IN THE TAX COURT OF SOUTH AFRICA
HELD IN PRETORIA

CASE NUMBER: 12906/
DATE: 5 July 2012

In the matter between:

AB MINING (PTY) LTD **Appellant**

and

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

JUDGMENT

---

(1) The appellant a prospecting and mining enterprise has lodged an appeal against the respondent's tax assessment in respect of the years 2003 to 2006 for a tax liability in the amount of R12 889 189.00.

(2) The essence of the appeal relates to:

The 2003 Tax Year – The Capital Gains Tax in the amount of R1 719 229 in respect of the alleged disposal of the C Mining Dump.

(i) The appellant contends that it did not dispose of the C Mining Dump, nor the rights thereto within the meaning of *"disposal"* as envisaged in ***Paragraph 11 of the Eight Schedule of the Income Tax Act 58 of 1962 (The Act);*** and

(ii) the appellant contends that it did not own the C Mining Dump but only acquired the rights to certain platinum bearing materials thereon, which rights were to be exploited in conjunction with the D Company, in a 50% by 50% joint venture, consequently, the provisions of the ***Eighth Schedule of The Act*** are inapplicable to the transaction concerned, as are the penalties imposed in terms of the provisions of ***Section 76 of The Act*;**

(b) **The 2004 Tax Year – The Fair Value Adjustment in the amount of R2 638 070**

(i) The appellant contends that the assessment insofar as the amount constitutes the disallowance of the deduction of the depreciated value of shares in E Mining (Pty) Ltd, which shares were purportedly written off, is factually incorrect, as E Mining (Pty) Ltd never issued shares to the appellant in lieu of any loans it advanced to it; and

(ii) on the contrary the appellant asserts that the amount in question constitutes an allowable deduction under ***Section 11(a) of The Act***, and is made up of office expenditure and salaries incurred by the appellant when it took over the staff and premises of E Mining (Pty) Ltd for its own purposes to raise capital from the public during a reverse take-over bid aimed at rescuing the latter to secure its listing on the Johannesburg Stock Exchange.

(c) **The 2005 Tax Year – Capital Gains Tax – The Alleged "*Disposal*" of Chrome Tailings Rights in the amount of R8 million;**

(i) The appellant contends that the assessment is based on the incorrect assumption that it acquired certain mineral rights from F Company and G Company for no consideration, and thereafter disposed off these rights between itself, the L Consortium, D Company and NO Company for a deemed consideration of R8 million;

(ii) the appellant contends that this assumption is factually incorrect as no disposal of mineral rights *per se* occurred within the meaning of ***Paragraph 11 of The Eighth Schedule***;

(iii) the platinum bearing mineral rights were not acquired from the said entities on behalf of the L Consortium, but were previously acquired by the appellant from the C area's farmers on behalf of the L Consortium; and

(iv) the appellant only obtained an undertaking from F Company and G Company to divert their chrome

waste tailings pipelines to the processing plant of the L Consortium, consequently, this undertaking did not constitute a valuable right which can be considered as an "*asset*" for Capital Gains Tax purposes.

(d) **The 2005 Tax Year – Capital Gains Tax and Donations Tax – The "*Disposal*" of 38% income share held in the L Consortium**

Ad Capital Gains Tax – R14 993 024)

(i) The appellant contends that the respondent's application of ***Paragraph 38 of The Eighth Schedule*** to the transaction concerned, as being a disposal of an asset to a connected person in relation to itself for a consideration which does not reflect an arms' length price, is factually and legally incorrect;

(ii) On the conclusion of the transaction in issue, the parties were totally unrelated, and the transaction was primarily aimed at severing their relationship with the least cost implications to each other, with each party retaining all existing rights and benefits;

(iii) the transaction constitutes a *bona fide* agreement concluded between parties acting at arms' length consequently, the provisions of ***Paragraph 38 to The Eighth Schedule*** are inapplicable, due to the fact that the undertaking by the appellant to pay 38% of its income to L Consortium (SA), is a mere contingency, which has no apparent market value and did not constitute the disposal of an "*asset*";

(iv) furthermore, the respondent's determination of the transactions "*market value*" is flawed, because lacks a scientific basis and does not take cognizance of a number of important factors.

(e) **The Donations Tax (deemed donation – R5 586 607)**

(i) The appellant contends that the respondent's application of ***Section 58 of The Act*** to the transaction is flawed as no gratuitous "*disposal*" of "*property*" took place within the meaning of ***Section 58 of The Act;***

(ii) the parties merely intended to sever their existing relationship as shareholders of Company UK, with the least cost implications for either party and with the retention of all their existing rights;

(iii) the respondent failed in terms of ***Section 58 of The Act*** to make a proper valuation in determining the adequacy of the consideration, it merely relied on a totally unsubstantiated valuation by S Entity, which was not part of the transaction concerned;

(iv) the respondent's calculation of the Rand value of the "*donation*" based on the selling price of L Company (UK) shares to S Entity is fundamentally flawed, because the respondent used the contractual conversion rate of R12.00 to a British pound sterling urged by S Entity, instead of an exchange rate of R11.481 to the pound in accordance with the respondent's published rates as at 1 February, 2005; and

(v) consequently, insofar as the interest is calculated retrospectively on a penalty of R931 101, this amounts to the appellant being penalized twice for the same "*offence*".

(f) **<u>The 2006 Tax Year – The Accrual of Management Fees – R368 167</u>**

(i) The respondent's inclusion of the relevant income in the 2006 tax year is contrary to the respondent's accepted practice in the previous tax years and goes against the accrual principle, namely that an accrual occurs only once the recipient has acquired an unconditional legal claim to the payment of a determinable amount;

(ii) in *casu*, the Management Fees were calculated as a percentage of sales, were only determinable 4 calendar months after transaction date, consequently, there was no accrual prior to the date of the determination of such sales figures in the 2007 tax year confirming the correctness of the appellant's tax return for the tax year concerned;

(iii) the respondent's view regarding the accrual of the relevant income, is disputed on the grounds firstly, that the income, on which the respondent bases its assessment argument, has accrued 4 calendar months

subsequent to February 2006, namely in June 2006, which falls within the 2007 tax year, secondly, such income was disclosed in the appellant's interim financial statements for the six months ending 20 June 2006;

(iv) the actual income on which the fees were based could, contractually, only be determined four calendar months subsequent to the delivery and processing date of the minerals concerned, when the quantities and quality of platinum bearing metal prices, penalties and exchange rates became known, consequently, the exact income in respect of February 2006 accrued in respect of the 2007 tax year;

(v) the fact that the February 2006 management accounts of the L Consortium reflect the correct income in respect of that month, is due to the fact that the management accounts were prepared subsequent to June 2006, when the actual production figures for the month February 2006 became available for the first time; and

(vi) further the relevant L Consortium accounts were prepared for management purposes only and

consequently, have no formal legal standing outside that group.

(g) **<u>The 2003 – 2006 Tax Years – Deduction of Overseas Travel Expenses – R393 725.00</u>**

(i) The appellant contends that the expenditure concerned is deductible in terms of ***Section 11(a) of The Act*** as it was incurred by it in order to raise working capital for the company's operations *inter alia,* through loans from private investors and from public funds through a possible listing on the London Stock Exchange; and

(ii) the expenditure claimed represents only about 10% of actual costs, as all private and capital expenditure as well as the major part thereof borne by Company UK was added back.

(h) **<u>The 2003 – 2006 Tax Years – Penalties in terms of *Section 76 of The Act* – R1 895 590.00</u>**

(i) the appellant contends that the respondent's imposition of penalties is based on the alleged non-

disclosure of income or incorrect statements on the relevant tax returns, which allegedly resulted in the avoidance of tax; and

(ii) in the present case no such non-disclosure or incorrect statements were made and no tax was raised in addition to what was properly declared in the relevant tax returns.

(I) ***Ad* Penalties and interest under Section 76 of The Act R5 024 2990**

(i) the appellant contends that the penalties in question are not applicable because it was not guilty of transgressing ***Section 76 of The Act***;

(ii) the respondent's decision to apply the provisions of ***Section 58 of The Act*****,** regarding a so-called "*deemed donation*", does not entitle it to raise penalties for failure to submit a Donation's Tax Return in circumstances where the appellant on reasonable grounds, disagrees with the opinion of the respondent as to whether or not a donation had taken place pursuant to the provisions of ***Section 58 of The Act;*** and

(iii) if the respondent requires clarification of any information in a tax return it is obliged in terms of ***Section 74A of The Act*,** to request further information or explanations.

(j) ***The Interest under Section 89(2) of The Act***

(i) the appellant contends that interest is payable if tax is not paid in full within the period specified in the Notice of Assessment, or within the period prescribed by ***The Ac;***

(ii) in terms of ***Section 60 of The Act*** under ordinary circumstances Donation's Tax is payable within 3 months *"from the date upon which the donation---takes effect;*

(iii) however, in cases where the respondent exercise its discretion under ***Section 58 of The Act*** and deems the disposal of property as a donation, such donation can only take effect as from date of the Notice of Assessment consequently, the respondent is precluded from raising interest retrospectively from the date of the transaction; and

(v) to hold otherwise would create an anomalous situation, as it would allow the respondent to claim interest in respect of taxes which were not legally claimable, nor payable during the period prior to its Notice of Assessment.

(k) The 2006 Tax Year – Capital Expenditure – R6 122 435

(i) The appellant contends that the L Consortium incurred expenditure in the amount of R 24 489 741 in respect of the construction of its processing plant, and its 25% share of such expenditure amounted to R6 122 435, which amount qualifies for deduction in terms of ***Section 36 of The Act.***

THE EVIDENCE

Mr. X's Evidence

(3) Mr. X the appellant's former Chief Executive Officer testified that the appellant acquired the mineral rights to the C Mining Dump from the C area's farmers on 7 September 2001 for an amount of R2.4 million, plus certain E Mining (Pty) Ltd shares to the value of R550 000, as well as a contribution of R75 000 towards the C area's farmers' arbitration costs. D Company paid R2.4 million to the C area's farmers.

(4) In 2002 he approached Mr. P the chief executive officer of D Company and offered to sell the C Mining Dump for an amount of

R3.5 million. He was under the impression that there he was selling 50% of the C Mining Dump to D Company. The appellant set up a joint venture with D Company for the exploitation of the mineral rights to the C Mining Dump on a 50/50 basis.

(5) D Company brought all its mineral rights into the joint venture with the appellant pertaining to the exploitation of C Mining Dump mineral rights. After seven months the joint venture with D Company was terminated. The mineral rights remained in the name of the appellant and were subsequently sold to K Company for a mere R10.

(6) In a letter dated 21 February 2002 addressed to the respondent. The appellant agreed that D Company's paid R1.3 million for the procurement of a 50% ownership of the C Mining Dump.

(7) D Company paid R3 million half of that was in respect of the appellant's costs estimated of R7 million in setting up the L Consortium. Q Auditors accounted for this transaction in the financial statements as a sale of 50% of the C Mining Dump to D Company for the amount of R1.3 million. He became aware of this aspect after seeing correspondence to the respondent pertaining

thereto. Mr. Y the appellant's public officer was also under the impression that the C Mining Dump was sold to D Company.

(8) The accounting treatment of this transaction was incorrect. The appellant's auditors erroneously treated the amount of R1.3 million of the R3.5 million paid by D Company as a consideration for the acquisition of a 50% share in the C Mining Dump and accounted for it as susceptible to Capital Gains Tax because of the assumed disposal of the C Mining Dump to D Company, whilst the remaining 50% ownership of the C Mining Dump was shown as an asset in the appellant's balance sheet.

(9) There was no "*disposal*" of any rights to D Company which could form the subject-matter of any Capital Gains Tax assessment, as the appellant retained ownership of the rights concerned. The L Consortium project had nothing to do with the C Mining Dump. The payment of R3.5 million also has nothing to do with the C Mining Dump.

(10) D Company was not interested in the C Mining Dump, it was interested in the L Consortium. Due to not understanding what D Company desired. A draft sale agreement was prepared in terms

whereof the appellant was to sell the C Mining Dump to D Company for R3.5 million.

(11) He only discovered on 3 June 2003 what D Company actually intended to purchase after the latter had already paid the appellant R3.5 million. An apology in writing was sent to D Company regarding the misunderstanding.

(12) The L Consortium was formally launched on 20 October 2003, in terms of a Notarial Consortium Agreement between the appellant, U Holdings, and D Company with each member contributing either cash , mineral rights or services. The construction of the processing plant, cost of R24.5 million. The partners shared profits in the percentage ratio of 25/50/25, respectively.

(13) The appellant was not required to make any cash contribution to L Consortium because it was its project. The appellant's contribution was the time, expenditure and services rendered in establishing the L Consortium. It was agreed that the appellant would own 25% of the L Consortium for the intellectual property and in putting the consortium together. D Company paid R16 million in cash for a 50% share of the L Consortium.

U Holdings paid 615.999 pounds sterling with the caveat that the appellant would redeem any shortfall.

(14) The appellant did not transfer the C Mining Dump mineral rights to D Company, same were made available to the L Consortium as its capital contribution to the project. The R3.5 million was not solely received towards not only for the payment of those *mineral rights, but also as compensation for "expenditure* time and services" in establishing the L Consortium project.

(15) He was author of the E Mining (Pty) Ltd rescue offer to raise capital for the appellant. The appellant acquired control of E Mining (Pty) Ltd and its staff which became employed by the appellant. It was put to him that the notion that the C area's mineral rights always remained vested in the appellant was at variance with the content of the documentation forwarded to the respondent.

(16) E Mining (Pty) Ltd was to transfer its shares to the appellant once the rescue operation had succeeded. The share value would be determined by how much money the appellant had expended in the rescue operation in respect of the staff and office expenditure. E

Mining (Pty) Ltd was to invoice one lump sum to the appellant for all its staff and office expenditure.

(17) The transfer of shares never happened, because the rescue operation was not approved by the JSE. In 2001 on his instructions, letters were written setting out the factual situation regarding E Mining (Pty) Limited rescue attempt and were dispatched to the respondent. The dispute was whether the R2.6 million expenditure was a write off of shares or whether the appellant was claiming same in respect of the payment of salaries and office expenditure.

(18) The appellant was not allowed by its auditors Q Auditors to claim the funds it had expended, because as these funds had nothing to do with running of the appellant's affairs. The E Mining (Pty) Ltd rescue plan was subject to suspensive conditions which were not fulfilled. The conversation of the debt into shares was not carried through and shares were not issued to the appellant.

(19) The E Mining (Pty) Ltd shares were suspended from trading on the JSE. Q Auditors informed him that under these circumstances it was necessary to write off the value of the E Mining (Pty) Ltd shares as the shares were now worthless.

(20) He was not aware at the time how the E Mining (Pty) Ltd loan was dealt with by the appellant's auditors Q Auditors in the financial statements. He became aware of the fair value adjustment in the 2009 financial statements. The fair value adjustment, in the 2004 financial statements submitted by the appellant was erroneous. The fair value adjustment basically revolved around a wrong entry, which was incorrectly noted.

(21) In the correspondence the appellant exchanged with the respondent it stated that the purpose of intervening in E Mining (Pty) Ltd, though it is bankrupt and without assets the appellant's motivation was to take over its business because it was listed in the JSE. E Mining (Pty) Ltd it was a conduct for raising funds for the appellant.

(22) It was put to him that the respondent relied solely on the 2004 tax returns for raising its assessment. Further, the appellant's 2004 tax returns which were not withdrawn or rectified reflected that the appellant's financial results were adversely affected by the write-off of the R2.6 million investment. He knew of the write offs because the appellant was the major investor in Company UK. He

never perused the appellant's financial statements, but identified two matters which have been incorrectly reported in these accounts, namely the purported sale of the C Mining Dump and the write off of R2.6 million expended on behalf of E Mining Limited's staff salaries and office expenditure.

(23) He was asked why were the financial statements were not revised following the discovery of the issues which were incorrectly reported. He responded that he did not think the appellant's public officer Mr. Y actually knew what the transactions were about. He was the only person who had put all these contracts together and knew the background. It was as a result of the investigation by the respondent that the incorrect entries were discovered.

THE EVIDENCE OF MR. Y

(24) He was acting the *de facto* chief executive officer and public officer of the appellant. He conceded that he was not suitably qualified to attend to the appellant's financial and tax affairs. Q

Auditors the appellant's auditors submitted its tax returns up to the 2004 tax year, thereafter RS Auditors took over.

(25) He assisted the Q Auditors in responding to the respondent's queries. His explained the transactions as he understood them. He relied on the auditors to ensure that the transactions were correctly recorded. He did not question any of the accounting entries.

(26) In the appellant's 2004 financial statements, the E Mining (Pty) Ltd loan was supposed to be converted into shares. In his view it was unlikely that the E Mining (Pty) Ltd shares would be transferred to the appellant as a result Q Auditors decided that the appellant had to write off the loan which the appellant made to E Mining (Pty) Ltd. Q Auditors did the fair value adjustment. When the financial statements were produced the loan was written off. He didn't query this, because he was advised that this had to be done.

(27) In response to a query in a letter addressed to the respondent in response to a query, he stated that the E Mining (Pty) Ltd shares were reflected as an asset in the appellant's financial statements in the 2004 financial year. In the course of 2009 Mr. X explained the

details of the E Mining (Pty) Ltd rescue to him. He then realized that there were no E Mining (Pty) Ltd shares that could have been written off as same were never transferred to the appellant.

(28) He signed the 2004 tax returns. Q Auditors advised him to state in the director's report that the appellant's financial statements were going to be adversely affected by the fair value adjustment write off.

(29) The C Mining Dump transaction was queried by the respondent on the 5 of June 2008. He was not personally involved in this transaction. In June 2008, he was still under the impression that D Company had purchased 50% of the C Mining Dump, because the appellant still received 50% of the profits of the joint venture with D Company. He explained that 50% of the C Mining Dump was sold to D Company for R1.3 million, and that this amount was included in the taxable income of the appellant.

(30) When Mr. X became involved in appellant's affairs he explained to him that the C Mining Dump that had actually not been sold. He wrote a letter to the respondent explaining the situation.

(31) The appellant was entitled to a 3.5% management fee from the L Consortium based on operating profits monthly production amounts were reflected in the appellant's financial statements because the payments were received after a four month cycle. It was impossible to predict what the amount payable would be in four months time because of the variables.

(32) For all the relevant tax years in question, he was the only director. Everything revolved around him. He interacted with Mr. X. He updated him of the appellant's affairs and developments, but regarding the audits and income tax returns, he did not involve him. He provided Mr. X with copies of the appellant's tax returns and financial statements because through Company UK Mr. X was the appellant's major shareholder.

THE EVIDENCE OF MR. Z

(33) He was appointed as the appellant's auditor for the tax years 2003 and 2004. He had discussions with Mr. X concerning the appellant's financial affairs but his main contact reference was Mr. Y. Mr. Y signed the representation letter to the respondent confirming that the appellant's financial statements presented to the auditors were free of any mistakes.

(34) In the 2003 financial year the general ledger account reflected the purchase of E Mining (Pty) Ltd shares. It was presented to him that the appellant was incurring certain expenditure on behalf E Mining (Pty) Ltd, and that the loan account would be settled through the acquisition of shares. The entries specifically reflected that E Mining (Pty) Ltd shares were purchased. The summary of the fair value adjustment figure was reflected as R2 638 million.

(35) His firm's accounting treatment of the C Mining Dump sale and the E Mining (Pty) Ltd issue was not criticized by the appellant, because it was accepted that his firm had acted on information supplied by Mr. Y.

(36) The 2003 financial statements reflected a sale of 50% of the C Mining Dump ownership to D Company. In the 2004 financial year no correction or adjustment was made regarding this entry, consequently, he assumed the existence of the sale of the C Mining Dump to D Company. The comprehensive agreement between the appellant and D Company signed on 3 June 2003 was not brought to his attention.

(37) In 2004 E Mining (Pty) Ltd was insolvent, consequently its shares had no value and the recovery of the loan advanced to E Mining (Pty) Ltd was not feasible because E Mining (Pty) Ltd was in liquidation. The E Mining (Pty) Ltd loan was initially reflected in the 2003 financial statements. The 2004 financial statements still reflected the loan.

THE EVIDECNE OF MR. VD

(38) He was appointed as the appellant's auditor in 2005. He prepared appellant's financial statements and submitted the tax returns for the financial years 2004/2005/2006. He was involved in the responses to the respondent regarding the investigation of the appellant's tax affairs.

(39) He accepted the correctness of the transactions accounted for by his predecessors Q Auditors. Before responding to the respondent's queries he personally researched the nature of the transactions queried by the respondent.

(40) In 2004 and in dealing with the fair value adjustment of R2.638 million in respect of the loan to E Mining (Pty) Ltd, were of the opinion that the loan was not recoverable consequently, it was

written off in order not to overstate the value of assets in the balance sheet.

(41) The loan account in the amount of R2.638 million was made up of certain payments made directly to E Mining (Pty) Ltd, which the appellant disbursed towards salary and office expenses. It was necessary for direct expenditure to be debited to the loan account, and not to the expenditure account.

(42) At the time the transactions were made, and the manner in which actual payments were accounted for, the plan was to rescue E Mining (Pty) Ltd in return for its shares to redeem the expenses paid by the appellant.

(43) Regarding the C Mining Dump, Q Auditors worked on the assumption that there was a 50% sale of the dump for R1.3 million to D Company. Q Auditors used the figure of R1.47 million as the original base cost of the C Mining Dump and came to a capital gain of R1 719 229, which was included in the tax return.

(44) Q Auditors arrived at the sale figure of R1.3 million because there were two invoices issued in respect thereof amounting to R1.3

million. The money was paid into the appellant's bank account. The sale account was credited with R1.3 million, that account prompted Q Auditors to concluded that there was a sale of the C Mining Dump for R1.3 million.

(45) The transaction should not have been credited as a sale of C Mining Dump, it should have been credited as an investment in the joint venture account in the 2004 tax year in view of the agreement signed in 2003, but no such correction was made in the 2005 tax year. In the financial statements for 2004, 2005 and 2006, the C Mining Dump continued to be shown at the cost of R1 475 million.

(46) He accepted the balance sheet and the opening balances based on the Q Auditor's 2004 audited accounts and carried on from there. He did not correct the financial statements because at the time he prepared the accounts he had not researched this information and consequently had no reason to believe that it was incorrect. The correct information came to light in August or September 2006 when he started responding to the respondent's queries.

(47) The off-take rights acquired by the appellant from G Company and F Company on behalf of the L Consortium during 2003 were

ceded to the L Consortium as part of the appellant's capital contribution. From an accounting point of view, that transaction needed to be accounted for in the appellant's financial statements. At the time of the conclusion of this transaction there was no monitory value for the appellant.

(48) He knew of the four months late payment system regarding the management fees paid by the L Consortium to the appellant. There was a four months delay because there were too many variables, like the exchange rates, commodity values and quantities extracted. He accounted for the management fees as soon as the concentrate quantum became known. He issued invoices on a monthly basis to the L Consortium which were accounted for four months later.

THE EVIDENCE OF MR. HK

(49) He was formerly employed by the respondent and was responsible for raising the assessments in relation to all the issues on appeal. He was aware of the Memorandum of Disclosure from S Entity. The assessments raised did not rely on it. He made his own enquiries and investigations.

(50) He identified the sale of the rights to process tailings from the C Mining Dump, which were sold or transferred to the L Consortium for R8 million and the sale of 38% of the 25% share in the L Consortium to the share holders of L Co. UK. The audit process took over a year, because there were various issues in dispute. He invited the appellant to make submissions and comment on the conclusions he had reached.

(51) Meetings were held whereat the issue of overseas travel was discussed. Trips to Kazakhstan and Finland could not be allowed because the appellant's officers were basically pursuing or investigating new projects which had no relation to the appellant's ongoing business. The appellant agreed that these amounts should be added back. It was agreed to split the travel costs equally because the trips appeared to have a dual purpose, some appeared to be capital, some revenue while others had both elements.

(52) He informed the appellant that the respondent intended raising additional tax and penalties on 50% of the travel costs. The appellant refused to accept liability. The appellant's view was that since the issue of additional tax had not been raised at the meeting,

it was not prepared to agree to the fifty-fifty split the respondent suggested.

(53) Notwithstanding the fact that the appellant withdrew from the said arrangement, the respondent nevertheless awarded the 50% split. Although this exigency was not discussed, with the appellant the assessment appeared to be in fair. He allowed the appellant the 50% split because the respondent had agreed to it. The penalty imposed was reduced to 20%.

(54) The source documentation he relied on in raising the assessment, were the appellant's financial statements and the directors' reports. The E Mining (Pty) Ltd loan was shown as a loan in the appellant's audited financial statements. The directors' report stated that working capital advanced to E Mining (Pty) Ltd in terms of the rescue offer, was to be settled by E Mining (Pty) Ltd shares valued at four cents per share, although trading in these shares was suspended on the JSE.

(55) The E Mining (Pty) Ltd transaction appeared to be capital in nature because it was shown as a loan. E Mining (Pty) Ltd intended to settle the loan by issuing shares to the appellant. Salaries and

various office expenses incurred on behalf of E Mining (Pty) Ltd covering a two or three years period were debited to the appellant. The expenditure was shown as a loan in each year.

(56) In the 2004 financial statements the loan was reflected as having been written off. Had it been an expense it would have been written off each year. To him these entries proved that the expenditure was a loan, and not an expense. As a result 40% an additional taxes were imposed relating to the fair value adjustment, and an additional penalty tax set at 40% was imposed.

(57) In raising the assessment in respect of the disposal of 50% of the rights to the C Mining Dump to D Company, he relied on the tax returns and the agreements furnished by the appellant. In the letters in response to the respondent's queries, the appellant confirmed that there was a disposal of the 50% of the C Mining Dump to D Company. Initially the appellant agreed to the 50% disposal but subsequently disputed it. The appellant kept changing its version as to what actually transpired regarding this issue.

(58) It was put to him that in respect of the purported sale of sale of 50% of the C Mining Dump, new evidence was submitted to him

setting out the real facts surrounding the issue supported by various documentations that he failed to consider the new evidence. Further it was put to him that there was an explanation regarding the fair value adjustment, the write-off of the shares was incorrect, that actually the amount of the write-off in the loan account was actually in respect of salaries and office expenditure incurred by the appellant itself, yet he failed to take these explanations into account.

(59) He responded that it was significant that the fair value adjustment figure was shown as a loan in the audited financial statements. He was not persuaded by the appellant's explanation because these were merely views the appellant's officers had, which were not supported by any real hard documentary evidence. The fact is these amounts were not written off in each year.

(60) He applied ***Section 58 of The Act*** to the transaction, and determined that it was a deemed donation. ***The Act*** requires him to determine the fair market value of the asset, as at the date upon which the donation takes effect. He determined that the market value of rights sold on June 2006 to S Entity in terms of *clause 52*

of agreement between S Entity and Company UK was R26 847 million.

(61) It was put to him that R26 847 million figure he made use of to determine the fair market value of the rights, was the one used in that regard by S Entity, that the same applied in respect of the calculation of the Capital Gains Tax, in that, that figure referred to a sale transaction that took place more than one and a half years previously, at that time when the OP Consortium was not operating.

(62) Further it was put to him that he did not take into account that at the time there was an increase in the Platinum price, and did not take into account that there was a *quid pro quo* in that the appellant had undertaken to part with the 38% of its income in L Co.SA and in turn undertook to part with 62% of its income to the appellant, that this had a huge effect on the value of the transaction. There was actually no sale *per se*, what had occurred was, the parties retained what they had, the transaction was merely a re-routing of the parties dividends.

(63) He conceded that he was probably not aware of these facts, but stated that the appellant in its objection to the assessments should have brought up these issues, but did not. What the appellant contested was the fact that there should not be Donations or Capital Gains Tax at all.

(64) It was put to him that regarding the F and G Company transactions, the appellant obtained these off-take rights for the benefit of the OP Consortium. He responded that he determined that the value of the off-take rights was R8 million, because in their own agreement, the parties to the L Consortium credited the appellant with R8 million. In the L Consortium accounts the appellant's contribution is fixed at R8 million. In the L Consortium agreement there is no mention of the appellant's capital contribution.

(65)He agreed that R4.5 million management fees were disclosed in the financial statements of end of February 2006. The 3.5% management fees were payable four months after delivery of the concentrate. The management fee for February 2006 would be in respect of the production for October 2005.

(66) It was put to him that the L Consortium the financial statements reflected income that was actually produced four months earlier, that it was it necessary to make an adjustment, because there was a difference between the amount of money received and the amount accrued.

(67) He responded that regarding management fees he discovered that the L Consortium statements did not tie up with what had been shown in the appellant's financial statements, namely that in the actual payments received, no accrual was actually shown. He conceded the applicability of the four months cycle accounting principle.

THE RESPONDENT'S SUBMISSIONS

THE 2003 TAX YEAR – THE CAPITAL GAINS TAX IN THE AMOUNT OF R1 719.229 IN RESPECT OF THE ALLEGED DISPOSAL OF THE C MINING DAMP

(68) The respondent argues that the disposal of 50% ownership of the chrome tailing rights to D Company by the appellant as contemplated in ***Paragraph 11(1) of the Eighth Schedule to The Act*** for a consideration in the sum of R3.5 million paid by D

Company to the appellant, falls within the purview of ***Paragraph 11(1) of The Eighth Schedule to The Act*** which provides:

> *"Subject to subparagraph (2), a disposal is any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset, and includes -*
>
> *(a) the sale, donation, expropriation, conversion, grant, cession, exchange or any other alienation or transfer of ownership of an asset;….*
>
> *(b) ……..*
>
> - *and constitutes the transfer…of an asset;*
> - *the sale of an asset;*
> - *or the alienation of an asset pursuant to* ***paragraph 1 of the Eighth Schedule to The Act".***

THE APPELLANT'S SUBMISSIONS

(69) The financial statements were incorrect in so far as the C Mining Dump was alleged to be disposed to D Company. The agreement concerning this exigency was incorrect in so far as it related to the C Mining Dump disposal, so too was the letter appellant sent to D

Company confirming the disposal of the C Mining Dump. The financial statements were all based on these letters. It is a simple mishap, an innocent mistake made by the auditors and Mr. Y who signed the 2003 the audited financial statements.

(70) The appellant believed that D Company 50/50 upfront cost for the procurement of the C Mining Dump was R3.5 million. This is what caused the problem with the accounts. The appellant subsequently advised the respondent, how this error happened. The respondent refused to accept the explanation and stated that it relies on what is reflected in the audited financial statements;

FAIR VALUE ADJUSTMENTIN THE AMOUNT OF R2 638.070

THE APPELLANT'S SUBMISSIONS

(71) The appellant argues that the deduction of fair value adjustment is fully justified, albeit mistakenly claimed by way of an adjustment and/or a write off of a loan converted into shares and states that the reason for the mistake is fully set out in correspondence with the respondent and is mainly attributable to a loan account mistakenly created in its books by virtue of the rescue offer, and the inadvertent transfer, to such loan account of all salary

payments and office expenditure, incurred by the appellant in respect of the E Mining (Pty) Ltd staff.

(72)

(i) the respondent was provided with the necessary book entries and other documentary evidence, in proof of the appellant's assertions and was requested to adjust the appellant's claim accordingly, which it failed to do;

(ii) at the time of the relevant financial statements and tax returns, the appellant's acting Financial Director was completely unaware of the state of affairs and readily signed off the financial statement the correctness of the relevant notes and extract from the directors' report are denied by the appellant;

(iii) although the "*rescue offer*" made due provision for the provision of loan capital by the appellant, against the conversion of such debts into equities, such transaction never occurred. On the contrary, the said offer also made provision for the termination of services of E Mining (Pty) Ltd employees and the re-employment of such employees by the appellant;

(iv) the relevant loan in the appellant's 2003 financial statements, as well as the note and directors' report referred to, all emanated from an erroneously-created loan account in its books by its bookkeeper at the time;

(v) in terms of the respondent's amended Statement of Grounds of Assessment, it now contests the relevant deduction on yet another ground, namely on the basis that the deduction was claimed in the 2004 tax year, whereas the underlying expenditure has been incurred in the 2002 and 2003 tax years, as a result, of the respondent's reassessment the appellant is precluded from claiming the deduction in the 2004 tax year;

(vi) appellant contends that it is now entitled to claim such deduction retrospectively in the 2002 and 2003 tax years, due to the fact that the respondent's new reason for the disallowance of the claim, was not mentioned at the time of the 2004 assessment;

(vii) this omission prejudices the appellant in the exercise of its rights in terms of ***Section 81 of The Act*** under circumstances where the relevant assessments had not become prescribed;

(viii) at the time of the 2004 assessment, the appellant would have been legally entitled to file an objection, on submission of reasonable grounds for its failure to do so earlier;

(ix) the primary reason for the appellant's failure to claim the deduction in the years concerned, is due to the fact that, at that time, the appellant and its auditors were unaware of the true facts, which only came to light upon receipt of the 2004 assessment and the respondent's disallowance of the appellant's claim; consequently,

(x) the appellant argues that the above explanation for the delay constitutes "*reasonable grounds*" and it should be allowed to claim the deduction concerned in the 2002 and 2003 tax years.

(73) Q Auditors erred, firstly, in converting the loan account into E Mining (Pty) Ltd shares, as no such shares were issued and, secondly, the loan account was not a loan proper, as it did not comprise of moneys lent to or paid on behalf of E Mining (Pty) Ltd, but consisted of expenditure incurred by the appellant for its own account and purposes and was created in order to determine the quantity of E Mining (Pty) Ltd shares eventually to be issued in pursuance of the Rescue Offer.

(74) The so-called deductible expenditure was never expensed in appellant's income statement at the time, simply because objectively viewed, it was not and never was deductible expenditure. According to the appellant, because E Mining (Pty) Ltd's rescue offer never materialized the loan became irrecoverable.

(75) The deductible expenditure claimed to have been incurred, was incurred in the 2002 and 2003 tax years and not in the 2004 tax year. The write off of the loan was only done in the 2004 tax year. The 2004 tax returns which are alleged to have been incorrectly prepared by appellant's auditors have not been formally withdrawn and remain the only authoritative source of reference. Consequently, pursuant to the ratio enunciated in the case of ***New State Areas Ltd v CIR 1946 AD 610 14 SATC 155,*** money spent in creating or acquiring an income producing structure or source of profit is capital expenditure and is not deductible. Similarly, even if the money was spent in acquiring part but not whole of a business, the expenditure would be capital in nature and is not deductible.

(76) Based on the 2004 tax returns submitted to the respondent and accompanied by audited financial statements, although the deal did not materialize the purpose of the loan advanced to E Mining (Pty) Ltd was to acquire a significant shareholding in the latter's business. The purpose and intention at the time of negotiating the deal, is decisive in determining the deductibility or otherwise of the loan advanced.

(77) The loan amount in appellant's tax returns for the 2004 tax year is reflected under non-current assets and not in the Income Statement. This, beyond doubt, is indicative of the amount in question being on capital account as opposed to being on revenue account.

(78) Expenditure must be deducted in the year in which it is actually incurred. By failing to do so, the appellant forfeited its right to claim such expenditure in any other year. See ***Concentra (Pty) Ltd v CIR 12 SATC 95 at p.98***

(79) Money expended with the purpose of acquiring either the whole or part of business is capital in nature. The purpose of the deal between the appellant and E Mining (Pty) Ltd was intended that the appellant acquire the latter's business in a manner that

resembled a reverse takeover. Money expended by a taxpayer to achieve a reverse takeover is reflected on the capital account.

(80) A reverse takeover is tantamount to acquiring an income earning structure in that, if the reverse takeover materialized, the appellant would have generated additional income, and its income earning structure would have been enhanced to include another asset in the form of E Mining (Pty) Ltd. It is erroneous for the appellant to now require the respondent to recognize the expenditure in question as incurred in the 2004 tax year;

THE 2005 TAX YEAR – CAPITAL GAINS TAX AND DONATIONS TAX – THE DISPOSAL OF 38% INCOME SHARE HELD IN THE L CONSORTIUM ADD CAPITAL GAINS TAX R14 993 024 THE APPELLANT'S SUBMISSIONS

(81)The appellant argues that no liability for Capital Gain Tax and Donation Tax arise due to the fact that it did not dispose of any asset or property, but merely undertook to pay the minority shareholders' future income share to L Co. SA and to receive the

majority shareholders' future income share from L Co. SA, in facilitation of the share swop arrangement.

(82) The undertaking, which appellant was contractually bound to give, in terms of the share swop agreement, thus merely constituted a promise to pay an undisclosed amount in future, upon the happening of an uncertain event, which promise does not constitute an "*asset*" or "*property*", due to its contingent nature;

(83) Furthermore, such undertaking was not given "*for a consideration not measureable in money",* or for "*an inadequate consideration*", for the simple reason that it entitled the appellant to a 62% share of the future L income from L Co. SA, which is, in effect, the *quid pro quo* received by the appellant. In any event no consideration was intended due to the fact that both groups of shareholders already owned the said income rights;

(84) The "*disposal*" requirement is not satisfied, as both parties already owned the rights concerned and instead of the income accruing to them as dividends via the two UK Holding Companies, it would henceforth accrue as dividends from one of the said companies

only, therefore, only a different conduit is used to pass-on the dividends to them, namely L Company (UK).

(85) The transaction was not the sale or disposal of any asset but the acquisition by the majority shareholders of appellant's holding company (Company UK) or of the shares held by the majority (the 38 percent interest) thus acquiring full control over the appellant, but with the exclusion of the dividend rights attaching to such shares.

(86) The R8 million value attributed to appellant's contribution, in the L Consortium accounts, cannot be considered as the "*proceeds*" of such transaction as the transaction does not fall within the ambit of the Capital Gains Tax provisions of ***section 58 and paragraph 38 of the Eighth Schedule to The Act.***

THE RESPONDENT'S SUBMISSIONS REGARDING DONATIONS TAX IN RELATION TO THE APPELLANT'S 38% PARTICIPATION SHARE

(86A) Capital Gains Tax is levied, in terms of ***Paragraph 38 of The Eighth Schedule,*** on the "*disposal*" of an "*asset"* and where such disposal is for no consideration, ***Paragraph 38*** requires the proceeds to be determined at *"market value"* of such asset.

(a) In terms of ***Section 58 of The Act***, the Commissioner may deem a "*disposal*" of "*property*" as a donation when it has been disposed of for an "*inadequate consideration*";

(b) Consequently the appellant is liable for Donation Tax in terms of ***section 54 of The Act*** in respect of the said transaction as there was disposal of the appellant's 38% participation shares to L Co. SA for no consideration;

(c) In the absence of a *quid pro quo*, notwithstanding the intentions and motives of the parties to the transaction, the transaction is sufficient to attract Donations Tax because at the time when the transaction was concluded there was disposal of an asset for no consideration.

ADD DONATIONS TAX

THE RESPONDENT'S SUBMISSIONS

(87) the respondent argues that the appellant is liable for Donations Tax in terms of ***section 54 of The Act*** in respect of the said transaction as there was disposal of the appellant's 38% participation share to L Co. SA for no consideration. In the absence of a *quid pro quo,*

notwithstanding the intentions and motives of the parties to the transaction, the transaction is sufficient to attract Donations Tax.

(88) The respondent argues that the appellant's 38% participation right in the L Consortium was an unconditional personal right which constituted an incorporeal asset, part of which was disposed of for no consideration, thus bringing the transaction within the scope of ***Para 38 of The Act,*** as being an "*asset disposed for*" "*a consideration not measurable in money".*

(89)The respondent argues that the purpose and aim of the transaction, (a promise to part with 38% of L Consortium income stream) need to be determined not in isolation but by an analysis of the underlying Share Exchange Agreement between the appellant and L Co. SA.

THE RESPONDENT'S SUBMISSIONS CONCERNING THE 2005 TAX YEAR-DISPOSAL OF CHROME TAILING RIGHTS BY THE APPELLANT TO THE L CONSORTIUM IN RETURN FOR A CONSIDERATION OF R8 MILLION.

(90) The respondent contends that the mineral rights acquired from G Company and F Company were acquired for no consideration as

there was no capital outlay made by the appellant when the mineral rights were acquired.

(91) The mineral rights and or intellectual property rights contributed to the L Consortium by the appellant were shown on its balance sheet as an asset which was used exclusively in the business of the consortium, consequently, there was transfer of an asset by the appellant to the L Consortium pursuant to ***clause 7.1 of the Notarial Consortium Agreement*** which provides as follows:

> *"The object and purpose of which the consortium is established, shall be to – (7.1.1) acquire the right to mine and/or take ownership of the consortium minerals";* and

clause 8.2.2 provides as follows: *"It is recorded that GB Mining has, as at the effective date, contributed to the Consortium, certain mineral rights and intellectual property which shall, together with the GB Mining contribution, comprise GB Mining's aggregate initial cost…"*

(92) The respondent contends that the appellant by divesting itself of an asset in favour of the L Consortium in circumstances where the latter uses the asset and contributes it for commercial purposes,

there was transfer of an asset (mineral rights and intellectual property) from the appellant to the L Consortium, "*there was a disposal of a right…*".

if it is accepted that the object and purpose of the L Consortium was to acquire the rights to mine and/or ownership of the said minerals, it is obvious that in essence, the Consortium became the transferee while the appellant became the transferor of the said mineral rights.

The Accrual of Management Fees

The Appellant's Submissions

(93) In terms of the L Consortium Agreement the appellant became entitled to a Management Fee of 3.5% of the consortiums net operating profit before tax which;

(a) could only be determined once payment was received by the L Consortium in respect of the sale of the "*Consortium concentrate*", in terms of off-take agreements concluded with BA Holdings and J Holdings. The agreements provided for payment on the 10 day of the fourth month following the delivery of the concentrate;

(b) the delayed payment was due to the fact that the platinum bearing metal content of the concentrate, its basket price,

chrome penalties and the relevant exchange rates, could only be determined by the L Consortium as at the date, after the net income became known, on which the royalty was to be calculated. This is clearly evidenced by L's Production Sheet for the period March 2005 until May 2006.

(c) It is quite evident that the accrual of the Management Fees only accrued once the L Consortium's net income was determined, on which such fees could be calculated; and

(d) the Management Fees income was duly disclosed in the appellant's financial statements for the 2007 financial year and cannot be taxed twice.

(94) The appellant argues that the respondent's argument that the Management Fees accrued as per the L Consortium's management accounts as at 28 February 2006 is without legal substance for the following reasons:

(i) the amounts shown in the said management account did not legally accrue as at end of February 2006 and only accrued four months later, but the accounts were prepared subsequent to June 2006 with retrospective effect; and

(ii) the relevant accounts were prepared for management purposes only and thus have no legal standing *vis a vis* third parties.

(95)The respondent's inclusion of the amount of R368 167 in the 2006 year of assessment is contrary to the "*accrual*" principle because the appellant did not acquire an unconditional legal right to claim payment of a determinable amount. ***Lategan v CIR 1926 CPD 203, 2 SATC 16; CIR v People's Stores (Walvis Bay) (Pty) Ltd 1990 (2) SA 353, 52 SATC 9***

(96)The respondent erroneously based the inclusion of the additional amount in taxable income on information as detailed in Management Accounts of the L Consortium compiled after the end of the 2006 financial year when the information became available

(97)The evidence however shows that at the end of the financial year it was impossible to determine the amount to be received as management fees relating to the production during the last four months of the year because this information only became available during the 2007 tax year and the amounts were declared in the 2007 tax year consequently the taxation of the amount in the 2006

tax year will therefore result in double taxation.

THE RESPONDENT'S SUBMISSIONS

(98) The financial statements of the L Consortium reflected the sum of R615 316.00 as the total of management fees received by the appellant in the 2006 tax year. The appellant on the other hand only reflected the sum of R247 149.00 as the management fees received from the L Consortium in the 2006 tax year.

(99)The respondent contends that as the appellant became unconditionally entitled to the sum of R615 316.00 in the 2006 tax year, the whole amount ought to have been included in appellant's gross income in the 2006 tax year on an accrual basis and not in the 2007 tax year.

(100)The appellant's contention that the information required for the determination of Management Fees only became available after the 2006 tax year has no merit, such information became available during the 2006 tax year.

(101)The Financial Statements of the Joint Venture (Consortium) in no uncertain and unequivocal manner reflected the determinable

amount payable to the L Consortium partners in proportion to their interest held in the consortium covered the period commencing 1 March 2005 to 28 February 2006. The total amount accrued and was received by the appellant to is the sum of R615 316.00, and not R247 149.00 as disclosed by the appellant in its tax return for the 2006 tax year.

(102) The respondent argues that the fact that any omission, default or the making of incorrect statements was due to the appellant's accountant is no defence, the appellant is ultimately responsible for its own tax affairs.

Ad Penalties in respect of Section 76 of The Act

(103) ***The Section*** provides for penalties in respect of the following transgressions in regard to tax returns:

(a) the failure to render a tax return;

(b) the omission of an amount of income from such return; and

(c) the making of an incorrect statement which may result in tax evasion.

(104) The respondent may request in terms of ***Section 74A,*** further information, or explanation of any amount and information disclosed in such return which he wishes to query, as part of the assessment process.

Such supply of additional information will only serve as ground for imposition of penalties if it proves certain statements in the return to be incorrect, the acceptance of which may have resulted in tax evasion.

(105) **Ad Capital Expenditure – R6 122 435**

The appellant contends that since the L Consortium incurred an amount of R24 489 741, in respect of the construction of its processing plant, the appellant's share of which came to R6 122 435 qualifies for deduction in terms of ***Section 36 of The Act.***

(106) In the present instance all transactions which had tax consequences have been duly disclosed in the relevant tax returns and although the C Mining Dump transaction and Fair Value Adjustment have been incorrectly described, the respondent's acceptance of such errors would not have resulted in any tax evasion.

(107) As a matter of fact, in the case of the C Mining Dump additional taxes in the form of Capital Gains Tax were erroneously tendered, whilst in the case of the Fair Value Adjustment the amount of the deduction claimed remained claimable despite the error, thus not having any possible tax consequences. Consequently Q Auditors should have claimed the amounts concerned as a deductable expenditure in the 2003 and 2004 tax years, instead of in the 2004 tax year only.

(108) **Ad Donations Penalties and Interest**

Penalties

(i) The appellant contends that the respondent's discretion to apply the provisions of **Section 58,** by regarding the transaction concerned as a deemed donation, does not entitle him to raise penalties for an alleged failure to submit a Donation Tax return as a taxpayer cannot be expected to know beforehand the decision of the respondent in that regard.

(ii) Furthermore, the decision concerned raises questions of law to be ruled upon by a court of law, and therefore by the imposing of a penalty the respondent postulates that its interpretation and application of the law are unassailable and the only possible interpretation.

(109) **Interest**

(i) ***Section 89(2)*** imposes interest if tax is not paid in full within the period specified in the assessment notice, or within the period prescribed by ***The Act.***

(ii) under ordinary circumstances, Donations Tax is payable within 3 months "*from the date upon which the donation…takes effect"* ***(Section 60).***

(iii) where ***Section 58*** is applied, the deemed donation only "*takes effect*" on date of the assessment notice.

(110) The appellant argues that the respondent in raising interest retrospectively creates an anomalous situation, in that it becomes entitled to interest in respect of taxes not legally due at the time of the transaction concerned.

THE RESPONDENT'S SUBMISSIONS CONCERNING THE IMPOSITION OF ADDITIONAL TAX

(111) The respondent contends that ***Section 76(1) of The Act*** applies equally to all issues that constitute the basis of the present tax appeal as there was either; a default on omission or the making of incorrect statements. If any of the above elements are present the

appellant is obliged to pay additional tax, being an amount equal to twice the difference between the tax calculated in respect of the taxable income returned by it.

(112) ***Section 6(2)*** grants it power to exercise a discretion informed by considerations such as extenuating circumstances, the intention to evade tax, and any other relevant consideration. The fact that the quantum of additional taxes ranges between 10% and 40% is indicative of the fact that its discretion is with due regard to all relevant considerations.

(113) The respond further argues that the fact that any omission default or the making of incorrect statements was due to the appellant's accountants is no defence. The appellant as the taxpayer remains ultimately responsible for its own tax affairs.

(114) The respondent contends that, the fact that the quantum of additional taxes ranged between 10% and 40% is indicative of the fact that the respondent exercised its discretion with due regard to all other relevant considerations.

The alleged disposal of F Company/G Company rights

(115) The appellant in terms of the National Consortium Agreement secured off-take agreements with the chrome mining companies F Company and G Company, on behalf of the L Consortium.

(116) These agreements provided for the delivery by both companies of their chrome-waste tailings by pipeline to the L Consortium Plant, against payment of a royalty, based on actual platinum recovery and sales, as well as removal of such tailings material from the G Company Dam.

THE APPELLANT'S SUBMISSIONS

(117) Prior to the conclusion of the agreements concerned it was understood by all parties concerned that the said material would be delivered to the L Consortium and that the agreements would be concluded on its behalf. A formal assignment of the rights was made on 2 June 2005, with due notice to the parties concerned.

(118) The assignment of these rights did not constitute the "*disposal*" to the L Consortium of any "*asset*" for Capital Gains Tax purposes, because the agreements were acquired on behalf of the L Consortium and were negotiated by the appellant as part of its

"*capital contribution*" to the L Consortium, in which it held a 25% interest.

(119) The appellant argues that no disposal of "*assets*" occurred which could be taxed for Capital Gains Tax purposes because the appellant acquired the rights concerned as agent for the L Consortium, and secondly the rights so acquired was part of its capital contribution towards the partnership which constituted the L Consortium.

THE RESPONDENT'S SUBMISSIONS

(120) The respondent contends that the mineral rights acquired from G Company and F Company were acquired for no consideration as there was no capital outlay by the appellant when the mineral rights were acquired, yet the mineral rights and or intellectual property contributed to the L Consortium by the appellant were shown on its balance sheet as an asset, used exclusively in the business of the L Consortium. Consequently, there was indeed transfer of an asset by the appellant to the L Consortium.

(120A)(a) The respondent contends that a right to share in the net operating profits produced by the L Consortium is an asset capable of being transferred from one person to the other;

(b) ***Clause 3,*** of the L Consortium founding agreement provides: "*As from the effective date, L Co SA will be deemed to have acquired a 38% share in the Participation Share"*. *Clause 3.2* further makes provision for the 38% share as follows: "*In as much as the consortium agreement provides for pre-emptive rights in favour of the consortium participants and that the consortium participants were not prepared to waive their pre-emptive rights, the parties acknowledge that for all purposes of the relationship between them, L Co SA will be regarded as a 38% owner of the Participation Share;*

(c) The respondent submits that on interpretation of the clauses referred to above, it is clear that the transfer of an asset from the appellant to L Co. SA eventuated and was achieved;

(120B) In terms of ***Para 33(3)(b) of the Capital Gains Tax Provision*** the tax is not imposed in circumstances where only the use of the asset is transferred, but ownership is retained;

(a) as the rights concerned were acquired by the appellant as the agent for the L Consortium, no formal transfer was necessary as the L Consortium had already acquired ownership by way of operation of law;

(b) It follows that irrespective of whether the appellant had acquired the relevant off-take rights as an agent for the L Consortium, or for its own account, they were contributed to the L Consortium in both instances as part of its capital contribution and a twenty-five percent share was retained as co-owner thereof;

(c) Therefore, a partner's capital contribution to a partnership cannot be regarded as "*the disposal of....any asset*" for Capital Gains Tax purposes, in respect of which *"proceeds"* are received for the following reasons:

(121)***Section 11(a) of The Act*** provides 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 – (a) expenditure and losses*

actually incurred in the production of income, provided such expenditure and losses are not of a capital nature;…"

(122)The pre-eminent and principal test for the capital or revenue nature of expenditure or loss is the enquiry whether it should properly be regarded as part of the cost of performing the income earning operations of the taxpayer, in which case it is of a revenue nature, or as part of the cost of establishing or enhancing or adding to the taxpayer's income earning structure….in which case it is of a capital nature. ***See Emslie et al, Income Tax – Cases and Materials 2nd edition p. 343, New Areas Ltd v CIR 1946 AD 610, 14 SATC 155***

<u>THE RESPONDENT'S SUBMISSIONS REGARDING OVERSEAS TRAVEL</u>

(123) The respondent contends that:

(a) as the reasons for the travel are closely linked to growing the appellant's business the overseas travel expenditure fell to be treated as capital expenditure; and

(b) the overseas travel expenditure sought to be deducted is capital in nature in that such

expenditure was more attached to the cost of establishing, enhancing or adding to the appellant's income earning structure as opposed to being attached to the cost of performing its income earning operations.

(124) The respondent's contention regarding the appellant's overseas travel expenses is that the overseas travel expenditure was attached to the cost of "*establishing, enhancing or adding to*" the appellant's income-earning structure. Consequently, insofar such expenditure related to the raising of working capital, it forms part of the cost of performing its income-earning operations and therefore constituted an allowable deduction in terms of ***Section 11(a) of The Act.***

2003 – 2006 TAX YEARS DEDUCTION OF OVERSEAS TRAVEL EXPENSES R393 725.00

(125)The respondent contends that the overseas travel expenditure sought to be deducted is capital in nature in that such expenditure was more attached to the cost of establishing, enhancing or adding to its income earning structure as opposed to being attached to the cost

of performing its income earning operations. The reasons given for travelling overseas were invariably given among others as follows:

(i) establishing of a new office in London;

(i) investigate the possibility of a listing.

<u>THE APPELLANT'S SUBMISSIONS</u>

(126) Because the reasons for the travel were more closely linked to growing the business of the appellant the overseas travel expenditure fell to be treated as capital expenditure. Consequently, the expenditure is fully deductible under ***section 11(a) of The Act*** as being incurred in the production of the Company's income.

See: CSARS v Creative Productions (Pty) Ltd 61 SATC 106

<u>The 2004 Tax Year – The Fair Value Adjustment</u>

(127) The respondent contends that the amount of R2 638 070 is not deductible in terms of ***section 11(a) of The Act*** because the appellant proffered two different versions to the respondent regarding the circumstances which led to the accrual of expenditure/loan advance as the "*Fair Value Adjustment.*"

(128) The first version contained in the director's report in the 2004 financial statements, in Note 4 to the 2004 financial statements reads as follows: *"Loan Account – E Mining Loan: "….The results of the company were adversely affected by a write off of the R2 638 070.00 investment in E Mining (Pty) Ltd";*

(i) the appellant's 2004 tax returns, more fully amplified in a letter from the appellant's representative dated 12 June 2009, stated: "*The rescue operation, envisaged for E Mining (Pty) Ltd at the time, was to inject loan capital and to transfer business assets to the company, so as to strengthen its balance sheet, in order to apply to the JSE for a relisting of its shares…..thus recapitalizing the company in order to continue its mining activities";*

(ii) the respondent contends that the so-called deductible expenditure was never expensed in appellant's Income Statement at the time, simply because objectively viewed: it was not and never was deductible expenditure;

(129) The second version more fully set out in appellant's letter dated 29 July 2009 is as follows: " *(appellant) made a "Final Rescue Offer"*

to the shareholders of E Mining (Pty) Ltd, which offer was in effect a reverse take over of E Mining (Pty) Ltd and entailed, inter alia, the immediate payment of certain creditors by (appellant), the takeover of its key personnel....".

(130) The respondent contends that:

(i) the rescue offer never materialized as the Financial Services Board declined to approve the offer, consequently, the loan became irrecoverable;

(ii) the deductible expenditure claimed to have been incurred in terms of the second version was incurred in the 2002 and 2003 tax years and not in the 2004 tax year. The write off of the loan was only done in the 2004 tax year;

(vi) the 2004 tax returns which are alleged to have been incorrectly prepared by the appellant's accountant have not been formally withdrawn and remain the only authoritative source of reference, consequently, pursuant to the ratio enunciated in the case of ***New State Areas Ltd v CIR 1946 AD 610 14 SATC 155,*** money spent in creating or acquiring an income

producing structure or source of profit is capital expenditure and consequently not deductible;

(viii) similarly, even if the money was acquired as part and not the whole of the business, the expenditure would be capital and not deductible;

(v) in law expenditure must be deducted in the year in which it is actually incurred, by failing to do so, the appellant forfeited its right to claim such expenditure in any other year. See ***Concentra (Pty) Ltd v CIR 12 SATC 95 at p.98.***

THE ANALYSIS OF EVIDENCE

(131) In the evaluation of facts and issues in dispute, the court is guided by ***section 82 of the Income Tax Act No 58 of 1962 ("The Act").***

"*The burden of proof that any amount is –*

(a) exempt from or not liable to any tax chargeable under this Act; or

(a) subject to any deduction, abatement or set off in terms of this Act; or

(b) To be disregarded or excluded in terms of the Eighth Schedule. Shall be upon the person claiming such

exemption, non-liability, deduction, abatement or set off, or that such amount must be disregarded or excluded, and upon the hearing of an appeal from any decision of the respondent, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong".

(132) *Disposal by the appellant of 38 percent of the 25% participation share in the L Consortium earnings to L CO. SA Add CGT*.

Paragraph 38 of the Eight Schedule is not applicable due to the fact that:

(a) The transaction was in the form of a multi-party agreement between two groups of shareholders and their companies, which entailed the exchange of assets of equal value and was thus unproductive of any capital gain;

(b) The parties were not "*connected parties*" after completion of the share swap exercise, which was specifically designed for such parties to become fully disassociated and was completely at arms' length and for an equitable consideration;

(c) There was no disposal of any "*asset*", as the undertaking by appellant to pay part of its after-tax income, from the L

Consortium, upon the happening of an uncertain future event, merely constituted a promise to pay, which did not constitute an "*asset*", and in the hands of the recipient it merely constituted a "*spes*", namely, a hope, or expectation to receive something in future;

(d) The undertaking to pay an undisclosed amount in future, contingent upon the happening of an event, does not have an ascertainable market value, nor can it be treated as having been received or accrued.

(133) Even if the transaction could be regarded as a Capital Gains Tax event, (which it is clearly not), the respondent's determination of market value, in any event, has no scientific basis and is not supported by any relevant information or expert opinion.

(134) On the contrary, it is completely ignores the following important factors, namely that;

(i) the appellant did not dispose of 38% of its participation right in the L Consortium, as its members failed to waive their pre-emptive rights, as provided for in the Notarial Consortium Agreement

and consequently failed to consent to the transfer of those rights to L Co. SA;

(135) On the contrary, the appellant merely promised to pay, in future and after tax, 38% of the amount received from the L Consortium, if any.

(136)(i) the Sale of shares and loan accounts in Company UK, the consideration for which, was used as basis for the respondent's valuation, occurred 17 months after the transaction in issue, when the L Consortium had already been fully operative and the platinum price had increased dramatically;

(ii) it was put to Mr. X that prior to this arrangement, that full 25% resided in the appellant, it was dividend stream that was moved from the appellant to L Co. SA, consequently, there was a transfer of something. He responded, that it never happened, because no dividends ever came out of L Consortium, only 3.5% management fees came into the appellant from the L Consortium;

(iii) after the split the appellant remained with 100% of the income stream, 3.5% of the management fees that is what

the unbundling achieved. The shareholders were in the same position as they were when they started. Everything was housed in the appellant, all the other parties still had an interest but indirectly;

(iv) it was put to Mr. X that he is saying that all these agreements were allowed just for one reason because L Co. SA would not be accepted as a member of the L Consortium. He responded that the appellant's interests in respect of the L Co. SA were waived in favour of L Company (UK);

(v) the agreement between the Grey shareholders which is L Company (UK) and Mr. X shareholders in IM UK has nothing to do with the L Consortium. The 38% participation share still resided in the appellant. Prior to the unbundling of the appellant, it owned 25% of the L Consortium. It was put to Mr. X that any asset contributed towards the L Consortium became its property;

(vi) further it was put that the contribution made by the appellant to the L Consortium for all intents and purposes became the property of the L Consortium and was accounted for as such. He responded that the appellant owned 25% of the L Consortium, it was its asset, the L Consortium is made up of

three entities, 25% belonged to the appellant are it gets taxed, and thereafter it's paid out as a dividend. The shareholders are in the same position as they were from day one, they receive their dividends, consequently it is not an income stream;

(vii) it was put to Mr. X that L Co. SA has 38% of the participation share, its actual entitlement is to 38% of the net income derived by the appellant from its 38% participation share, which is actually the share in the L Consortium, that it therefore it cannot be a dividend, as it was a share of net income and not a dividend, because the L Consortium was not a separate legal entity and does not pay a dividend;

he responded that basically the net income derived from L Consortium is distributed to the participating parties, when it gets back to the appellant, it is accepted as income and is thereafter taxed and then a dividend is distributed. The 25% ownership of L Consortium belongs to the appellant, 38% it is a dividend. It was put to Mr. X that the 38% is profit and was not a share because it is the 38% of the profits accruing from the L Consortium after being distributed to the participants, that the appellant receives 25% of those profits, then it goes out as dividends as 38% to the shareholders. He

responded that no profits were ever distributed by the time he joined the appellant

<u>The agreement regarding the 38% profit distribution</u>

The contentions:

(137) The Respondent contends that the transaction in which the appellant disposed of 38% of its participation in the L Consortium was a donation taxable under ***section 54 of The Act.*** The appellant contends that in fact no asset or property was disposed of as the appellant merely undertook to pay (the former) minority shareholder's future income to that entity's South Africa entity L Co. SA.

The Evidence:

(138) At the outset it should be stated that neither the appellant nor the respondent clearly articulated the facts prevailing here. It would appear that prior to this transaction;

(a) the appellant's shares were wholly held by a UK entity, IM UK;

(b) 62% of IM UK's shares were held by the so-called Mr. X shareholders and 38% by the so-called Grey shareholders; and

(c) the appellant in turn held 100% of the rights to the so-called L Consortium joint venture;

(d) at the same time, there was another South African entity, in existence LK SA, with a somewhat parallel set of circumstances and whose LK SA's shares were wholly held by a UK entity, RS UK;

(e) 38% of IM UK's shares were held by the so-called Mr. X shareholders, and 62% by the so-called Grey shareholders; and

(f) LK SA in turn held 100% of the rights to the so-called L Consortium joint venture.

(139) In terms of the reciprocal transactions, each minority shareholding party gave up these minority shares to the existing majority. The majorities thus become 100% shareholders. At the same time, the subsidiaries each disposed of a corresponding minority interest in their joint ventures.

(140) In consequence of this, the broad underlying economic interests of the two groups of shareholders remained similar in that each group previously had an economic interest in the other's venture via cross shareholdings in the UK gave up these crossholdings in exchange for a direct holding in each other's ventures via a direct interest awarded to their respective South African subsidiaries.

(141)In the court's view, for the appellant's disposal of 38% of its participation in the L Consortium joint venture to have been a donation under ***section 54 of The Act,*** the disposal must have been for an inadequate consideration, or for no consideration at all, the latter being the contention of the respondent. There was in fact a consideration, in that the appellant acquired a 62% interest in the second joint venture as a *quid pro quo*, something the respondent seems to have lost sight of.

(142) The inference of the interlinking of the transactions between the parties was that the value of the rights given up by each party was similar to the rights received, although no evidence was led on this point. However, the respondent's contention was that there was no consideration at all, which is clearly incorrect, rather than on the valuation of the consideration. Consequent, the court's

finding is that the respondent has failed to show that there was a donation as envisaged in terms of ***section 54 of The Act,*** consequently the appellant's appeal is upheld regarding this issue.

WITNESSES – CREDIBILITY

MR. X

(143) Of the witnesses who gave evidence, it is our view the evidence of Mr. X was an unreliable witness who although he was the main moving spirit of the appellant's affairs as its major shareholder through Company UK feigned ignorance of its financial affairs and only averted to issues which were not substantiated by the appellants documents. On numerous occasions, he asked the court to disregard positions set out in written documents (comprising agreements, correspondence, annual financial statements and tax returns, amongst others), on the basis that the positions he expounded were correct, in contrast with these documents.

(144) In the case of a large corporate group with many senior executives involved in decision-making, it is possible that different executives might have differing interpretations of corporate documents, but in this case this situation did not prevail. The witness was at all times one of the prime decision makers (and arguably was the prime decision maker for most of the period in

dispute) of the group of the entities in which the taxpayer company resided.

(145) Furthermore, while Mr. X was ostensibly not an executive of the taxpayer company, the appellant was the major asset of Company UK the group, Mr. X was involved in. For most of the period in dispute the appellant's important decisions were taken when Mr. Y was the only director who was (by his own admission) not suitably qualified to act as the appellant's Financial Director or Public Officer, and such decisions were not actually known by the latter, but were curiously explained by Mr. X who was ostensibly not involved in the appellant's affairs and seemed to be only peripherally involved in the appellant's decision-making processes. The objective uncontroverted proven facts show that Mr. X was the appellant's prime executive mover and mind.

(146) In these circumstances, it seems highly likely that Mr. X was intimately aware of most if not all of the appellant's material documentation, including material agreements, correspondence, annual financial statements and tax returns despite Mr. Y's illogical improbable testimony to the contrary.

(147) Regarding the latter two items, the statement by Mr. X that, during the entire period covered by the dispute, he never at any time saw the appellant's annual financial statements (or the tax returns or tax calculations) is simply not credible, given that the appellant was the Company UK group's primary asset. The denial by Mr. X of such a critical point inevitably calls into question the veracity of almost all material aspects of his evidence.

F Company / G Company off-take rights

The contentions:

(148) The respondent contends that the appellant disposed of the chrome tailings rights to the L Consortium for a consideration of R8 million. The appellant contends that the rights in question were acquired by it on behalf of the consortium, consequently, no disposal occurred; and in any event, there was no transfer of ownership *per se*, as the appellant was one of the partners in the L Consortium, and thus retained co-ownership; further, the rights had no commercial value, but merely comprised contingent rights and this did not constitute property, and finally that the appellant's contribution to the L Consortium was not these rights at all, but was (at least partly) for services, namely the undertaking to negotiate a source of supply of new feed-stock for

the L Consortium, which (it was contended) itself had no commercial value.

The Evidence:

(149) ***Clause 17.1.1 of The "Notarial Consortium Agreement"*** concluded on 20 October 2003 between the parties establishing the L Consortium provides that its first object and purpose is to "*acquire the right to mine and/or take ownership of the L Consortium minerals".*

(150) In turn in **clause 1.2.23** "*Consortium minerals*" are defined as collectively the D Company/G Company minerals (ie. the relevant minerals to which D Company is the holder of the rights, per ***clause 1.2.5***), the AB Mining/G Company minerals (ie. the relevant minerals to which AB Mining is *entitled to* in the relevant area, per ***clause 1.2.35***), the F Company minerals (ie. the relevant minerals to which AB Mining, D Company and J HOLDINGS *are the holders* of the rights, per ***clause 1.2.13***) and the G Company/J Holdings tailings (ie. the tailings dump situated within the G Company mining area, containing minerals to which AB Mining was the holder of the rights, per ***clause 1.2.61***).

(151) Furthermore, ***clause 2.1*** states clearly that the appellant has, prior to the execution date, negotiated with all the relevant parties to obtain the right to mine and/or take ownership of the three classes of rights referred to above, namely the AB Mining/G Company minerals, the F Company minerals and the G Company/J Holdings tailings. The remainder of clause 2 refers to the mineral rights already held by D Company, and then goes on to state that the parties have agreed to conclude a transaction whereby the Consortium would obtain the right to mine and/or take ownership of the Consortium minerals, construct and commission the plant, produce concentrate, sell this concentrate, appoint D Company to manage and operate the plant, and that the parties to the Consortium shall participate in the net operating profit in accordance with their participation interests.

(152) ***Clause 1.2.39*** of the agreement provides that each of the parties shall make "*initial capital cost contributions*" to the capital costs of the Consortium incurred in the construction and establishment of the plant. In the case of two of the Consortium partners, this contribution was expressed as cash contributions, with D Company share being R16 million and U Holdings an estimated Sterling equivalent of R8 million, amounting to some £615 000.

(153) In the case of AB (Pty) Ltd (the appellant), this contribution was expressed in ***clause 8.2.2 and 8.1.3*** as a combination of "*certain mineral rights and intellectual property*" together with an undertaking to inject cash to the extent that the contribution actually received from one of the parties (U Holdings) was less than R8 million.

(154) Given that ***clause 1.2.49*** pursuant to the partnership interest ratios were set at D Company 50%, AB (Pty) Ltd 25% and U Holdings 25% it is clear that the combined initial capital cost contributions (for 100%) totaled R32 million.

(155) In the courts view, there is no contemporaneous evidence that the relevant rights acquired by the appellant were acquired on behalf of the L Consortium. It would have been a simple matter for the parties to have mentioned this salient fact in the Notarial Consortium Agreement and further to record a refund of these costs to the Appellant, than require that the appellant make a R8 million cash contribution to the Consortium, in the manner proportionately applied to the other two partners. This simple recordal did not occur.

(156) The inescapable conclusion is that, while the appellant (and possibly the other parties) might have envisaged that these rights would, if agreement could be reached, be exploited in the L Consortium, the appellant took the sole risk in acquiring these rights, and never had any claim on the other parties prior to the conclusion of the Notarial Consortium Agreement. In short, Appellant acquired these rights solely on its own account and for its own account.

(157) This raises a further question. When these rights were acquired by the L Consortium, the appellant exchanged a 100% interest in these rights for a 25% interest in the L Consortium which now owned these rights. Clearly, the appellant disposed of an asset, but what was the value of the asset received in return? No evidence was led as to the market value of the L Consortium at the time the agreement was concluded, but an inferred value exists. This follows from the fact that the other two partners agreed to spend up to R24 million in aggregate (their initial capital cost contributions) without the appellant being required to incur any cost.

Mr. Y

(158) He was the sole director of the appellant during most if not all of the period covered by the dispute. He was (by his own admission) not suitably qualified to act as the appellant's Financial Director or Public Officer, or its *de facto* chief executive officer. He was peripherally involved in the appellant's decision-making processes despite contrary assertions, the objective proven facts show that he deferred to Mr. X, the major shareholder of Company UK, the appellant's 100% share holder concerning the appellant's major decisions. While his evidence was largely credible, his ostensible tendency to abrogate his responsibilities as a director to others (the auditors, in matters financial, and Mr. X in almost all other material matters) calls into question the value of his evidence.

Mr. VD

(159) He was appointed the appellant's auditor after the resignation of Q Auditors. He was a credible witness.

Mr. Z

(160) He was the Q Auditors audit partner most involved in dealing with the appellant's annual financial statements and tax returns

during the period Q Auditors were the appellant's auditors. He was a credible witness.

Mr. HK

(161) He was the respondent's official most involved in dealing with the appellant's tax returns and representations. He was a credible witness who conceded vital aspects in favour of the appellant.

The C Mining Dump / Tailings rights

The contentions:

(162) The Respondent contends that certain chrome tailings rights relating to the C Mining Dump were disposed of by the Appellant to D Company. The Appellant contends that these rights were not disposed of at all, but were simply made available for joint exploration by Appellant and D Company in a joint venture which terminated after seven months.

The evidence:

(163) An option over the Dump rights (together with prospecting rights) was acquired by Appellant on 7 March 2001. In the event of the

option being exercised, the consideration was set at R2.4 million in cash and certain E Mining (Pty) Ltd shares and options, apparently valued at some R0.55 million, thus totaling R2.95 million.

Mr. X attempted to sell 50% of these rights to D Company. In fact, Appellant's Public Officer Mr. Y stated in a letter to the respondent dated 10 June 2008 that, prior to entering into the 7 March 2001 agreement referred to above, the appellant had entered into a verbal agreement with D Company in terms of which D Company would acquire 50% of the C Mining Dump and the mineral rights.

(164) Further letters by Mr. Y followed in 2008, referring to this sale to D Company as being a verbal contract with the sale taking place in February 2002 with D Company paying R3.5 million for its 50% ownership of which R1.3 million would be paid to the appellant, with R2.2 million being paid on behalf of the appellant to the C area's farmers (who were apparently still owed this amount in terms of the option contract).

(165) A great deal of rather vague and contradictory evidence was tendered by Mr. X regarding this purported apparent sale, but it

became clearer that by 8 February 2002 D Company was rather interested in an arrangement whereby it (or its subsidiary) would:

(a) pay a sum for the Appellant's expenditure on the development of the C Mining Dump to date; and

(b) would thereafter share in revenues and costs of mining the C Mining Dump on a 50/50 basis.

(166) This was evidenced in a fax sent by Mr. X to a certain Mr. P the chief executive officer of D Company. On 21 February 2002, Mr. X sent a further fax to Ms. P stating, "*As agreed with your goodself your 50/50 upfront cost for the procurement of the dump is R3 500 000.*"

(167) Mr. Y stated in a letter to the respondent on 23 June 2008 that, although the D Company sale agreement was signed on 20/21 February 2002 (which fell into the appellant's 2002 financial year ended February 2002) the transaction was only implemented and completed the following year because arbitration proceedings between the affected C area's farmers was only concluded on 23 May 2002.

(168) It is not clear whether this factor was relevant to the timing issue, as the arbitration arguably only affected the rights of the C area's farmers between themselves, *inter se*, and not the rights of the appellant in relation to the body of the C area's farmers. However, the benefit of doubt can be given to the appellant, which then assumes that the transaction should be accounted for in the financial and tax year ended February 2003.

(169) Respondent conceded that the transaction was on capital account, but contested the appellant's treatment of same in its 2002 Annual Financial Statements, both as to timing, and as to the figures therein reflected.

(170) On 27 November 2008, Respondent accordingly revised Appellant's 2003 tax return, to tax it on a capital gain of R859 915, made up of R3.5 million in proceeds, less R1.78 million (made up of 50% of the R2.95 million option price, plus 50% of subsequent related exploration costs).

(171) The appellant accepted this as far as the taxable gain was concerned, but objected to the penalties of 50% imposed on their

resulting cumulative taxable income (after taking into account an existing mining loss).

(172) Despite all of the above, the evidence of Mr. X, was that it was only in June 2003 that he "*finally*" became aware that D Company was not interested in an outright purchase of 50% of the C Mining Dump mineral rights information he apparently never conveyed to Mr. Y or the appellant's auditors until some time between 2 February 2009 at which stage the appellant was still indicating that a sale of rights *did* indeed take place on 12 June 2009 which date the appellant first contended that no such sale took place.

(173) In June 2003, following Mr. X's new understanding of the matter, an agreement was signed between the appellant, represented by Mr. X as evidenced by his signature to the agreement and D Company on 3 June 2003. This agreement dealt with the C Mining Dump tailings, and the formation of a joint venture to be established pursuant to an agreement known as the L Consortium project agreement. This L Consortium project apparently related to the Platinum bearing metals rights held by the Appellant in relation to the C farm, excluding the C Mining Dump rights.

(174) This agreement effectively provided for the appellant to deliver the C Mining Dump tailings to D Company's concentrate plant, whereat the material would be processed into concentrate, this concentrate to be sold to BA Holdings Platinum Ltd. The appellant was to be paid, for the tailings so delivered, 50% of the consideration paid by BA Holdings, less 50% of the operating costs. Operating costs and Capital costs were to be shared on a 50/50 basis between the appellant and D Company.

(175) The agreement further recorded a "*start-up contribution*" of R7 million, as an aggregate initial contribution made by the parties in equal shares, to facilitate the implementation of the transaction and the L Consortium project.

(176) The appellant's portion of the amount of R3.5 million was described as a contribution by way of time, expenditure and services rendered in establishing the L Consortium project and the tailings project. Appellant's counsel argued that this amount was a "*refund*" to the appellant. The appellant's argument is that no sale of rights ever took place, that the agreement of 3 June 2003 between the appellant and D Company merely provided for a joint

venture requiring the appellant to deliver tailings material, against payment for this material, with costs and revenues being split on a 50/50 basis, that consequently the R3.5 million contributed by D Company into the joint venture was merely a "*refund to*" the appellant in relation to its past expenditures.

(177) The Courts view is that given its adverse finding regarding the credibility of Mr. X, the significantly overwhelming documentary evidence (to which the appellant's sole director, and Public Officer, Mr. Y, the appellant's external auditors, were all parties extending from 2002 to as late as 2 February 2009 indicating that a sale of rights *did* indeed take place (the first contention by appellant to the contrary was only made on 12 June 2009) and the vagueness of the eventual agreement of 3 June 2003 as to the nature of the R3.5 million in question, the court's finding is that a sale of 50% of the C Mining Dump mineral rights for R3.5 million did in fact take place in 2003, in one or other form, either as an outright sale, or as portion of appellant's contribution to the joint venture.

(178) The injection by one party of 100% of an asset (intangible or otherwise) for a cash consideration into a joint venture in that

party only has a 50% participation is a disposal of 50% of that asset for such consideration. Although the agreement of 3 June 2003 is somewhat vague as to the treatment of the R3.5 million paid by D Company as its "*start-up contribution*", the fact that appellant repeatedly referred to or accepted the amount as being the proceeds on the sale of rights, the most recent such acceptance being on 2 February 2009, and in the light of the appellant's reference in court to this sum being a "*refund*".

(179) The appellant has not discharged the onus set out in ***section 82 of the Income Tax Ac***t, required to show that this amount is not liable to tax, or is to be disregarded or excluded in terms of the ***Eighth Schedule to The Act***. As to the imposed penalty of 50%, the court finds that the penalty was justified in the circumstances, given the difficulties the appellant's inconsistent disclosures posed to the respondent's efforts to establish the facts.

(180) It should also be noted that this penalty was not imposed on the gross tax liability of the appellant relating to this R3.5 million, but rather on to the appellant's net cumulative tax liability for 2003, after the set-off of other losses, resulting in a relatively moderate penalty.

(181) Finally, it is worth noting that, even if there was more reliable evidence that no sale of rights ever took place, and that the agreement of 3 June 2003 between the appellant and D Company merely provided for a joint venture, the fact remains that a sum of R3.5 million was contributed by D Company as a *"refund to*" the appellant in relation to past expenditures by the appellant. The evidence shows that this sum was received in part by the appellant itself, with the remainder being used to pay the option price owed by the appellant to the C area's farmers. As such, this was a beneficial receipt by the appellant is subject to tax as a capital gain or possibly even as a revenue gain, the latter being more onerous than the former. Consequently the appellant's appeal regarding this is dismissed.

The fair value adjustment

The contentions:

(182) The Respondent contends that the adjustment of R2 638 070 related to the write-off of the value of a loan the appellant made on capital account, and the resultant loss is of a capital nature. The appellant contends that the adjustment related to its own operating

costs in relation to staff and operations taken over from E Mining (Pty) Ltd, and that these cost were thus on revenue account, and deductible under the ***section 11(a)*** general deduction formula.

The Evidence

(183) An amount of R2 638 070 was incurred over a period, in relation to costs associated with an attempt by the appellant to rescue the financially parlous listed entity E Mining (Pty) Ltd with the apparent aim of achieving a listing for Appellant through a so-called reverse takeover. Mr. X's evidence on this matter was once again a mixture of vagueness coupled with unsubstantiated conjecture.

(184) Requests to clarify the aspects of these transactions as reflected in the appellant's tax return, and the nature of the loan in question were repeatedly referred by him to the company's auditors. Mr. X contended that all the funds making up the loan were spent on the appellant's own staff, offices and costs, and that the description of this expenditure as a R2 638 070 "*investment in OTR Mining Limited"* in the appellant's annual financial statements for 2004 was "*another error*".

(185) In answer to a question put to him from the bench on this point, Mr. X stated that he *never* looked at the appellant's annual financial statements, and that he was "*not involved*" in the compilation of the appellant's annual financial statements, despite the fact that Mr. X was a director and major shareholder of Company UK, the appellant's 100% shareholder, and that the appellant was its principal investment.

(186) In the course of cross-examination, Mr. X stated that the staff paid were in fact E Mining (Pty) Ltd's employees, but were "*working for*" the appellant. Not only is this contradictory to the appellant's annual financial statements, but this also contradicts the published press notification by E Mining (Pty) Ltd dated 17 January 2003 in which specific reference to "*The conversion of R2 466 000 of debt owing by OTR to GB Mining to be converted to equity*" is made. Mr. X's evidence also contradicts Mr. Y's evidence who testified that the amount represented expenditure by the appellant "*on behalf of*" E Mining (Pty) Ltd.

(187) In the court's view, it is clear that the amount of R2 638 070 was incurred by the appellant on behalf of E Mining (Pty) Ltd in the

form transactions on loan account, resulting in a loan to the latter that was intended to be converted into E Mining (Pty) Ltd's, equity in the event of a successful rescue of that entity, so achieving a listing for the appellant through a so-called reverse takeover. Expenditure relating to the purchase of equity is generally of a capital nature, as is expenditure relating to the obtaining of a listing, consequently, the appellant did not discharge the onus of showing why this expenditure should not be so regarded. Consequently the appellant's appeal on this issue is dismissed.

(188) Only after an overrun in excess of this sum would the appellant be required to contribute its 25% proportionate cash cost pursuant to (***clauses 8.2.1 and 8.2.3***). Thus, it can be inferred that the appellant obtained a right to 25% of an asset with a minimum aggregate cash cost of R24 million. This 25% interest was thus worth a minimum of R6 million.

(189) As to the remainder of the appellant's arguments: Firstly, the argument that no transfer of ownership (of the rights) *per se*, took place, as the appellant was one of the partners in the L Consortium, and thus retained co-ownership. The fact of the

matter is that the appellant received a 25% interest with a minimum value of R6 million. This is undoubtedly a receipt or accrual within the meaning of the gross income definition in ***section 1 of the Act.***

(190) In our view no evidence was tendered which discharged the appellant's onus. Secondly, the argument that the rights had no commercial value is clearly disproven by the terms of the Notarial Consortium Agreement, in which a clear value was assigned. Thirdly, the argument that the rights merely comprised contingent rights is similarly not borne out by the evidence.

(191) Finally, the argument that the appellant's contribution to the L Consortium did not relate to these rights at all, but was (at least partly) for services, namely the undertaking to negotiate a source of supply of new feed-stock for the L Consortium, which (it was contended) had itself no commercial value, is especially puzzling. Besides the fact that the Notarial Consortium Agreement flatly contradicts this assertion, if it were in fact to be correct, it would lay the appellant open to being taxed on a gain of a revenue nature rather than of a capital nature, resulting in a far more onerous position than that currently contended for by the respondent.

(192) The court's view is that the appellant benefited from an accrual of a capital asset of a probable value of R6 million in exchange for the relevant rights, consequently the appellant's appeal regarding this issue is dismissed.

THE MANAGEMENT FEES

THE CONTENTIONS

(193) Regarding this exigency the dispute relates to certain Management Fees not received at year end, in addition, the appellant contends that these fees had not accrued. For gross income purposes, for an amount to have accrued:

(i) there must be unconditional entitlement;

(ii) the right must be vested, not contingent;

(iii) the mere passing of time is not a condition, in this context; and

(iv) the amount must be capable of being valued.

(194) The Management Fees in dispute were stated by the appellant to be based on the "*net operating profits*" as determined once the

sale proceeds could be ascertained under the IRS and J Holdings contracts. Accordingly, it follows that these Management Fees could not themselves accrue until the accrual under the BA Holdings Services Limited Agreement and NN Platinum Mining Agreement contracts took place.

(195) The issue is accrual of management fees to the appellant, and not accrual of proceeds from the sale of the consortium concentrate. For the appellant's argument to succeed, it needed first to show that the management fees accrued to the appellant at the same time that the proceeds from the sale of the concentrate accrued to the L Consortium.

(196) The appellant merely argued that the proceeds from the sale did not accrue, and that the management fees did not accrue because they are calculated as a percentage of the sales of the consortium concentrate.

(197) Contract BA Holdings Services (IRS) undertook to purchase concentrate from the L Consortium. The concentrate was to have defined proportions of metals, and if certain minimum quantities of metals were not present in any metallurgical month, IRS was

not obliged to accept it, but had the discretion to do so, subject to penalties.

(198) Pursuant to the agreement the purchase price was calculated by reference to a complex variable formulae, only ascertainable once the metal proportions and content were precisely known. In terms of ***clause 7.1*** payment was due on the 10th business day of the 4th month following the close of the metallurgical month in which the concentrate was delivered to IRS. In terms of ***clause 16*** this payment could be further delayed if market conditions resulted in IRS not selling on the smelter products

(199) Although no market condition delay was provided for. The terms of the NN Platinum Mines (J Holdings) Contract were substantially similar to the (IRS) Contract, with payment due on the last day of the 4th month following the delivery month, in both cases, it is clear that the delay of a minimum of 4 months between delivery and payment was occasioned by the need to clearly ascertain and agree the metal content ratios and quantum, and the need to process the material through the smelting process into saleable form.

(200) During this period market prices could vary substantially, and all of these factors made determination of the proceeds impossible to predict at time of delivery. This, coupled with the ability of the purchasers to reject the delivery on assay (expressly the case for IRS, and implicitly so for J Holdings) ensured that any accrual that might be calculated on delivery would reflect an amount that was contingent both as regards vesting as well as quantum.

(201) The questions to be answered are, assuming that BA Holdings Services Limited accepted the concentrate:

(a) does the fact that the purchase price could only be determined one month prior to the payment month mean that there was a contingency?;

(b) does the fact that after the purchase price had been determined, the L Consortium had to wait 10 business day before it could claim payment mean that there was a contingency?.

(202) Bearing in mind that after the acceptance of the concentrate, no further performance was required of the L Consortium; all that was

required to determine the purchase price and claim payment was the passage of time.

<u>The effect of *Section 24M of The Act*</u>

(203) One of the appellant's arguments is that the proceeds did not accrue because they could not be determined. In 2004, ***section 24M*** was inserted in ***the Income Tax Act, 1962*** in order to deal with a situation where an asset is disposed of during a year of an assessment for an amount that cannot be quantified during that year of assessment. The relevant Explanatory Memorandum states that ***section 24M*** applies to both contingent amounts and accrued amounts that could not be quantified. The example given for accrued amount that could not be quantified is a consideration based on target levels of profit or revenue.

(204) The introduction of ***section 24M*** indicates that it is possible for an amount to accrue even if it cannot be quantified. Thus, the fact that the amount could not be determined does not in itself mean that it did not accrue.

Section 24M applies to disposals made during years of assessment commencing on or after 24 January 2005. It is therefore applicable in this case as the year in question is 1 March 2005 to 28 February

2006. However, neither the appellant nor the respondent referred to it.

(205) The respondent contends that the management fees in question accrued to AB Mining (Pty) Ltd because they were reflected in L's Detailed Income Statement for the period in question. It is possible for an amount to be included in accounting income before it is included in taxable income or vice versa.

(206) According to the appellant Management Fees totaling R368 167.00 did not accrue in the 2006 tax year but only in the 2007 tax year, only the sum of R247 149.00 accrued it in the 2006 tax year. There could be no accrual of the said amount (R368 167.00) in the 2006 year as management fees were calculated as a percentage of sales of consortium concentrate, which sales were only determinable 4 (four) calendar months after the transaction date due to a number of factors such as the variables in PGM content of the concentrate, its basket price, chrome penalties and the relevant exchange rates.

(207)The appellant argues that Financial Statements (Management Accounts) of the L Consortium were compiled after the end of the 2006 financial year when the information became available, that

prior to the 2006 financial year end, the required information was not available and no amount was determinable to be included in the appellant's financial statements or the tax calculation of the L Consortium.

(208) Mr Van Breda on appellant's behalf submitted that the respondent erroneously based the inclusion of the additional amount in the taxable income on information as detailed in Management Accounts of the L Consortium, which were compiled after the end of the financial year when the information became available, at the end of the financial year.

(209) Further counsel argued that it was impossible to determine the amount to be received as Management Fees relating to the production during the last four months of the year because this information only became available during the 2007 tax year. In any event these amounts were declared in the 2007 tax year, consequently, taxation of the amount in the 2006 tax year will result in the appellant being susceptible to double taxation.

(210) It does not automatically follow that because the management fees are calculated as a percentage of the consortium concentrate sale, they accrue at the same time. The question to be answered is whether the appellant had an unconditional entitlement to the management fees. This question was not answered. The appellant contended that the management fees were calculated as a percentage of sales of the consortium concentrate.

(211) The calculation of the management fees is set out in the detailed income statements of L Consortium show that the management fees were calculated as a percentage of **operating profit**. Operating profit is an accounting concept based on accounting sales.

(212) Accounting sales are not necessarily the same as sales for tax purposes. Consequently, even if it is accepted that the management fees did not accrue because the sales did not accrue, this would not assist the appellant because the management fees were based on operating profit (and therefore accounting sales). If the accounting sales were the same as tax accrual in this case, this should have been shown or stated, which is not the case.

(213) The Appellant has not shown the connection between the accrual of the management fees and the accrual of proceeds from the sale of the consortium concentrate.

The argument that the proceeds did not accrue is based on two agreements, BA Holdings Services Limited (IRS) agreement and J Holdings Limited agreement. These agreements are similar, in import an evaluation of one suffices for illustration purposes.

The BA Holdings Services Limited Agreement

(214) The agreement provides that any one metallurgical month's deliveries shall meet certain specification. If these are not met BA Holdings may accept the concentrate at its sole discretion, provided that it shall be entitled to levy a penalty.

The purchase price was dependent on a **Price Index (PI).**

(215) The purchase price is defined as: 81.30% + 0.833333% (**Price Index**-$450), where Price Index was between $450 and $ 900. If **Price Index** was below the range $450 and $900, the parties negotiated the terms (Bundle G: 813, clause 6.1). It follows therefore that the **Price Index** had to be known in order to determine the purchase price

(216) The **Price Index** was determined by dividing the number of contained Platinum ounces into the sum of contained Platinum, Palladium, Gold and Rhodium, multiplied by the **Ruling Market Price** in US Dollars of each of Platinum, Palladium, Gold and Rhodium. Consequently, to determine the Price Index the **contained ounces** of Platinum, Palladium, Gold and Rhodium, and the **Ruling Market Price** of each had to be known.

(217) The **Ruling Market Price** of each of the metals was based on specific averages for the month prior to the month of payment. Consequently, even if the contained ounces were determined, the purchase price could only be determined one month prior to the month of payment.

(218) Consequently, it follows therefore that there is a contingency with regard to the fact that BA Holdings Services Limited could accept or reject the concentrate if it did not meet the specified requirements. This fact is not raised by the appellant's in its evidence as the reason for the non-accrual.

Assuming the concentrate was accepted, the purchase price could only be determined once the contained ounces and **Ruling Market**

Price were known. The **Ruling Market Price** could only be determined at the end of the month prior to the month of payment. In terms of ***clause 7.1*** the purchase price was due on the tenth business day of the fourth month following the close of the metallurgical month during which the concentrate was delivered.

(219) Mr MG on respondent's behalf argued that prior to the receipt or accrual event occurring there must be an amount which may assume the form of money or the value of every form of property earned by the taxpayer. The Financial Statements of the L Consortium unequivocally reflected the determinable amount paid for the Financial Statements of the Consortium covered the period commencing 1 March 2005 – 28 February 2006 or received by the appellant or the total amount that accrued to it is the sum of R615 316.00 and not R247 149.00 as disclosed by the appellant in its tax returns for the 2006 tax year.

(220) Consequent upon the contingencies described above, it is the court's view that the earliest point at which accrual of Management Fees took place would be the time at which the proceeds accrued under the IRS and J Holdings contracts, a minimum of 4 months after delivery of the concentrate to IRS and

J Holdings. Consequently, the respondent is directed to recalculate the accruals of these Management Fees in accordance with the court's finding.

<u>Overseas travel</u>

The contentions:

(221) The respondent contends that a significant portion of the appellant's overseas travel costs was capital in nature, and accordingly non-deductible, as it was more attached to the cost of establishing, enhancing or adding to its income-earning structure, as opposed to being attached to the cost of its income-earning operations.

(222) The appellant contends that, while this is correct in the case of some instances previously conceded to the respondent, the remaining instances relate to the raising of capital (presumably working capital) to fund the day to day running of the company, in other words, its operating expenditure.

The Evidence:

(223) The evidence by both parties the appellant and the respondent was at best confusing. It was agreed that the parties had previously agreed to some specific disallowances (for example, relating to the setting up of a London office, and travel to Kazakhstan) and that the remaining expenditure in contention contained elements of capital and revenue in nature, and would thus be allowed as deductible to the extent of 50%, as a rough apportionment of these characteristics.

(224) The appellant apparently subsequently withdrew from this agreement, on the basis that an "*additional tax*" penalty of 20% was imposed on the resultant tax due, and that this had not been part of the agreement. No clear evidence was led by the appellant on an instance by instance basis as to why the specific overseas trips were not capital in nature, other than a statement by Mr. X that some £5.5 million was raised as a result of various of these trips, which was used to fund the appellant's operating costs.

(225) In the court's view, it is the appellant's responsibility to discharge the onus of showing why an amount is deductible. It is not the court's duty to make extrapolations from contentions, where these are unsupported by corroborative evidence, consequently, the

court is unable to make a specific finding as to the exact quantum of expenditure that is not of a capital nature, and thus cannot set aside the respondent's approach of disallowing 50% of the expenditure not already conceded by the appellant, as being capital in nature, consequently the appellant's appeal regarding this issue is dismissed.

The Mining capital expenditure

The contentions:

(226) The appellant contends that the mining expenditure incurred by the L Consortium on its new processing plant amounted to R24 489 741, and that the appellant's participation share as an L Consortium member was 25%, namely R6 122 435, which amount was accordingly deductible under ***section 36 of The Act***. The respondent's Counsel did not comment on this contention in his heads of argument, but in the evidence of respondent's witness, Mr. HK it was contended by the respondent that only 62% of this 25% participation share qualified as the appellant's mining capital expenditure, on the basis that the remaining 38% related to L Co. SA's interest in this 25% participation share.

The Evidence:

(227) The facts relating to this existence as presented to the court are not clear. To begin, it has already been established that pursuant to the Notarial Consortium Agreement the two other partners to the L Consortium agreed to spend up to R24 million in aggregate (their initial capital cost contributions) on the required plant without the appellant being required to incur any cost.

(228) Only after an overrun in excess of this sum would the appellant be required to contribute its 25% proportionate cash cost pursuant to ***clauses 8.2.1 and 8.2.3.*** It is thus unclear why, if this plant cost R24 489 741, the appellant's share as a Consortium member was a full 25%, rather than only 25% of the excess over R24 million.

(229) There is the question of the 38% interest in the L Consortium, held by L Co. SA, and which has already been alluded to. No conclusive evidence was led as to true nature of this interest, although Mr. X repeatedly and misguidedly stated that LK SA was merely entitled to a proportionate "dividend" as a result of this interest. If this interest is in fact an undivided share of 38% of the 25% participation share (which was similarly an undivided

share, and *not* an equity share) in the L Consortium, then the respondent's approach appears to be correct.

(230) The only relevant evidence before the court is encapsulated in the agreement of 28 October 2005 governing the relevant shareholding reorganization. ***Clause 3.1*** provides for LK SA to acquire a 38% share in the Participation Share. The Participation Share is defined as the 25% participation share which the appellant holds in the L Consortium. This would entitle LK SA to 38% of the net income derived by the appellant from the Participation Share pursuant to ***clause 4.1***.

(231) Further, LK SA would be obliged to contribute 38% towards any overrun on capital costs in terms of ***clause 5*** – this is a reference to the R24 million limit as traversed above, with any excess expenditure over this limit to be proportionately funded by the appellant. In the light of this, it seems clear that LK SA has an undivided share of 38% of the Participation Share, with the appellant holding the balance of 62%.

(232) In the court view, this aspect is referred back to the parties to determine if, in fact, the holder(s) of the 25% Participation Share

did in fact incur a charge of R6 122 43, being 25% of expenditure of R24 489 741 incurred by the L Consortium on its new processing plant, having regard ***clauses 8.2.1 and 8.2.3 of the Notarial Consortium Agreement.***

(233) Thereafter, whatever amount was in fact legally so incurred should be treated as a deduction of mining capital expenditure in terms of ***section 36 of The Act***, split between the appellant (62%) and LK SA (38%) in accordance with their respective interests in the Participation Share.

Penalties (additional tax) and interest

The contentions:

(234) The respondent contends that the additional taxes imposed are appropriate to the circumstances, and that the conditions set out in ***section 76 of The Act*** are all met, and that the respondent has exercised his discretion appropriately, taking into account considerations such as extenuating circumstances, and has accordingly reduced the additional tax from a maximum of 200% to a range of 10% to 40%.

(235) The appellant in contradistinction contends that the additional taxes imposed by the appellant under ***section 76 of The Act*** are not valid as the section requires the existence of tax evasion.

The Evidence:

(236) ***Section 76 of The Act*** requires there to be default, omission or incorrect statements in a return, which has led to a shortfall in tax paid. It does not have a requirement that tax evasion (a criminal act) should be present.

(237)In the court's view, the contentions of the appellant in this regard are erroneous because tax evasion is not a prerequisite for additional tax to be imposed. The respondent in turn should not merely cite the fact that the additional tax is not being levied at the maximum level as evidence that the Respondent has exercised his discretion on an informed basis, as required by **section 76(2)(a) of The Act.**

(238) Evidence setting out the nature of extenuating circumstances, and the nature of the deliberations should more clearly be laid before the court. Notwithstanding these reservations, in the light of Mr. HK's evidence, the is court satisfied that a process did in fact take

place, and that the final determination of the level of these additional taxes is not inappropriate in the circumstances, consequently the appellant's appeal regarding this issue is dismissed.

(239) In the premises the following is made:

(a) The appeal is dismissed in its entirety save that in respect of the management fees the respondent is directed to recalculate the accruals of these management fees in accordance with the court's finding in ***paragraph 240*** of the judgment because the appellant has not shown the connection between the accrual of the management fees and the accrual of the proceeds from the sale of the consortium concentrate;

(b) The appellant is ordered to pay the respondent's costs.

Dated and signed at Johannesburg on the 05 July 2012.

____

MOKGOATLHENG J

JUDGE OF HIGH COURT

____

MARIUS: VAN BLERCK MEMBER OF THE TAX COURT

____

JACQUI KILLAN: MEMBER OF THE TAX COURT

DATE OF HEARING:

DATE OF JUDGMENT:

COUNSEL FOR THE APPELLANT: C van BREDA AND S MOERDIJK

INSTRUCTED BY: PIERRE WOLMARANS & ASSOSCIATES

COUNSEL FOR THE RESPONDENT: M O MOKGATLE

INSTRUCTED BY:THE STATE ATTORNEY