax Court

SARS opposed the application, alleging that DEF Mining had abandoned the section 11(a) issue by not including it as part of its appeal and having admitted to SARS's finding in relation to this ground at the objection stage.

In *DEF Mining (Pty) Ltd v the Commissioner for the South African Revenue Service* (IT24578) (27 January 2021) (as yet unreported), the Tax Court dismissed an application brought by the applicant, DEF Mining, in terms of rule 35(2) of the Tax Court's dispute resolution rules to amend its statement of grounds of appeal under rule 32. The Tax Court's dispute resolution rules were promulgated under section 103 of the Tax Administration Act 28 of 2011.

In terms of rule 35, there are two ways in which the parties to a dispute can amend a statement. Rule 35(1) enables parties to agree to an amendment, or, where there is no agreement, rule 35(2) allows them to apply to the Tax Court for an order in terms of rule 52. Under rule 52(7), this includes an order concerning the postponement of the hearing.

A court has the discretion whether or not to allow an amendment and will usually allow it in instances where:

- the party seeking the amendment can prove that the amendment will not prejudice the other party;
- the amendment is made in good faith; and
- granting the amendment will ensure that justice is done in deciding the real issues between the parties.

As the Tax Court's dispute resolution rules do not specifically outline the procedural steps to follow when seeking to amend a statement, rule 42(1) must be considered. Rule 42(1) provides that where "*these rules do not provide for a procedure in the tax court, then the most appropriate rule under the rules for the High Court ... may be utilised by a party of the tax court*". In this regard, rule 28 of the Uniform Rules of Court becomes relevant as it deals with the amendment of pleadings and documents, and outlines the procedure to follow.

Background

Two weeks before trial, DEF Mining provided the respondent, the Commissioner for the South African Revenue Service (SARS), with notice to amend its rule 32 statement. The notice to amend was brought in terms of the approach outlined above. Accordingly, DEF Mining sought to:

- present as an additional ground of appeal, the deductibility of its qualifying expenditure in terms of section 11(a) of the Income Tax Act 58 of 1962 (ITA), for the 2013, 2014, and 2015 years of assessment from income derived by DEF Mining from its mining operations;
- attach as an annexure to its rule 32 statement, a document which reflected the classification of its expenditure during the relevant years of assessment; and
- provide a summary of its arguments in relation to the section 11(a) issue.

SARS opposed the application, alleging that DEF Mining had abandoned the section 11(a) issue by not including it as part of its appeal and having admitted to SARS's finding in relation to this ground at the objection stage. Moreover, the contents of the annexure which DEF Mining sought to attach, were inconsistent with the documents provided to SARS, as the amounts claimed had not all been included during the objection.

In considering the position in relation to amendments, the court referred to *Caxton Ltd v Reeva Forman (Pty) Ltd* [1990] (3) SA 547 (A), in which it was held that the court has the discretion to allow or deny an application to amend an appeal, with due regard to certain fundamental principles. In *Ciba-Geigy (Pty) Ltd v Lushof Farms (Pty)* [2002] (2) SA 447 (SCA), also referred to by the court, it was held that where a party seeks an amendment at

What to consider when seeking to amend an appeal in Tax Court...*continued*

In the case of an amendment involving a withdrawal of an admission, the court has a discretion to grant or refuse an application.

an advanced stage of the proceedings (much like in this case), that party would be required to provide reasons for the delay. In this instance, the considerations that would apply included DEF Mining being required to:

- prove that it did not delay its application after becoming aware of the evidentiary material upon which it intended to rely;
- provide an explanation of the reason for the amendment; and
- show *prima facie* that it had a triable issue (i.e. a dispute that would be relevant if proved by DEF Mining in its application).

First ground of amendment

DEF Mining had previously raised the section 11(a) issue as a ground of objection but did not include it as part of its grounds of appeal. According to DEF Mining, the reason for the omission was that it relied on advice from its professional advisors at the objection stage that SARS's decision to disallow this ground of objection appeared to be correct. Thereafter, and on that basis, DEF Mining admitted SARS's finding and confirmed that it would not base its deduction on the provision. As a result, the appeal proceeded on the issues which remained between the parties.

DEF Mining further alleged that it had subsequently received contrary advice that its expenditure for the relevant years of assessment qualified to be deducted under section 11(a) of the ITA, which motivated DEF Mining to bring the notice of amendment and thus revive the section 11(a) issue. In addressing SARS's arguments, DEF Mining submitted that although the section 11(a) issue effectively amounted to a new ground, because SARS had considered this ground at the objection stage, its introduction in the appeal would not cause prejudice to SARS. In addition, DEF Mining submitted that its decision not to pursue the ground at the first instance did not amount to an abandonment of the section 11(a) issue in the appeal.

The question therefore became whether DEF Mining's decision not to pursue the issue amounted to an abandonment and whether it could withdraw the admission previously made to SARS in the latter's decision to disallow the ground at the objection stage.

In relation to the abandonment issue, the Tax Court held that as a result of its decision not to include the section 11(a) issue in its rule 32 statement, DEF Mining had created the impression that it would waive its right to raise the issue in the appeal. Especially since DEF Mining had previously admitted that SARS's finding in relation to the issue was correct (i.e. that the expenditure was capital in nature and did not qualify for deduction under section 11(a)).

In this regard, the court referred to *Amod v SA Mutual Fire & General Insurance Co Ltd* [1971] (2) SA 611 (N), in which it was held that in the case of an amendment involving a withdrawal of an admission, the court has a discretion to grant or refuse an application for the amendment of a pleading, but will require a reasonable explanation of the circumstances under which the admission was made and the reasons why it is sought to be withdrawn. The court concluded that DEF Mining had failed to explain the circumstances under which the admission was made to SARS and the reasons why it sought to withdraw the admission.

What to consider when seeking to amend an appeal in Tax Court*...continued*

Taxpayers and their tax advisors must be cognisant of the opportunity afforded to them at the time of lodging an objection.

Second and third grounds of amendment

The court considered whether DEF Mining could include the document reflecting the classification of its expenditure during the relevant years of assessment, which it sought to attach as an annexure to its rule 32 statement, as well as the summary of its arguments in relation to the section 11(a) issue.

DEF Mining submitted that the new annexure differed from the annexures that related to the initial grounds of objection, on the basis that the new annexure included a classification of all expenditure incurred in the relevant years of assessment. Furthermore, the new annexure did not only apply to its argument in relation to the section 11(a) issue, but the remaining issues in the appeal too. SARS, on the other hand, opposed the inclusion of the new annexure on the basis that it would have to consider expenditure which it did not previously deal with. It argued that DEF Mining had previously accepted that certain of the expenditure constituted capital expenditure, and DEF Mining had conceded that the contents of the new annexure and the initial annexures differed.

In considering these arguments, the court held that the difference in the annexures was an indication of prejudice to SARS as it would be required to deal with a case which had not previously been presented to it. In addition, the court could not find sufficient reason as to why the new annexure was not presented to SARS at an earlier stage. The court further referred to rule 7(2)(b) of the Tax Court's dispute resolution rules, which requires that a taxpayer lodging an objection to an assessment includes the documents required to substantiate the grounds of objection, and which the taxpayer had not previously delivered to SARS for purposes of the disputed assessment. On this basis, the court concluded that DEF Mining was not permitted to introduce the new annexure in terms of the Tax Court's dispute resolution rules.

In light of the above, the court refused to allow the application for amendment on all grounds.

Comment

A few lessons can be learned from this judgment. Firstly, taxpayers and their tax advisors must be cognisant of the opportunity afforded to them at the time of lodging an objection to an assessment to deliver documents substantiating the grounds of objection. Secondly, where a taxpayer seeks to introduce (at the appeal stage) documents that were not delivered at the objection stage but which were required to substantiate a ground of objection or appeal, the taxpayer may run the risk of not succeeding with an application to include these documents. The key issue is whether the introduction of the new documents could be seen as an attempt to introduce a new ground of appeal. Finally, where parties make an admission of fact, they must understand the consequences of the admission and how it may affect their case going forward, especially if they want to withdraw the admission at a later stage.

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