



**THE SUPREME COURT OF APPEAL OF SOUTH AFRICA
JUDGMENT**

Not Reportable

Case No: 154/2022

In the matter between:

ENVIROSERV WASTE MANAGEMENT (PTY) LTD

APPELLANT

and

**THE COMMISSIONER FOR THE SOUTH
AFRICAN REVENUE SERVICE**

RESPONDENT

Neutral citation: *Enviroserv Waste Management (Pty) Ltd v The
Commissioner for the South African Revenue Service
(154/2022) [2023] ZASCA 180 (18 December 2023).*

Coram: DAMBUZA AP, ZONDI, NICHOLLS and GORVEN JJA and
MALI AJA

Heard: 13 March 2023

Delivered: This judgment was handed down electronically by circulation to the parties' representatives by email, published on the Supreme Court of Appeal website, and released to SAFLII. The date and time for hand-down is deemed to be 11h00 on 18 December 2023.

Summary: Income tax law – s 12C(1)(a) of the Income Tax Act 58 of 1962 (the ITA) – whether cells built into landfills and used for treatment and storage of waste qualify as plant under the section – whether they qualify as buildings under s 13 of the ITA – decomposition and biodegradation of the waste in the

cells is a process similar to manufacture – the appellant is entitled to claim depreciation allowance in respect of the cells.

Income tax law – understatement penalty imposed for an incorrect statement made in income tax returns – reasonable care not taken in completing returns – Commissioner for the South African Revenue Service did not prove prejudice under s 102 read with ss 221 and 223 of the Tax Administration Act 28 of 2011.

ORDER

On appeal from: The Tax Court of the Western Cape Division of the High Court, Cape Town (Cloete J sitting as a court of appeal):

- 1 The appeal is upheld with costs.
 - 2 The order of the tax court is set aside and replaced with the following order:
 - ‘1 The appeal is upheld with costs.
 - 2 The appellant’s 2015 and 2016 additional assessments are referred back to the Commissioner for the South African Revenue Service in terms of s 129(2)(b) of the Tax Administration Act 28 of 2011 to be altered accordingly.’
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JUDGMENT

Dambuza AP (Zondi, Nicholls and Gorven JJA and Mali AJJA concurring)

Introduction

[1] This appeal concerns the interpretation of s 12C(1)(a) of the Income Tax Act 58 of 1962 (the ITA). More particularly, the issue is whether cells constructed by the appellant, Enviroserv Waste Management (Pty) Ltd (Enviroserv), on its landfill sites constitute plant used directly in a process of manufacture or a process similar to manufacture. Allied to that is the question whether Enviroserv was entitled to claim a depreciation allowance from the Commissioner for the South African Revenue Service (the Commissioner) in respect of the cells. A further issue is whether an Understatement Penalty (USP) levied by the Commissioner for Enviroserv’s failure to disclose interest due to it by it from its Ugandan subsidiary, was properly imposed.

[2] The tax court of the Western Cape Division of the High Court, Cape Town, per Cloete J (the tax court), dismissed an appeal against disallowances by the Commissioner, of depreciation claims made by Enviroserv in terms of s 12C(1)(a) of the ITA. That court also imposed an understatement penalty against Enviroserv, at 15% of the understated amount, for failure to disclose interest income due from a loan made to a Ugandan subsidiary. This appeal is with the leave of the tax court.

The facts

[3] Enviroserv conducts a business of waste management services. This entails collection of pre-classified solid waste from clients in return for fees. The waste is taken to landfill sites located in Holfontein, Shongweni, and Chlookop within the country, and in Mozambique and Uganda. There the waste is treated, recycled and disposed of as defined in s 1 of the National Environment Management: Waste Act No 59 of 2008 (the Waste Act). Enviroserv collects and manages waste of more than 10 tonnes in every month.

[4] The first issue relating to interpretation of s 12C(1)(a) concerns the process of converting hazardous solid waste material to waste material that is safe for disposal. At the landfill sites, the waste is weighed, its classification (per truck) is confirmed and it is taken into the 'workface' (the inside of a cell). The cells are constructed by a process of excavation on a landfill site, and installation in the cells of a subsoil and drainage system. Inside the cell, the waste is treated, prior to its disposal, to 'change its physical, biological, or chemical character or composition' to reduce its hazardous impact on the environment.

[5] The dispute between the parties emanates from claims made by Enviroserv to the Commissioner as depreciation allowances in respect of the

cells, for the 2015 and 2016 income tax assessment years. The amounts claimed were R48 947 694.61 in respect of 2015 and R41 306 206.93 for 2016. These amounts constituted 40% and 20% depreciation in respect of the cells for the years 2015 and 2016 respectively. The Commissioner disallowed the claimed amounts, maintaining that the cells are waste disposal assets as defined in s 37B of the ITA, and that Enviroserv was only entitled to claim depreciation at 5% per year in respect thereof. The Commissioner then raised additional assessments in respect of the disallowed claims.

[6] Furthermore, the Commissioner levied an understatement penalty (USP) of 25% in respect of claims for future expenditure made under s 24C of the ITA against Enviroserv for the same years. During the same years Enviroserv has failed to declare interest income of R25 910 000 due to it in respect of a loan advanced to its Ugandan subsidiary. Because of financial constraints, the subsidiary had not been able to pay the interest and Enviroserv impaired it for accounting purposes, as 'not fully recoverable, but still due'.

The issues

[7] Enviroserv described the process that takes place in the cells as follows. The waste that is collected contains organic or inorganic elements or compounds that may have a detrimental impact on the environment because of inherent physical, chemical or toxicological characteristics. It is therefore treated with chemicals, which include lime, cement, caustic soda, ferrous sulphate, hydrogen peroxide, sulphur, sodium metabisulphite, and other chemicals in order to remove the hazardous compounds. It is deposited into the cells where it gets broken down and decomposes, producing a liquid substance known as leachate (contaminated fluid). The cells are designed in such a manner that the toxin laden leachate is produced in the cells from decomposition and biodegradation of the hazardous solid waste in the cells. The

leachate gathers at the bottom of the cell and is drained and pumped away to a storage dam or tank. There it is treated through processes such as reverse osmosis, nano filtration, freeze crystallisation, and evaporation or micro encapsulation, for further removal of toxins before it is disposed safely as prescribed in legislation. The remaining solid waste is stored in the cells indefinitely and the landfill is monitored for 30 years to ensure that no leakage of toxic substances occurs.

[8] Enviroserv maintained that the process that takes place within the cells is ‘manufacturing’ or a process akin thereto. Consequently, so it argued, the cells constitute plant used directly in the process of its manufacturing activities or a process similar thereto as provided in s 12C(1)(a) of the ITA.

[9] In the statement filed in terms of rule 31 of the Tax Court Rules, the Commissioner pleaded that ‘the process in which the cells are used (the storage of waste) is ancillary to manufacture’. However, the Commissioner ultimately insisted that the cells are essentially used for storage of waste and not for a process similar to manufacture.

[10] In a letter addressed to Enviroserv, dated 29 March 2019, the Commissioner alleged that leachate is not manufactured, but is rather an ‘unwanted’ product that happens when water enters the landfill. The Commissioner’s theory was that the landfills are constructed in order to avoid formation of leachate inside them. If leachate somehow forms in the landfill, it is treated and does not enter the environment.

[11] Furthermore, the Commissioner asserted that cells are buildings rather than plant because they are:

‘. . . immovable property that has been structured to fulfil the purpose of waste disposal. The various layers constructed cannot be viewed as plant as these are not fixtures, implements, machinery or apparatus used in carrying on any industrial/manufacturing process but permanent structures. The landfill is an asset used to handle resultant pollutants outside the ongoing process.

Thus the landfill will be classified as an environmental waste disposal asset that is more akin to the longer useful life of a manufacturing building and is similar to the examples provided in the EM [Explanatory Memorandum], namely dams, reservoirs, evaporation ponds, etc.’

[12] The approach adopted by the tax court to the issues was, first, to enquire whether the landfills and the cells built thereon constituted a plant qualifying as an environmental treatment and recycling asset or whether they were environmental waste disposal assets. While accepting that the treatment of leachate commenced in the cells, the court found that ‘the principal activity of the constructed cells’ is the final disposal of the waste streams managed by Enviroserv. It concluded that the landfills are manufacturing buildings rather than plant. Therefore, they qualified as waste disposal assets provided for under s 37B(2)(b) rather than manufacturing plant as provided in s 12C. The court then made adjustments to Enviroserv’s income tax assessments for the years 2015 and 2016 from the claimed depreciation of 40% and 20%, to 5%.

[13] The tax court also agreed with the Commissioner that there was a misstatement in Enviroserv’s tax returns in that the interest of R25 910 000 should have been included as accrued gross income for the assessment year 2016, and that the failure to include it resulted in an overstatement of Enviroserv’s losses. The parties had, in any case, agreed that an upward adjustment of R25 910 000 should be effected on Enviroserv’s taxable income. The Commissioner had also conceded, in the tax court, that the penalty rate be reduced because Enviroserv had made a voluntary disclosure of the understatement, after notification of the commencement of the South African

Revenue Service (SARS) audit. The tax court reduced the penalty rate from 25% to 15% (from a standard case of reasonable care not taken in preparing the tax returns to voluntary disclosure after notification of audit).¹

This appeal

[14] In this appeal, in addition to appealing the dismissal of its depreciation claims, Enviroserv contends that the Commissioner should not have levied any penalty on the s 24C claims, because the understatement resulted from a ‘bona fide, inadvertent error’ as contemplated by ss 222(1) to 223 of the Tax Administration Act 28 of 2011 (the TAA). Under s 223 of the TAA, 15% is the penalty percentage rate applicable for understatement in standard cases where reasonable care has not been taken in completing an income tax return.²

The depreciation claims

[15] In the relevant parts, s 12C(1)(a) of the Act regulates the grant of depreciation allowance for plant and machinery as follows:

‘In respect of any–

(a) machinery or plant . . . owned by the taxpayer . . . and . . . brought to use for the first time by the taxpayer for the purposes of the taxpayer’s trade (other than mining or farming) and . . . used by the taxpayer directly in a process of a manufacture carried on by the taxpayer or any other process carried on by the taxpayer which is of similar nature;

...

a deduction equal to 20 per cent of the cost to that taxpayer to acquire that machinery, plant . . . shall be allowed in the year of assessment during which the asset is so brought into use and in each of the four succeeding years of assessment. . . ’

¹ See the understatement penalty percentage rates set out in s223(1) of the Tax Administration Act 28 of 2011 (the TAA).

² Other understatement cases in respect of which percentage penalty rates are stipulated are obstructive and/or repeat cases, voluntary disclosure after notification of audit or criminal investigation, and voluntary disclosure before notification of audit or criminal investigation.

[16] There is no definition in the ITA for ‘process’ or ‘manufacture’ or ‘process of manufacture’. This Court made this observation in *SIR v Safranmark*.³ In that case, this Court considered the meaning of ‘process of manufacture’ as used in s 12 of the ITA (the predecessor of s 12C). The Commissioner’s predecessor, the Secretary for Inland Revenue, had disallowed Safranmark’s claims for ‘machinery initial allowance’ and ‘machine investment allowance’ in respect of machinery used to cook Kentucky Fried Chicken. Provision was made for these deductions under s 12(1) of the ITA in respect of ‘new or unused machinery or plant brought into use by the taxpayer for the purposes of his trade used by him directly in a process of manufacture or any other process which in the opinion of the Secretary is of a similar nature’⁴

[17] In upholding Safranmark’s claims, this Court cited with approval the following interpretation attributed to ‘process of manufacture’ in *Secretary for Inland Revenue v Hersamar*:⁵

‘Neither of the governing words in the phrase under consideration, viz “process” and “manufacture”, are words of any exact significance. Consequently the whole phrase, “a process of manufacture”, is one to which it may be very difficult to assign a meaning expressed in terms which would properly distinguish between all cases which fall within the scope of the phrase and those which should fall outside its scope. The word “process” can cover an unlimited multiplicity of types of operations: “manufacture”, in its widest sense, can be said to mean the making of any sort of article by physical labour or mechanical power. DARLING J in *McNicol v Finch* (1906) 2 KB 352 at 361 stated that “the essence of making or manufacturing is that what is made shall be a different thing from that out of which it is made”.’

[18] It was not in dispute that Enviroserv’s waste management services entail treatment of hazardous solid waste so that it would be safe for storage. In reaching the conclusion that the cells are used for waste storage – a purpose that

³ *Secretary for Inland Revenue v Safranmark (Pty) Ltd* 1982 (1) SA 113 (A) (*Safranmark*).

⁴ *Safranmark* at 118F-G.

⁵ *Secretary for Inland Revenue v Hersamar (Pty) Ltd* 1967 (3) SA 177 (A) at 186H-187A.

is ancillary to manufacture – the Commissioner ignored the process of separation of the leachate from solid waste in the cells prior to the draining of the leachate from the cells. The omission of the process that occurs in the cells, and consideration only of the ultimate storage of treated waste in the cells, which is the final stage in the chain of waste management steps, is incorrect.

[19] By all accounts, the generation of leachate through decomposition and biodegradation occurs in the cells. The Commissioner admitted this much in his rule 31 statement, stating that ‘SARS accepts that the treatment of leachate into a form that is suitable for lawful disposal (“treated leachate”) . . . is a process similar to manufacture’. It was not in dispute that the purpose of treatment of the hazardous waste is essential for change in the physical, biological and chemical character of the waste in order to minimise its impact on the environment. And the tax court accepted that the treatment of leachate and the production of leachate was a process similar to manufacture. In as far as the tax court’s interpretation of the section was founded on the ‘principal activity’ of the cells, it finds no support in the words used in the s12C(1)(a). Importantly, there is no evident reason why such principal activity should be based on the number of years of waste storage and not the process of manufacture which is essential for safe storage of the waste.

[20] Any dictionary meaning used to interpret the process of manufacture must be informed by the words used in s 12C(1)(a), the purpose of that section and the context within which the section applies. The dictionary interpretation advanced by the Commissioner that, for a process of manufacturing to have taken place, there must have been ‘manual labour or mechanical process’ finds no support in the words used in s 12C(1)(a). Nor does it find support in the context where the production of the end product (in this case the leachate) is drained from the solid waste as a result of the design of the plant or machinery

(in this case the cells). The dictionary definition of ‘manufacture’ as ‘the act or process of producing something’⁶ is more consistent with the words used in the section, except that the end product must be different from the original material.

[21] Furthermore, nothing in the section can be interpreted to mean that raw material is ‘insufficient’ as an end product of the process of manufacture as contended by the Commissioner. The test is whether that which is made is different from that out of which it is made.⁷ In *Secretary for Inland Revenue v Cape Lime Company Ltd*,⁸ this Court held that:

‘... it does not offend against reason to say that the blasting operation at the quarry, whereby a portion of the raw material is removed from the rock face and fragmented in the process of doing so, is the commencement of a series of operations in which different techniques are employed at successive stages in order to manufacture lime from the natural deposits of limestone on the respondent’s land. The first stage of change in the raw material takes place at the quarry as a result of the blasting operations which remove rock from the face of the quarry and breaks it up into smaller portions, some of which have to be subjected to further blasting in order to reduce them to a size suitable for feeding into crushers.’

In the present case too, the fact that the decomposition and biodegradation resulted in the formation of unhazardous waste and leachate (raw material) does not detract from the fact that the leachate, produced from the process that occurred in the cells, is essentially different from the components that went into its production.⁹ In the same vein no words in s12C(1)(a) support the interpretation that the end product must be useful or wanted.

[22] Is s 37B of the ITA the correct provision to apply? The first issue raised by the Commissioner in this regard is that the cells do not constitute plant as envisaged in s 12C(1)(a) and they are not fixtures, implements, machinery or

⁶ See Merriam-Webster.com Dictionary, Merriam-Webster, <https://www.merriamwebster.com/dictionary/manufacture.webster.com/dictionary/manufacture>, as at 16 August 2023.

⁷ See *Safranmark* para 18.

⁸ *Secretary for Inland Revenue v Cape Lime Company Ltd* 1967 (4) SA 226 (A) at 234G-H.

⁹ *Safranmark* at 117E-H.

apparatus used in conducting or promoting Enviroserv's business. Instead, they are rather structures, 'something akin to dumps or reservoirs as provided in s 37B'. The tax court agreed with the Commissioner, highlighting the fact that the cells are used as storage facilities in perpetuity and cannot be re-used.

[23] The correct approach, however, is to enquire into whether the apparatus, fixture, or machinery is utilised in conducting the activities of the business – referred to as the functionality test: 'If it is, it does not matter that it consists of some structure attached to the soil'.¹⁰ In this case, the utilisation of the cells by Enviroserv for extraction of leachate and for storage of non-hazardous waste is clearly in the conduct of its business.

[24] Section 37B(2)(b) regulates depreciation of environmental treatment and recycling assets, and environmental waste disposal assets of a permanent nature which are used by a taxpayer in a process that is ancillary to a process of manufacture or any process similar thereto. Plant and equipment are depreciated at a rate of 40/20/20/20 per year. Permanent structures such as reservoirs and dumps are depreciated at the rate of 5% per year.

[25] Importantly, the definitions part of s 37B reads thus:¹¹

'Deductions in respect of environmental expenditure. –

(1) For purposes of this section–

¹⁰ *Blue Circle Cement Ltd v Commissioner for Inland Revenue* 1984 (2) SA 764 (A) at 774D.

¹¹ The rest of the section regulates the rates at which allowances are given, as follows:

'(2) There shall be allowed to be deducted from the income of the taxpayer, in respect of any year of income tax assessment an allowance equal to–

(a) . . .

(b) in the case of a new and used environmental waste disposal asset owned by the taxpayer or acquired by the taxpayers in terms of an agreement contemplated in paragraph (a) of the definition of an "instalment sale agreement" in terms of section 1 of the Value Added Tax Act, five per cent of the cost to the taxpayer to acquire the asset in the year of assessment that it is brought into use for the first time by that taxpayer, and five per cent in each succeeding year of assessment.'

“environmental treatment and recycling asset” means any air, water and solid waste treatment and recycling plant or pollution control and monitoring equipment (and any improvement to the plant or equipment) if the plant or equipment is–

- (a) utilised in the course of a taxpayer’s trade in a process that is ancillary to any process of manufacture or any other process which, in the opinion of the Commissioner, is of a similar nature; and
- (b) required by any law of the Republic for purposes of complying with the measures that protect the environment; and

“environmental waste disposal asset” means any air, water and solid waste disposal site, dam dump, reservoir, or other structure of a similar nature, or any improvement thereto, if the structure is–

- (a) of a permanent nature,
- (b) utilised in the course of a taxpayer’s trade in a process that is ancillary to any process of manufacture, or any other process which, in the opinion of the Commissioner, is of a similar nature, and
- (c) required by any law of the Republic for the purposes of complying with the measures that protect the environment.’

[26] A sensible interpretation of the definition of ‘environmental waste deposit asset’ in s 37B(1) is that, where a disposal asset is not an indispensable part of the process of manufacture but is utilised for the ancillary purpose of compliance with legal prescripts aimed at protecting the environment, then the provisions of this section are applicable. In other words, where the desired results can be achieved without utilisation of the asset, then the asset is ancillary to the process of manufacture of similar process. Where, as in this case, the asset is an indispensable part of the manufacturing process, it cannot be ancillary to that process.

[27] Significantly, clause 5.4.1 of Enviroserv’s licence prescribed that:
 ‘All leachate produced by the site must be collected in containment works constructed according to condition 4.13 from where it must be treated in a leachate treatment plant.’

The decomposition, biodegradation and extraction of the hazardous leachate is an indispensable part of the treatment of the hazardous solid waste. The fact that the cells, in which leachate generation occurs, are also used to permanently store the non-hazardous material, does not detract from their use directly in the process of manufacture or a process similar thereto. The conversion of the collected hazardous solid waste material into waste that is safe for storage is the purpose of Enviroserv's business. The 'unwanted' leachate is an intended or desired product of the processes performed by that business.

[28] Consequently, contrary to the Commissioner's contention, the cells are not waste disposal assets. Neither are they 'buildings' as envisaged in s 13 of the ITA.¹² The cells were constructed with the specific intention that they would be used as plant wherein the extraction, collection and disposal of leachate would occur, with a special drainage system installed for collection of leachate.

Understatement penalties

[29] The basis for imposition of an understatement penalty¹³ is the prejudice suffered by the Commissioner as a result of understatement of income by a taxpayer. 'Understatement' is defined in s 221 of the TAA as:

'any prejudice to SARS or the *fiscus* in respect of a tax period as a result of -

- (a) a default in rendering a return;
- (b) an omission from a return;
- (c) an incorrect statement in a return; or
- (d) if no return is required, the failure to pay the correct amount of "tax".'

[30] It was submitted on behalf of the Commissioner that Enviroserv failed to exercise reasonable care in completing its return because the decision to reduce the loan was taken by its own management rather than external advisors. Its tax

¹² Section 13 of the ITA deals with deductions in respect of buildings used in a process of manufacture.

¹³ As provided for under s 223 of the Tax Administration Act 28 of 2011.

manager, being a chartered accountant, should have realised that the glaring assessed loss of ‘almost R26 million needed to be treated with care’. However, in the statement prepared in terms of rule 31 of the Tax Court Rules, the Commissioner gave no details of any prejudice suffered by SARS. He merely identified, as one of the issues in dispute, the issue ‘whether the understatement penalties issued by SARS ought to be remitted or reduced’.

[31] This Court has held that it is not sufficient for the Commissioner to merely show that a taxpayer’s conduct falls within the provisions of s 221 (read with s 223(1)) of TAA (that is: whether the taxpayer’s conduct constitutes ‘substantial understatement’, reasonable care not taken, no reasonable grounds for ‘tax position’ taken, gross negligence or intentional tax evasion). The Commissioner must show that the reprehensible conduct caused prejudice to SARS or the fiscus.¹⁴

[32] Enviroserv contended that because it had suffered losses amounting to R4 billion during the relevant period, the erroneous understatement would not have resulted in any prejudice to SARS. That is because no income tax liability would have arisen from the understated amount. There was no response from the Commissioner on this aspect.

[33] The high watermark of the Commissioner’s case towards discharging the burden of proving prejudice,¹⁵ was a submission at the hearing of this appeal, that prejudice is not limited to financial prejudice; it includes the risk that the misstatement will hamper the ability of SARS to effectively administer tax legislation.

¹⁴ *Purlish Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* [2019] ZASCA 4 para 20.

¹⁵ Section 102 of TAA.

[34] However, these arguments do not assist the Commissioner in my view. Even if the prejudice includes mere risk to SARS (which we do not decide in this matter) the Commissioner made no effort to prove that risk. It remained incumbent upon the Commissioner to do so given the express onus to prove prejudice. Having failed to make any averment regarding any risk it was exposed to as a result of the misstatement the Commissioner did not discharge the onus placed on it under ss 221 and 223(1). As it was submitted on behalf of Enviroserv, the tax court should have considered whether the Commissioner had discharged the burden to prove the prejudice suffered by SARS.

[35] Consequently I grant the following order:

- 1 The appeal is upheld with costs.
- 2 The order of the tax court is set aside and replaced with the following order:
 - ‘1 The appeal is upheld with costs.
 - 2 The appellant’s 2015 and 2016 additional assessments are referred back to the Commissioner for the South African Revenue Service in terms of s 129(2)(b) of the Tax Administration Act 28 of 2011 to be altered accordingly.’

N DAMBUZA
ACTING PRESIDENT

Appearances

For the appellant: T S Emslie SC
Instructed by: MacRobert Incorporated, Pretoria
Lovius Block Inc, Bloemfontein

For the respondent: A Liversage SC
Instructed by: State Attorney, Pretoria
State Attorney, Bloemfontein.