IN THE REVENUE APPEALS TRIBUNAL ESWATINI

JUDGMENT

CASE NO: RATE/IT003/22

In the appeal between:

RATE/IT003/22 **APPELLANT**

And

ESWATINI REVENUE SERVICES- **RESPONDENT**

THE COMMISSIONER GENERAL

Neutral Citation:	*RATE/IT003/22 v Eswatini Revenue Services, The Commissioner General (003/22) (2023) RATE 003* (April 2023*)*
Coram:	Ms Fikile Dlamini, Ms Ntombenhle Shongwe, Mr Sandile Dlamini (Members)
Heard:	17 April 2023
Delivered:	This judgment is to be handed down electronically by circulation to the parties, legal representative by email and uploaded on email platform. The date for hand-down is deemed to be 26 May 2023

Summary: *Infrastructural Initial Allowance -Wear and Tear allowance -Disallowed allowances-For Year ended March 2022*

The Appellant claimed initial infrastructural and wear and tear allowances for its transmission and distribution lines as allowable deductions from the computation of its gross income for the year ended March 2022. In respect to initial infrastructural allowance the Appellant argues that due to the nature of its business which requires transmission and distribution lines to be installed at varying intervals of the year and are spread all over the country, a unique and more feasible approach should be adopted for it, where the Respondent verifies the assets on which initial allowances are claimed after the installation. The Respondent bases the denial of the initial allowance claims on the fact that the Commissioner General's certificate had not been sought prior to installation of these assets.

In respect to wear and tear allowance the Appellant submits that distribution and transmission lines are assets required to deliver the revenue generating token to the consumer and thus contribute to the Appellants taxable revenue, hence wear and tear allowance cannot be disallowed on these "assets" further that the source of funding for the assets, should not be a determining factor on whether an asset qualifies for wear and tear or not.

The Respondent denied allowances for both initial infrastructural allowance and wear and tear allowance sought by the Respondent in the tax year ended March 2022, stating that an agreement had been reached that the transmission distribution lines will be classified under ***"capital contributions" or "customer receipts"*** hence be excluded from the Appellant taxable income. The Respondent therefore argues that this exclusion further means Appellant cannot claim any deductions related to this income for tax purposes because it is only from "income" that these deductions may be allowed.

JUDGMENT

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1) The Appellant is RATE/IT003/22 a company engaged in the business of power generation, transmission, and distribution of electricity in the Kingdom of Eswatini. The company is public enterprise duly registered in terms of the laws of Eswatini, having its principal place of business at Luvatsi House, Mhlambanyatsi Road, Mbabane, Eswatini.

2) The Respondent is described as Eswatini Revenue Service, a semi-autonomous revenue administration agency on behalf of the state, established through the Revenue Authority Act No. 1 of 2008. This organisation operates within the broad framework of government but outside of the civil service. The Commissioner General cited herein his official capacity as the Chief Executive Officer of Eswatini Revenue Service, a legal body charged with the responsibility of revenue collection on behalf of the Government of Eswatini.

3) A brief history of the matter is set in the paragraphs that follow; The Appellant was subjected to an Income Tax desk audit by the Respondent, in which the Respondent sought to authenticate the credibility of the figures reported by the Appellant for the period ended 31 March 2022. Following the audit, the Respondent informed the Appellant of the outcome of the audit (in a letter dated 27 October 2022), to the effect that its Income Tax account had been adjusted to add back the amount of SZL 320 429 138.65 (Three Hundred and Twenty Million, Four Hundred and Twenty-Nine Thousand, One hundred and Thirty-Eight Emalangeni and Sixty-Five cents). This “Add Back” amount was constituted by deductions that had been claimed by the Appellant that had been disallowed by the Respondent.

4) The majority of the disallowed deductions were attributed to claims in respect of an Infrastructural initial allowance deduction to the amount of SZL 273 008 674.59 (Two Hundred and Seventy-Three Million, Eight Thousand Six hundred and Seventy-Four Emalangeni and Fifty-Nine cents) and a wear and tear / depreciation allowance of SZL 45 809 565.38 (Forty-Five Million Emalangeni, Eight Hundred and Nine Thousand, Five Hundred and Sixty-Five Emalangeni, Thirty-Eight cents). The total of which equated to SZL 318 682 880.39 (Three Hundred and Eighteen Million, Six Hundred and Eighty-Two Thousand, Eight Hundred and Eighty Emalangeni and Thirty-nine cents).

5) The remainder of the total add back amount constituted of other disallowed deductions such as provisions for doubtful debts, leave pay provisions, performance bonus provisions, provisions for post retirements benefits and long service awards provisions, all of which were accepted by the Appellant as claimed by the Respondent, hence are not part of this appeal.

6) The Appellant objected to the disallowance of both the initial allowance as well as the wear and tear allowance, further raising an objection on the penalties imposed on it by the Respondent following the adverse audit outcome. Objection of the two contested

allowances is captured in letters dated 25 and 27 October as well as 14 November 2022, respectively.

7) In respect to the initial allowance, the Appellant argues that owing to the unique nature of its operations, a unique and probable approach to deal with the Appellants Tax accountability should be adopted. In particular that the Respondent can always verify the assets for which initial allowances have been claimed, after the fact. This was mainly due to the fact that the reason for disallowing the deduction for initial allowance was the failure by the Appellant to produce proof of allowance as evidenced by a certificate from the Commissioner General attesting that the asset qualifies for an initial allowance deduction.

8) The Appellant further included in its objection the request for the Respondent to waive the penalties imposed on it following the Audit outcome, stating that its understanding is that penalties are imposed within the spirit of discouraging the falsification of information declared to the Commissioner, which it had not done. The Appellant argued that the outcome of the audit was actually based on the differences of interpretation of the law as between the parties. Therefore, it is punitive of the Respondent to impose such a harsh penalty.

9) In respect of the first two objection grounds, the Respondent maintained that all deductions claimed by the Appellant being the initial infrastructural allowance and the wear and tear allowance, were properly disallowable. The Respondent however, upheld the ground of objection to waive the penalty it had imposed on the Appellant, where it considered that indeed they had not reached common ground on the correct tax treatment of **"customer receipts" and/ or "capital contributions"** transactions, for the years over which the penalty is calculated.

10) The Respondent confirmed having received Appellant's objection where the factual background in support of the objection has carefully been advanced. The last paragraph of a letter dated 9 December 2022; states as follows:

> ***……please note that if you are not satisfied with the above responses, you have the right to appeal against the CG's decision to the Eswatini Revenue Appeals Tribunal- in term of section 15 (1) of the Revenue Appeals Tribunal Act No. 13 of 2019 (hereinafter 'RAT Act).***

11) Dissatisfied with the Respondent' determination, the Appellant lodged its Appeal under section 15 (1) of the Revenue Appeals Tribunal Act 13 of 2019 (RATE), which appeal eventually found its way to this Tribunal on the 9th of January 2023.

12) Mr Sandile Khumalo and Mr Thabiso Masina appeared on behalf of the Appellant and Ms Bongekile Singwane and Mr Dumezweni Mdluli appeared on behalf of the Respondent.

13) The Appellant has raised the following two grounds of appeal and submitted as follows:

1. The Appellant submits that; "Additions to the infrastructure are made every day as per requests from customers and are spread countrywide. It is impractical to make a pre-application for the allowances. This was explained to ERS in previous years and ERS has been doing post verification audits. This has been a common practice and understanding between the EEC and the ERS.

2. The Appellant submits that; "The source of funding should not be a determining factor on whether an asset qualifies for wear and tear or not. The Income Tax Order grants a 5% wear and tear allowance on transmission and distribution lines. The network gets depleted over time and needs to be replaced".

14) The main subjects of discussion in this appeal are three issues for determination and the Tribunal breaks them down below:

14.1 Firstly, the Appellant seeks the Tribunal to determine whether they are entitled in law to claim infrastructural initial allowance for transmission and distribution lines purchased using customer receipts/capital contributions.

14.2 Secondly, the Appellant seeks the Tribunal to determine whether the non-adherence by them to the prior certification of the assets as qualifying assets barred the claim for initial allowance.

14.3 Thirdly, the Appellant seeks the Tribunal to determine whether they are entitled in law to claim wear and tear allowance or a depreciation allowance for its

transmission and distribution lines purchased using customer receipts /capital contributions.

15) Appellant's submission

The Appellant in the above cases advances the following main arguments as to its case;

15.1 The Appellant comes before the Tribunal to contest the validity of two rulings by the Commissioner General, the first of which is the disallowance of a claim for initial infrastructure allowance for all newly capitalized assets. The second of which is the disallowance of wear and tear allowance on transmission and distribution lines.

15.2 As to the initial infrastructural allowance the Appellant argued in the main that, for the Respondent has for 10 tax years (following an Audit for the Tax years 2007-2011) allowed the Appellants claim for initial infrastructural allowance on newly capitalized assets without prior application, this would be followed by a post verification audit by the Respondent. The Appellant argues that to this end an established way of working or "precedent" for the treatment of the claim of this allowance had been established mutually by the parties. The Appellant argues Respondent brought to an abrupt end, the "precedent" which was arbitrary, unjust, and unfair. The Appellant argued that due to the established practice as between the parties, the Respondent was in law **estopped** from unilaterally deviating from the practice not having given the Appellant sufficient notice of the change in treatment of this allowance.

15.3 As to the disallowance of the wear and tear allowance, the Appellant refutes that it is not entitled to claim wear and tear allowance on the transmission and distribution lines merely because the transmission lines are constructed using funds contributed for by customers named "customer contributions". The Appellant in turn argues that the Respondent ought to distinguish between two receipts from customers, the first being a "capital contribution" which the Appellant concedes are capital in nature, and the second being "customer receipts" generated from the sale of electricity. For it is the second receipt type that is generated revenue and thereby taxable income. Therefore, because it is

these assets that contribute wholly to generate this taxable income, they qualify for the claim for wear and tear allowance as envisaged by Section 14(1)(c) of the Income Tax Order. Stating further that the fact of the asset being constructed using customer contribution is immaterial and does not disqualify them from the claim for as captured in Section 14(1)(c) of the Order.

15.4 Relying on the case of ***Volkswagen South Africa (Pty) Ltd vs Commissioner for SARS***[1] where the court held;

> ***"… that the accrual of rebates calculated with reference to capital expenditure, to which the Appellant became entitled under a government scheme to assist and support the motor industry should be regarded as accruals of a Revenue and not Capital nature. Thus, fell <u>to be included in the Appellants gross income</u>.***

15.5 This was to say in fact even the capital contributions must fall as its gross income. This is due to their aim of assisting the Appellant to mass distribute electricity which would otherwise be capital intensive venture.

15.6 Therefore, praying that both the disallowed claims for initial infrastructure allowance and wear and tear allowance for the year ended 31 March 2022, be accordingly allowed.

16) The Respondent's submission

16.1 The Respondent submits that following extensive deliberations between the parties it was agreed that money received from customers for electrification of their household or business entity is <u>not</u> ***gross income*** and therefore must be excluded in the calculation of gross income.

16.2 Having agreed as such the Respondent argues that the Income Tax Order is clear that in respect of both the allowances claimed, section 14 (1) of the Order

[1] *(1123/2016) [2016] ZASCA 190*

is clear that the said deduction shall be from "gross income". Therefore, considering the prior agreement the Respondent ***disallowed them on the basis of them not forming part of the Appellants gross income*** (main argument).

16.3 With respect to the argument by the Appellant in respect of initial infrastructural allowance, which is that the Respondent had allowed the infrastructural allowance for 10 years prior to the "abrupt" disallowance, thereby establishing custom between the parties. The Respondent argues that the allowance of this initial infrastructural allowance is as a result of an *erroneous notion* that had transpired between the two parties and therefore cannot be understood to be custom. The Appellant's notion of it being custom is defective in understanding. Thereby praying that the Appeal be dismissed with cost.

17) Members Analysis

17.1 With the above foundational explanation from both parties, the Tribunal will commence to address the arguments from which we have drawn the issues for determination for the existence of a final and conclusive agreement.

17.2 According to the parties the issue in dispute is whether the Appellant was entitled to the Initial infrastructural and the wear and tear allowances as claimed, both of which were disallowed by the Respondent.

17.3 The Tribunal now turns to the evidence of the Appellant to determine whether they were correct to conclude that they are entitled legislatively to claim initial infrastructural allowance for transmission and distribution lines purchased using customer receipts/capital contributions.

17.4 The first question involves the interpretation and application of the relevant provisions of the Income Tax Order on initial infrastructural allowance. Section 7 of the Order provides that "Gross income ***means the total amount whether in cash or otherwise received by or accrued to or in favour of any person, excluding such receipts or accruals of a capital nature"***. In order to understand the initial

infrastructural allowance, reference must be made to this provision. Further Section 14 (1) (e) (ii) prescribes the "initial infrastructural allowance" rule. In essence, the critical focus rests on the whole phrase of the section 14 (1) (e) (ii) of the Income Tax Order which gives a real meaning to the initial infrastructural allowance.

section 14 of the Order, whose sub paragraph (1) (e) (ii) states that;

> ***"For the purpose of ascertaining the taxable income of any person, there shall be deducted from the income of such person, infrastructural machinery, plant or facilities, including transmission equipment, lines and pipes used in provision of infrastructural services which was brought into use by the taxpayer for the first time for the purposes of the taxpayer's business, an allowance (to be known as "infrastructural initial allowance") for the year of assessment during which such infrastructural machinery, plant or facilities are first used equal to fifty percent of the cost incurred by the taxpayer on or after the 1st July 2000;***
>
> ***Provided that a taxpayer shall only be entitled to claim a deduction in respect of the infrastructural initial allowance if the taxpayer notifies the Commissioner in a manner prescribed by him that he intends to claim such allowances and the Commissioner shall, by certificate issued under his hand, have certified them as assets qualifying for the initial allowances". (emphasis added)***

17.5 As to the initial infrastructural allowance the Appellant contends before the Tribunal that, the Respondent has for 10 tax years allowed the Appellant's claim for initial infrastructural allowance on newly capitalized assets without **prior application,** this would be followed by a post verification audit by the Respondent. The Appellant in this appeal employs a scheme where customers contribute funds for the purchasing of transmission and distribution lines, which are the assets on which the allowances are claimed. These received funds were, by virtue of an agreement between the Appellant and the Respondent classified as "capital contributions" or "customer receipts". By virtue of this classification, the Appellant and Respondent **agreed** they will be excluded from the computation of the Appellants taxable income. The Appellant further argues that

to this end an established way of working or “precedent” for the treatment of the claim of this allowance had been established mutually by the parties.

17.6 The approach to be adopted by this Tribunal in this appeal against the decision made by the Respondent regarding the established practice between the parties is the first question that this Tribunal should consider. It should be noted that, a preliminary issue on a mutual agreement was raised by the Appellant. The Tribunal noted that there was a mutual agreement made between the parties without taking into account the importance of concluding that agreement in writing and the tax implications that would flow therefrom.

17.7 The challenge to the Tribunal on this mutual agreement between Appellant and Respondent is the handling of this position between Appellant and customers as if it was a deviation from the standard route of the Appellant’s customary work venture which eventually accorded unusual conditions not anticipated in the law. Our jurisprudence has shown time and again that where a contract is not drafted with an integrated understanding of all the applicable legal requirements, the parties often end up paying the price.

17.8 The Appellant argued that due to the established practice as between the parties, the Respondent was in fac**t estopped** from unilaterally deviating from the practice not having given the Appellant sufficient notice of the change in treatment of this allowance. The Tribunal is of the view that, the conduct of the Respondent has led Appellant to believe that they have reached common practice and understanding in this matter. Despite the agreement between the two parties, the Tribunal reiterates the opinion that they both acted with genuine ignorance and furthermore, their conduct was equally consistent with mere oversight about the requirement of the law.

17.9 The second issue, the appellant seeks the Tribunal to determine whether the non-adherence by them to the prior certification of the assets as qualifying assets barred the claim for initial allowance. The Respondent argues that upon the legal prerequisite for claiming initial infrastructure allowance, which is to notify the

Commissioner in writing of the intention to claim such an allowance.[2] The Order states in section 14(1)(e)(ii)(c) that;

> ***"…a taxpayer shall only be entitled to claim a deduction in respect of the allowances referred to in subparagraphs (i), (ii) and (iii) if, on installation of such machinery, plant, facility or building, the taxpayer notifies the Commissioner in a manner prescribed by him that he intends to claim such allowances and the Commissioner shall, by certificate issued under his hand, have certified them as assets qualifying for the initial allowances.***

17.10 The Appellant requested to claim the allowances after the fact in order to accommodate the uniqueness of its operations, which require installation of the transmission lines at varying intervals of the year and at various parts of the country. Therefore, to follow the procedure laid out in the principal Act would be cumbersome for them.

17.11 The Tribunal now turns to the reason why Respondent allowed the initial allowance in the past 10 years without providing consistency to the Appellant as all taxpayers are expected to follow the procedure laid down in the legislation. The gist of the above contention by Respondent is that the allowance of this initial infrastructural allowance is as a result of an *erroneous notion* that had transpired between the two parties and therefore cannot be understood to be custom. The question then arises before the Tribunal as to where did this erroneous notion happen? Does the erroneous notion awaken by the interpretation of the statute, or the computation of the initial infrastructural allowance in relation to the agreement. The Tribunal is cognisant of the view that the burden of proof that any amount is exempt from or not liable to any tax chargeable under this Order lies on the taxpayer.

Section 53 of the Income Tax Order states:

> ***…… The burden of proof that any amount is exempt from or not liable to any tax chargeable under this Order or is subject to any deduction or set - off, shall be upon the person claiming such exemption, non-liability,***

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[2] ERS Guidelines on the application initial allowance; also see section 14 (1) (e)(ii)(c) of the Income Tax Order.

deduction or set-off, and upon the hearing of any appeal from any decision of the Commissioner, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong.

17.12 The Tribunal is not disputing the fact that Respondent acted with authority because Appellant had a responsibility to notify the Commissioner in writing of the intention to claim such an allowance. This finding is also substantiated, in part by the fact that the Order requires an advance certification by the Respondent before a claim is made and this being a legal requirement, Respondent is within their right to expect it to be undertaken as such. However, Eswatini Revenue Service (ERS) as a law enforcement agency, their conduct of allowing the Appellant's claim for initial infrastructural allowance on newly capitalized assets for 10 tax years without prior application was in contravention of the legislation and, in that way, they made a representation to the Appellant to adopt deviation from established practice.

17.13 In a thorough linguistic analysis by the Tribunal, premised on the *erroneous notion*, we conclude that the Respondent has displayed a persistent disregard of the matter thus creating an assumption that it is not a legal requirement to acquire it before the claim. Indeed, as submitted by Appellant, no explanation was given by Respondent in its papers how they professionally rectified the error before bringing the set precedent to an abrupt end. The denial of the initial allowance due to absence of prior request and certification is in our view a type of error that could have been corrected by both parties without raising any defect in law. It is the Tribunal's view that, it was prudent therefore, for the Respondent to have at least notified the Appellant before bringing the established (erroneously or otherwise) precedent to an abrupt end.

17.14 Coming to the classification of customer receipts, The Tribunal is advised by the Appellant that these received funds were classified as "capital contribution" or "customer receipts." By virtue of this classification, they will be excluded from the computation of the Appellants taxable income. The Tribunal is in support of the law as the Act is vividly clear on deduction allowances. The Act is clear that deductions, including the ones that the Appellant claims are made pursuant to "ascertaining the taxable income" of a taxpayer and are therefore made from the

"income" of the taxpayer. The Act is also clear that the "Gross income" of taxpayer specifically excludes such receipts or accruals of a capital nature. It is the Tribunals view that the agreement was concluded in recognition of the customer receipts falling within the ambit of Section 7 of the Order.

17.15 The Tribunal needs now to consider if this classification was indeed correct to establish whether or not the customer receipts ought to be included in income and if excluded, whether such exclusion barred the Appellant from claiming the capital allowances.

17.16 The Income Tax Order contains no definition of capital receipts, however, the *locus classicus* often consulted in distinguishing whether an amount is capital or revenue in nature, is that of ***CIR v Visser (1937 TPD),*** in deciding whether a receipt in respect of an asset is income or capital in nature is the intention of the taxpayer. In this case, it was stated that the proceeds will be income in nature if the asset was acquired with the purpose of selling it at a profit, however, if the asset was acquired and held, not for the purpose of resale at a profit, but to produce income from that asset, then the proceeds on the sale of the asset will be capital in nature.

The court made the following analogy as an illustration;

> ***'Income' is what 'capital' produces or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in matters of income tax, but its application is very often a matter of great difficulty, for what is principal or tree in the hands of one man may be interest or fruit in the hands of another. Law books in the hands of a lawyer are a capital asset; in the hands of a bookseller, they are a trade asset.***

17.17 Applying the same analogy in the present case, the question by the Tribunal is whether the customer receipts in the hands of the Appellant are tree or are fruit. The case of ***BP Southern Africa (Pty) Ltd v CSARS (69 SATC 79)*** also dealt with the nature of expenditure. In the lower court it was decided that a payment for the right to operate under a certain name was of a capital nature. However, on appeal the Supreme Court of Appeal was of the opinion;

> ***"…that the amount was not of a capital nature as it was more closely connected to the taxpayer's income-earning activities (i.e., the fruit) than it was to its income-earning structure (i.e., the tree)".***

17.18 The latter case guides us as the Tribunal to consider whether the asset itself and the income earning activity are inextricably linked, such that one cannot occur, without the presence of the other. **In Californian Copper Syndicate v Inland Revenue**[3]**,** the court stated that;

> "…***where what is done is not a realisation or change of investment but is truly the carrying on or carrying out of business, such proceeds are assessable to income tax as profits".***

17.19 In the case at hand, the Appellant is carrying on the business of providing electricity to customers. First connecting customers to the electricity grid by procuring and installing transmission and distribution lines is a necessary concomitant of the provision of this service. It follows naturally that receipts from this transaction are part of the revenue generated from the Appellant's normal business activities hence should not be excluded on the basis of being capital in nature.

17.20 It is the Tribunal's view that the amounts noted as "Capital contributions" or "capital receipts" should have been included in the income of the Appellant. Having established that the amounts collected from customers should form part of the Appellants income, a further question arises to the Tribunal as to whether they can claim an initial allowance on the assets which are procured using contributions by customers.

17.21 The Tribunal when examining section 14 (1) (d) to (h) of the Order, noted that the intention of the legislature on the allowances provided was to offer tax incentives as a relief to a taxpayer who has incurred a cost in obtaining a business asset. Initial allowances for qualifying assets are all calculated on the 'cost to the taxpayer' of the particular asset.[4]

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[3] [1904] SLR 41_691

[4] Paper titled "Property and capital allowances".

17.22 In this regard, it follows that any initial allowance the Appellant is entitled to claim should be based on the cost incurred by the Appellant in the procurement of such asset. In this case, the question whether the initial allowance can be claimed would depend on the extent of the contribution (if any) made by the Appellant towards the cost of the asset (that is the cost it incurs). A contribution by definition connotes that the cost burden is shared. It can also mean a help or subsidy.

17.23 This finding is also substantiated, in part by the ordinary meaning of the word "contribution" in the Oxford dictionary which defines the word contribution to mean;

"The act of giving something to help a person or organization".

17.24 The tax implication of which would be that the Appellant will only claim initial allowance to the extent of the amount it contributed. This would accord with the provision of the Order in Section 14 (1) (e)(ii) where it states that the allowance may be claimed for;

> ***"…such infrastructural machinery, plant or facilities are first used equal to fifty percent of the cost incurred by the taxpayer on or after the 1st of July 2000; "(emphasis added)***

17.25 Thus, given that the Appellant cannot claim, they incurred the full cost of the procurement of the transmission lines, where they jointly contributed with the customer, it is expected that the Appellant would account for the cost of their contribution (if any) and that is the amount they would be entitled to claim 50% initial infrastructural allowance on, in terms of the law since that would the amount incurred.

17.26 The Appellant canvassed the arguments that grid connection charges are a type of service connection charge. Appellant claims Specifically that, these charges refer to the operation carried out to connect the supply point with the electricity grid of the distribution company, thus ensuring that the energy reaches your home. Service connection charges are all the costs involved in the operations

needed to start up a new supply point.[5] The Appellant further pointed out that the position in South Africa is similar to Eswatini as well in that customers are required to make a contribution towards ESKOM for the provision of new or additional capacity or for direct services rendered to a customer such as, the provision of service mains, the installation of equipment in the customer's substation, etc.

17.27 These charges are referred to as “standard charges” and are raised in addition to the standard tariff prices.[6] From the foregoing it becomes clear that the treatment in South Africa is that these are standard connection fees and are not treated as a separate capital transaction but included in the Utility Company’s gross income.

17.28 It is the Tribunal’s view that this request should have been made as soon as such transactions arose so that the Respondent would pronounce itself on the matter before any audit arose. In any case with the current arrangement in place (treating the income from customer receipts as capital) this prior request would not cure the fact that the Appellant is not entitled to claim initial allowance on assets whose cost is not borne by it. Were this not an issue, the Respondent could be enjoined to make an exception to this set of circumstances especially since the provision gives the Commissioner the discretion to prescribe the manner of notification in a way, he deems fit.

17.29 Again, the evidence before us is clear and convincing that both parties had not reached common ground on the correct tax treatment of “customer receipts”. Therefore, the Tribunal is of the view that in order to address and ensure a measure of certainty and consistency when dealing with customer receipts, Respondent as empowered, should make a practice note in order for taxpayers not to act contrary to the guidelines outlined therein without good reason.

17.30 As indicated earlier in this judgment, the second ground of appeal is whether Appellant is entitled in law to claim wear and tear allowance or a depreciation allowance for its transmission and distribution lines purchased using customer

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[5] 2023 Endesa Energía, Endesa S.A

[6] ESKOM Schedule of Standard Fees 2022/23 **www.eskom.co.za/tariffs**

receipts /capital contributions. In such circumstances, the Tribunal is entitled to look at the applicable legislation founded upon the circumstances giving rise to claim wear and tear allowance or a depreciation allowance. Section 14 (1) (c) of the Income Tax Order provides that;

> ***"For the purpose of ascertaining the taxable income of any person there shall be deducted from the income of such person such sum as the Commissioner may think just and reasonable as representing the diminished value by reason of wear and tear during the year of assessment of any plant machinery, implements, utensils and articles used by the taxpayer for the purposes of his trade;"***

17.31 The Appellant refutes that it is not entitled to claim wear and tear allowance on the transmission and distribution lines merely because the transmission lines are constructed using funds contributed for by customers named "customer contributions". The Appellant in turn argues that the Respondent ought to distinguish between two receipts from customers, the first being a "capital contribution" which the Appellant concedes are capital in nature, and the second being "customer receipts" generated from the sale of electricity. For it is the second receipt type that is generated revenue and thereby taxable income.

17.32 Therefore, because it is these assets that contribute wholly to generate this taxable income, they qualify for the claim for wear and tear allowance as envisaged by Section 14(1)(c) of the Income Tax Order. Stating further that the fact of the asset being constructed using customer contribution is immaterial and does not disqualify them from the claim for as captured in Section 14(1)(c) of the Order. Relying on the case of ***Volkswagen South Africa (Pty) Ltd vs Commissioner for SARS***[7] where the court held.

> ***"… that the accrual of rebates calculated with reference to capital expenditure, to which the Appellant became entitled under a government scheme to assist and support the motor industry should be regarded as***

[7] (1123/2016) [2016] ZASCA 190

accruals of a Revenue and not Capital nature. Thus, fell <u>to be included in the Appellants gross income</u>.

17.33 However, during the argument before us, the Respondent argues that they have disallowed this deduction on the basis that the income from which the depreciation allowance is sought to be deducted, was not included in the Appellants income due to the fact that it was classified as capital being "customer receipts" or "capital contributions". They have relied on Section 15(1)(f) of the Order for this disallowance, rationalizing that since the distribution and transmission lines were purchased not from the Appellants income but effectively from customer receipts then the Appellant is not entitled to claim wear and tear on these assets. It is contended by the Appellant, that the Respondent erroneously relied on Section 15 (1) (f) of the Income Tax Order in coming to its findings regarding the disallowance of the depreciation claim.

17.34 It is the Tribunal's view that the provision applicable to the disputed depreciation claim is s 14(1)(c) of the Order. This section grants a discretion to the Commissioner as he may think just and reasonable to ascertain the taxable income of any person. The Tribunal is of the view that this is a misguided application of Section 15(1)(f), since the funds used to procure the assets are distinguishable from the revenue generated by the asset. Deciding on the deductibility of the wear and tear based on the customer receipts/capital contributions is quite erroneous because the assets, regardless of how they have been procured, are in fact owned and utilized by the taxpayer in the ***production of taxable income*** which was in fact included in the gross income of the taxpayer and taxed. It is a misdirection to base a finding on incorrect statutory provisions. This Tribunal is thus entitled to intervene with the Respondent's determination and allow the wear and tear based on section 14 (1) c) of the Order.

17.35 The question arises therefore that if, by mere fact that the funds (customer receipts) used to procure the assets is excluded from income, does it follow that the right to claim wear and tear allowance falls away? It cannot be that the source of funds for the acquisition of the asset should have a bearing on the consequences of its use.

17.36 The Tribunal is of the view that the qualifying criteria for the application of wear and tear allowance is "owned by the taxpayer and used in the production of taxable income". The concept of usage underpins the deductibility of wear and tear allowance. The revenue declared to the Respondent is partly representative of the revenue generated by the asset, therefore, it is included in the income of the taxpayer and Section 15 (1) (f) of the Order does not apply.

17.37 Due to the order relating to the wear and tear allowance being based on an incorrect legislative provision, the issue stands to be reconsidered by the Tribunal. To this end, it is apparent that the legislature intended that, by virtue of use of an asset in the course of trade, that taxpayer must benefit from the Commissioner realising the diminishing value of the asset. The provision makes no further qualification, and it would be unfair of the Respondent to impute their own conditions of what qualifies for the allowance in the Act.

17.38 It is necessary, at this juncture, to pause and have regard to the methodology used in New Zealand,[8] where businesses that receive a capital contribution from customers i.e., have another party assisting to finance the asset, choose whether to treat it as income or a reduction in their depreciation asset base. The practical implication for either choice is that a business treats a contribution as income, it must return 10% of the contribution as taxable income every year for 10 years (meaning it is taxed gradually over a period of 10 years). If a business uses the contribution to reduce its depreciation asset base, it must reduce the tax book value of the relevant assets by the value of the capital contribution.

17.39 The Tribunal is of the considered view that, the fact that this position is not binding in the Eswatini context without legislative reform, the example serves to illustrate the fact that it would require an amendment of this nature and specificity in the legislation to disallow wear and tear/depreciation allowance claims on the basis that the asset was not funded by the taxpayer or was bought through funds not included in income. Since there is currently no express provision of this nature in Eswatini, the Respondent cannot read it into the meaning of Section 15 of the Order in that manner.

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[8] https://www.ird.govt.nz/ Inland Revenue Department of New Zealand. See explanatory note on New Zealand position on treatment of Capital allowances.

17.40 The South African context also presents another dimension to this. For instance, Interpretation Note 47 of the South African Income Tax Act 58 of 1962, elaborates on the use requirement as prerequisite for wear and tear allowance;[9]

> ***"Use requirement;***
>
> ***The allowance is deductible only to the extent that the qualifying asset is used by a taxpayer for purposes of his or her trade. The asset will be written off over its useful life."***

17.41 The interpretation further qualifies use in its ordinary dictionary meaning, being;

> ***"[t]ake, hold, or deploy (something) as a means of accomplishing or achieving something; employ; take or consume".***[10]

17.42 With the above foundational explanation, it becomes clear that an asset, whether acquired through a purchase, contribution, or donation, once the asset is employed for the business of the taxpayer and generates income for the entity, then the deduction is allowed on the basis that the asset diminishes in value as it is in operation for income generation. In this case for instance since, even after the said capital process has been completed and the lines energised, the customer will continue to buy electricity and in the event the lines are struck by lightning the Appellant will do repairs to restore the disruptions. It is thus the Appellant who bears the cost of the diminishing life of the asset since they thereafter own it regardless of funding.

17.43 The Interpretation Note cited above goes on to clarify how, wear and tear allowance is to be calculated of an asset acquired by the taxpayer in ways other than purchase by the taxpayer and states the following:[11]

> ***"The allowance on a qualifying asset acquired by a taxpayer by donation, inheritance from a person dying before 1 March 2016, distribution in specie or at a non-arm's length price from a connected person is based on the market value of the asset.***

[9] See point 4.1.5 at page 9 of the interpretation note.
[10] Lexico.com dictionary.
[11] See point 4.2.4 at page 11 of the interpretation note.

17.44 Therefore, in our considered view, there seems to be no basis in law in which the disallowance of the wear and tear allowance was founded by the Respondent and thus it was disallowed erroneously. To this end the Appellant submits a correct position in its grounds as contained in the Notice of Appeal that "*the source of funding should not be a determining factor on whether an asset qualifies for wear and tear or not*", noting further that "*the network gets depleted over time and needs to be replaced*". This use that causes the depletion of the network is in fact the qualifying criteria for the claim of wear and tear allowance because it what fundamentally generates (with a combination of other factors) the revenue that is taxable.

18) CONCLUSION

18.1 Having considered the basis of the appeal as advanced by the Appellant, which is the dissatisfaction with the disallowance of initial infrastructural and wear and tear allowances by the Respondent, it is apposite to highlight that the mainstay for the Respondent's case is that for the Appellant to claim these allowances the income related to them must be reflected in the Appellant's gross income.

18.2 In light of the above analysis, the Tribunal cannot overlook the fact that there was an agreement made between the parties, setting a precedent for the treatment of the claim of these allowances for ten (10) tax years on newly capitalized assets without prior application. We cannot ignore the fact that the issue of the agreement is critical. The Respondent as an enforcement entity cannot establish a pattern and change it without a prior notification. Respondent is supposed to allow a time for the conversion.

18.3 Unfortunately, in this instance, RATE/IT003/22 is an entity that serves the broader public, we are compelled as a Tribunal to consider the implications of this agreement and its violation in the country. It is also important for the Tribunal, when conducting proceedings and formulating judgments to observe the principles of equity and fairness. This helps to ensure that the remedies are as effective as possible in remedying breaches of the legislation in the country. The second will assist in terms of identifying good practices which can provide a source of inspiration for both parties.

18.4 In this case, the Appellant did what many taxpayers in its position would have done, which is to conclude that they are entitled legislatively to claim initial infrastructural allowance for transmission and distribution lines purchased using customer receipts/capital contributions. In our considered view, a sufficient advance warning of a change in the agreement should have been done to validate the arrangement. Therefore, they deserve the time to rectify it to meet the law because of their magnitude and their critical importance in the country.

18.5 The Tribunal stand with RATE/IT003/22 that effecting the change in the arrangement in the current year is detrimental as they should be allowed an adequate time to correct the situation. They must maintain the status quo and give an opportunity to adjust themselves. For these reasons, it is our view that the breaching of the agreement without a prior and precise warning, is fatally prejudicial to the taxpayer and justifies the relief sought.

18.6 In respect to the claim for wear and tear allowance and in particular whether it was legitimately disallowed by the Respondent, the Tribunal is of the view that the qualifying criteria for a claim for wear and tear allowance is ownership and use of an asset for the purposes of trade. The determining factor is whether the assets are used in the business of the taxpayer to generate revenue or not, thereby diminishing in value over time. In this case, the assets are employed to generate revenue which is taxable. On that basis the Commissioner General ought to grant an allowance for the diminished value as provided in Section 14(1)(c) of the Order.

19) ORDER

The Tribunal therefore makes the following orders:

1. The Appellant is not entitled to claim initial infrastructural allowance on assets whose cost is not borne by it, but they can claim to the extent to which they incurred the cost.

2. The Respondent is ordered to maintain the status quo in respect of both initial infrastructural allowance and wear and tear allowance and shall effect any changes in the Appellant tax assessment year commencing 2024/2025 so as to allow the Appellant to adjust accordingly.

3. The Respondent is hereby ordered to comply with section 14 (1) (c) of the Income Tax Order and allow the deduction on wear and tear allowance.

4. The income tax desk audit outcome dated 27 October 2022 is hereby set aside.

5. In this matter, each party should therefore bear its own costs

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MS FIKILE DLAMINI

CHAIRPERSON OF THE TRIBUNAL

I Agree.

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MR SANDILE DLAMINI

MEMBER OF THE TRIBUNAL

I Agree.

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MS NTOMBEHLE SHONGWE

MEMBER OF THE TRIBUNAL

Appearance

For Appellant: Mr Sandile Khumalo (with him Thabiso Masina)

For Respondent: Ms Bongekile Nsingwane (with her Dumezweni Mdluli)