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TAX SPECIALISTS SA

UNICUS TAX UPDATE

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Company EG & Company LS v CSARS

Procedural and substantive lessons



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HELLO & **WELCOME!**

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BACKGROUND

- The appellants were registered share block companies that owned commercial properties.
- Third-party leases were concluded directly by the companies; the companies received the rental and accounted for VAT.
- For 2023, the companies claimed deductions including amounts described as distributions to share block holders, producing nil taxable income.
- SARS selected the returns for verification, disallowed the distributions and treated the rental as taxable in the companies.
- The appeal proceeded on a stated case and documentary record - no oral evidence was led.
- The taxpayers then sought to raise preliminary points, including a section 42 / audit complaint.

PROCEDURAL ISSUE 1: NEW GROUNDS - WHAT THE COURT DECIDED

- The section 42 complaint had not been raised in the objection.
- It had also not been pleaded in the Rule 32 statement.
- The taxpayers attempted to raise it only as a preliminary point on the eve of the hearing.
- The court treated it as a fresh procedural challenge, not merely a different legal argument on the existing case.
- The court held that the objection and appeal process defines the issues and prevents a taxpayer from changing its case late in the process.
- It therefore held that the new ground could not be entertained.

PROCEDURAL ISSUE 1: NEW GROUNDS - COMMENT

- The court goes too far if its reasoning means the section 42 ground could never have been pleaded.
- Rule 32(3) permits a new ground if it attacks the same part or amount already placed in dispute.
- Baseline recognises that a new argument or different legal approach may attack the same part or amount; BASF states the distinction even more clearly.
- The section 42 challenge was directed at assessments already under objection. In principle, it could have been introduced as a pleaded new ground.
- But it was not pleaded. Rules 31-33 are the Tax Court pleadings and Rule 34 confines the issues to those pleadings.
- Better conclusion: the ground may have been permissible to plead, but it was unavailable at the hearing because the taxpayer had never pleaded it.

PROCEDURAL ISSUE 2: TAX COURT JURISDICTION - WHAT THE COURT DECIDED

- The court emphasised that the Tax Court is a specialised statutory tribunal and is not a High Court.
- It held that the Tax Court cannot conduct PAJA or legality reviews.
- It relied on UMK and the Constitutional Court's warning against giving the Tax Court review powers "through the back door".
- The section 42 complaint concerned the procedure followed by SARS, rather than the substantive correctness of the assessments.
- The court therefore held that the alleged procedural irregularity could not be used in the tax appeal to set aside the assessments.

PROCEDURAL ISSUE 2: TAX COURT JURISDICTION - COMMENT ON UMK

- UMK did not finally decide that section 42 non-compliance can never be a ground in the Tax Court.
- At paras 91-96, the Constitutional Court expressly considered procedural unfairness, including section 42(2)(b) non-compliance.
- It then said it was undesirable to express a definite conclusion on the Tax Court's power to determine that issue.
- For purposes of the section 105 analysis, it proceeded only on the assumption that such procedural unfairness could not be a ground of appeal.
- The present judgment therefore overstates UMK by converting an assumption into a binding rule.
- A full PAJA / legality review is plainly outside the Tax Court's jurisdiction. Whether a defensive validity challenge can be raised within a tax appeal remains a different and unresolved question.

PROCEDURAL ISSUE 3: VERIFICATION OR AUDIT?

- Court: verification checks or confirms information furnished by the taxpayer; an audit is a more extensive investigation.
- Court accepted that SARS's enquiries went beyond requests for supporting documents and involved a greater level of interrogation.
- Nevertheless, it characterised the process as an "extensive verification" directed at understanding and verifying the returns.
- The taxpayers had not produced enough evidence to show that the process crossed the line into an audit.
- Comment: the result is defensible on the evidential record. The matter proceeded on a stated case and no oral evidence explained what SARS was actually doing.
- The key factual question is not whether the questions were difficult, but whether SARS moved from checking disclosed information to independently investigating completeness, authenticity or broader affairs.

IF A "VERIFICATION" IS BECOMING AN AUDIT: WHAT SHOULD THE TAXPAYER DO?

- Keep a complete chronology of SARS requests, follow-up questions, meetings and calls.
- Identify enquiries that go beyond confirming the return and supporting documents - for example, testing completeness, investigating undisclosed transactions, using third-party information, moving into other years or reconstructing the taxpayer's affairs.
- Put the concern in writing: ask SARS whether the taxpayer has been selected for audit and, if so, request compliance with section 42.
- Preserve the original notices and all responses. The label "verification" is not decisive; the substance of what SARS did matters.
- If the issue reaches court, lead factual evidence from the person who dealt with SARS. A stated case is risky where the characterisation of the investigation is itself disputed.
- The evidential objective is to prove what SARS actually investigated.

SUBSTANTIVE ISSUE: HOW A SHARE BLOCK NORMALLY WORKS

- The share block company owns the immovable property.
- The shareholder's shareholding, together with the Use Agreement, gives the shareholder the right to use or occupy a specified part of that property.
- In a conventional arrangement, the shareholder may occupy the allocated unit or let that unit / use right to a tenant, subject to the scheme terms.
- Where the shareholder is the person legally entitled to the rental, there is a proper basis for the rental to accrue to the shareholder rather than the company.
- The company may receive qualifying levies from shareholders for collective expenses.
- Section 10(1)(e) does not exempt all income of a share block company - the levy exemption does not turn third-party rental earned by the company into exempt income.

WHAT WAS DIFFERENT HERE - AND THE SUBSTANTIVE RULING

- The companies themselves concluded the commercial leases in their own names as lessors.
- Tenants paid the companies; the companies issued the tax invoices, accounted for VAT and assumed the lessor obligations.
- Rental was pooled, expenses were deducted and only the net balance was distributed to shareholders.
- The documents did not establish proper individual allocations, cessions or agency arrangements showing that the shareholders were legally entitled to the tenants' rental.
- The original objection was also badly framed: it relied on section 10(1)(e) as though share block status exempted the companies' income generally.
- Court: the rental accrued to and was received by the companies. It was taxable gross income in their hands; later distributions to shareholders did not change that accrual.

KEY TAKEAWAYS

- New grounds: a new ground may be permissible, but it must be pleaded before the Tax Court can decide it.
- UMK: do not read an assumption made for section 105 purposes as a final ruling that every procedural validity challenge is outside the Tax Court's jurisdiction.
- Verification vs audit: build the factual record while the SARS process is happening; prove the substance of the investigation.
- Share blocks: identify who has the legal right to the rental. The tax result follows the actual rights and implementation, not the label "share block company".

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