



Synopsis

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Tax today*

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SARS's conduct in
clamping down on illegal
imports

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Decision approves SARS officers' conduct in search and seizure operation

The decision of the Supreme Court of Appeal in *CSARS v Saleem* [2008] ZASCA 19 – which set aside the judgment given by the High Court in favour of the taxpayer and approved the manner in which SARS officers had conducted themselves in a search and seizure operation – will have been greeted with jubilation by the Customs and Excise division of SARS.

The compelling logic of the SCA judgment is likely to be influential in several spheres.

The judgment will encourage SARS to be assertive in acting against suspected illegal imports.

The judgment is also likely to influence the Tax Courts and the High Court in the way in which they adjudicate on the duty of SARS officers where they swoop on taxpayers in their exercise of their draconian statutory powers to enter and search premises, require the production of documents and, where such documents are not produced, take follow-up action.

In this case, the further action that followed on the inspection of the premises was the seizure of goods on suspicion that they had not been lawfully imported.

The facts

Acting on complaints that retailers in the Brakpan area were trading in illegally imported goods, SARS inspectors had descended on a small clothing retailer in that town, trading as Payless Fashions. The inspectors examined its merchandise and observed that most of the clothing, shoes and bags were labelled “Made in China” and bore Chinese inscriptions.

The inspectors asked the manager in charge of the shop to produce the import documentation for the goods, or invoices showing from whom they had been purchased. The manager claimed that he was not the owner of the goods, that he did not know where the owner was, that the owner merely visited the shop from time to time, and that the goods had been purchased for cash from retailers or wholesalers in the Chinese district of Johannesburg. He offered to take the inspectors to those suppliers, but the inspectors declined.

All that the manager was able to produce were two or three invoices, which contained no description of the goods to which they related, nor did they reflect who the buyer was.

The SARS officers then served a notice of detention of the goods, which recorded that the goods would remain sealed and in detention at the shop premises, pending further investigation.

The officers also recorded that the detention would be lifted once supporting documents, such as commercial invoices, were produced. The purpose of the detention was to afford the owner of the goods an opportunity of proving that the goods had been lawfully imported. To this end, the shop manager was given three days to produce the necessary documents.

Prior to the effluxion of those three days, the shop manager introduced the SARS inspectors to a Mr Chen who said he was the owner of the shop. Chen had been present at SARS's initial inspection of the shop, but it seems that he had stood silently by when the manager had said that he did not know where the owner was.

Chen handed SARS some ten invoices, which suffered from the same shortcomings as the earlier ones – in particular, they did not reflect Payless Fashions as the purchaser, nor did they contain a description of the goods purchased. When asked for proof of ownership of the business, Chen produced a VAT number and an income tax number.

On checking, SARS established that the VAT number did not refer to a Mr Chen,

and that the income tax number was in respect of some unknown person.

SARS then removed the stock that bore indications that it had been imported from China. The volume was so large that the removal required an eight-ton truck.

Two days later, the taxpayer brought a High Court application for the return of the seized goods.

The approach of the High Court

In the High Court, the judge approached the detention and seizure of the goods in the light of the fundamental rights enshrined in the Constitution.

The enquiry, said the High Court, was whether the SARS officer in question, who had been acting in terms of section 88(1) of the Customs and Excise Act 91 of 1964, had the requisite reasonable suspicion that the goods in issue might be liable to forfeiture in terms of the Customs and Excise Act.

On an examination of the facts, the High Court held that the SARS officer had indeed had a suspicion that the goods had been illegally imported, but that, in the circumstances, the suspicion or belief was not reasonable.

The mere fact that the goods in question bore labels indicating that they were made in China, said the High Court, was

insufficient to justify the inference that they were imported. Moreover, the SARS officer should have accepted the taxpayer's offer to take him to his suppliers. By refusing to go with him, said the High Court, the officer made it practically impossible for the taxpayer to produce proof as to the persons from whom the goods had been obtained.

The court said that, for the SARS officer to base the seizure decision on the absence of supporting documentation, was not justified. Section 102 of the Act, said the court, did not necessarily require the production of invoices – other proof of non-importation could have been given, for example, by taking the SARS officer to the persons from whom the goods had been bought

The court concluded that the SARS officer had erred in not making proper inquiry so as to come to a rational decision.

The court accordingly made an order that the seizure of the goods had been unlawful, and that they must be returned to the taxpayer.

The approach of the Supreme Court of Appeal

SARS took the matter on appeal to the Supreme Court of Appeal, which held that the sole issue was the reasonableness of the suspicion on the part of the SARS officer that the goods were imported goods and that further

If the taxpayer cannot produce the requisite documents SARS can exercise its further statutory powers – in this case the power under the Customs and Excise Act to seize and detain goods with a view to forfeiture.



investigation would establish that they were subject to forfeiture under the Customs and Excise Act.

The court pointed out that SARS's hand in this regard is strengthened by the provisions of sections 101 and 102(1) of the Act, which require that any person carrying on business in the Republic must keep books, accounts and documents relating to his transactions, and produce them on demand.

The court said that the High Court had overlooked an important factor, namely that the taxpayer had not at any stage contended that the goods had not been imported. It followed that the High Court had erred in concluding that the SARS officer should have investigated whether the goods were imported goods.

The Supreme Court of Appeal went on to say that, when considering whether the SARS officer had reasonable grounds for seizing the goods, there were a number of material facts.

First, the goods were marked as being made in China and bore Chinese inscriptions, and the taxpayer had not contended that the goods were made locally.

Second, the inability of the taxpayer to produce any books or documents recording where and from whom the goods had been purchased.

Third, the suspicious conduct when the manager had said, in Mr Chen's presence, that he did not know where the owner was and then, on a subsequent occasion, introduced Chen to SARS as the owner.

Fourth, that Chen had produced false VAT and income tax numbers.

Fifth, that despite telling the SARS officer that he had bought the goods in Chinatown, Chen had been unable to produce documents in the form of invoices or duplicate receipts from the suppliers.

Implications of the SCA judgment

The thrust of the Supreme Court of Appeal judgment is the emphasis which it lays on the taxpayer's statutory duty to maintain records and be able to produce them to SARS officers on demand.

The judgment makes clear that the onus in this regard is on the taxpayer, and that where the requisite documents cannot be produced, this will be sufficient justification for SARS to exercise its further statutory powers – in this case the power under the Customs and Excise Act to seize and detain goods with a view to forfeiture.

The Supreme Court of Appeal said that it took issue with the High Court where the latter held that the SARS officer had to do more by way of investigation than wait for the requisite documentary proof from the taxpayer. The taxpayer was under a statutory duty to maintain books of account and documents to reflect from whom the goods had been purchased.

The Supreme Court of Appeal concluded that the taxpayer's inability to produce such documents, together with the other suspicious conduct, were sufficient grounds for the SARS officer to conclude that the goods were liable to forfeiture, and that SARS was therefore entitled to seize them.

The Supreme Court of Appeal upheld SARS's appeal against the High Court judgment, and aside the order made by the latter.

“Any law” means South African statute law

A body established under foreign law cannot qualify for tax exemption under section 10(1)(cA) of the Income Tax Act

Exemption from income tax is a prize, highly sought-after. The Income Tax Act 58 of 1962 lays down detailed criteria for gaining tax-exempt status.

The recent decision of the Pretoria Tax Court in case 10849 (presumably of 2008) which has just been released in electronic format, concerned a non-profit organisation that had enjoyed tax-exempt status in South Africa from 1970 to 1987 in terms of the Double Tax Convention between the Republic and the USA.

That convention was abrogated in 1987, and the taxpayer's claim for tax-exemption thereafter depended on its falling within one of the categories for tax-exemption in the Income Tax Act.

The decision in this case clarifies an important aspect of section 10(1)(cA) of the Act, namely whether the reference in that provision to an institution, board or body, other than a company, which is “established by or under any law” means South African statute law, or whether establishment under a statute of another country would suffice.

The taxpayer was a non-profit organisation formed in New York

The taxpayer in this case was a non-profit organisation, founded in New York and formed in terms of a special Act of the New York legislature.

It was a non-profit organisation carrying on the activities of an independent classification society, that is to say, an organisation that sets and maintains standards of safety and reliability by establishing rules for the design, construction and maintenance of merchant ships.

It seems that the taxpayer would have met the criteria for tax-exemption laid down in section 10(1)(cA) if it had been incorporated under a law enacted in the Republic. However, it was merely a branch of the New York-based organisation which carried on the aforementioned services for the benefit of the South African maritime community.

The case – and the taxpayer's claim for tax-exempt status – turned on the interpretation of the phrase “institution, board or body ... established by or under any law”.

SARS argued that the word “any” in the phrase “any law”, though potentially of

wide scope, meant in this context, South African law, and in particular South Africa's statute law.

Support for this interpretation is found in the Interpretation Act 33 of 1957 which defines “law” as “any law, proclamation, ordinance, Act of Parliament ... having the force of law.”

Bell's South African Law Dictionary defines “any law” as “an enactment having legislative authority in the Union”, and cites in support of this proposition the decision in *R v Adams* 1946 CPD 288 which held that the word “law” in the Criminal Procedure Act 31 of 1917 referred to “any law enacted by a body having legislative authority in the Union or any other law especially made applicable to in the Union”.

The decision in *R v Detody* 1926 AD 201 was to the same effect.

The taxpayer argued that the phrase “any law” must include the legislative enactments of foreign countries.

The court ruled that “any law” refers only to South African statute law

In the result, the Tax Court held that, in enacting section 10(1)(cA), the South African legislature must have intended the phrase “any law” to refer only to

South African statutes, for the entire purpose of the Income Tax Act is to control the revenue accruing to the state from taxes levied on the income of its citizens.

The court said that–

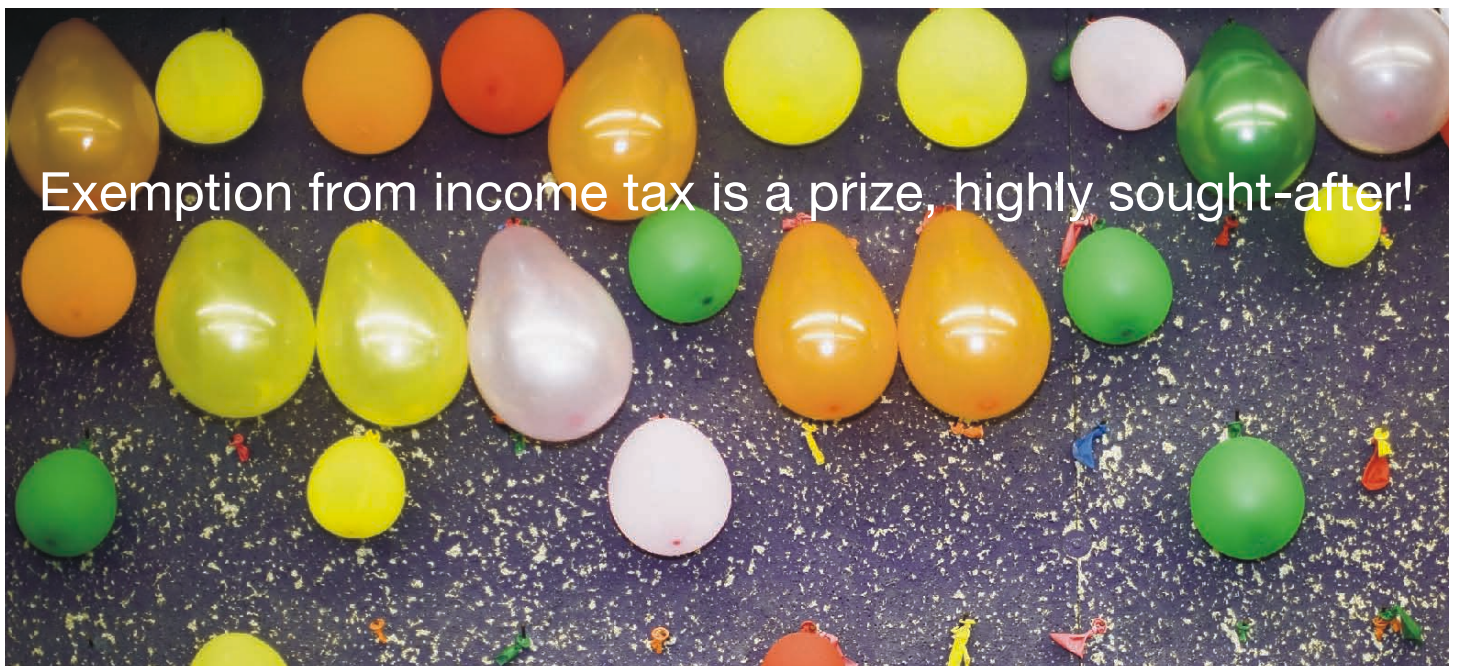
“To give recognition to creatures created by foreign statutes without any qualification or definition, might seriously endanger the entire object of the Income Tax Act.”

The court accordingly ruled that the taxpayer in this case did not qualify as a

body to which section 10(1)(cA) of the Income Tax Act applies.

The definition of the word “law” was crucial in this matter, as the body could not have enjoyed exemption by incorporating a subsidiary or registering as an external company (that is, a branch of the New York company), as the particular exemption specifically excludes companies incorporated or deemed to be incorporated under the Companies Act.

The difficulty for this particular taxpayer was that it had applied for tax-exemption in 1997, believing that it qualified for such exemption, and that it apparently took some eleven years for the matter to reach the Tax Court.



What happens when you declare more income than you received?



This taxpayer thought he was entitled to certain income (although he had not yet received it) and disclosed it to SARS in his tax return. Then, after being assessed to tax on that income, he learnt that he was not actually entitled to it.

Following hard on the heels of the *Brummeria Renaissance* judgment on the tax consequences of an interest-free loan – the shock-waves from which are still rocking the business world – comes a decision of the Pretoria Tax Court, also dealing with fundamental aspects of the concept of “accrual” in terms of the Income Tax Act 58 of 1962.

This new judgment, happily, resonates with common sense, business practicality and is soundly based in legal principle.

Gross income includes both receipts and accruals

In terms of the Income Tax Act, a taxpayer must disclose to SARS the total amount of income that has either been “received” by him or which has “accrued” to him during the tax year.

The meaning of “received” in this context has not proved troublesome, but the concept of “accrual” is more complex.

The fundamental principle is, however, not in doubt – an amount “accrues” to a taxpayer when he becomes “entitled” to it, in other words, when he acquires a

legal right, even if the amount has not yet been paid to him. This cardinal principle was laid down in *Lategan v CIR: 1926 CPD 203* at 208 and affirmed in *CIR v People’s Stores (Walvis Bay) (Pty) Ltd 1990 (2) SA 353 (A)*.

But what happens where the taxpayer thinks that he was entitled to a certain item of income (although he has not yet received it) and dutifully discloses it to SARS in his tax return, and then – after he has been assessed to tax on that income – learns that he was not, in fact, entitled to it? Clearly, he has paid more

tax than he ought to have, but how does he get his tax affairs set right?

This was the principal issue before the Pretoria Tax Court in ITC 1824 (2008) 70 SATC 27 in which the judgment was handed down on 3 April 2007 but which has only just been published.

The facts

In this case, the taxpayer had, in the year 2000, entered into a written agreement with its client, in terms of which the taxpayer was to provide the latter with “financial risk management services” in return for specified performance-related fees.

Thereafter, the taxpayer introduced an “electronic cash sweeping statement” for its client and rendered so-called “liquidity risk management” (LRM) services to the client, for which the taxpayer claimed to be entitled to a fee of some R19 million, which it duly invoiced. At the time of the hearing before the Tax Court, this invoice had not been paid.

The taxpayer claimed that it had also arranged for a contingent insurance policy to replace a general insurance fund (GIF). For this service, the taxpayer claimed that it was entitled to a fee of some R13 million, for which it also invoiced the client. The client paid this invoice.

Thereafter, the client disputed its liability for both of these fees, and claimed repayment of the R13 million that it had already paid the taxpayer.

The dispute went to arbitration. The arbitrator made his award in July 2004, holding that the taxpayer was not entitled to the amount it had claimed for the LRM claim or the GIF claim. The arbitrator also held that the client was entitled to be refunded the R13 million it had paid in respect of the latter.

In the meantime, the taxpayer had included the R19 million in respect of the LRM claim and the R13 million in respect of the GIF claim in its tax return for 2001. In June 2002, the SARS had assessed the taxpayer on a taxable income of some R30 million for that tax year, which included the two amounts that were the subject of the arbitrator’s ruling.

In terms of the Income Tax Act the taxpayer had 30 days to object to the assessment. The taxpayer did not lodge an objection because, at this time, it believed that it was indeed “entitled” to these amounts, and that the amounts had therefore “accrued” to it, and must therefore be included in its gross income for income tax purposes.

After the arbitrator gave his ruling in July 2004, both the taxpayer and the taxpayer and the client agreed that the arbitrator’s ruling was correct.

The taxpayer’s difficulties

The taxpayer was now faced with several difficulties.

Firstly, the 30-day period for objecting to the assessment which had included the arbitrated amounts had long since expired. Secondly, it was not clear whether the taxpayer was entitled to lodge an objection to an assessment which was arguably incorrect, but only because of the taxpayer’s own mistake.

What was the taxpayer to do? Should he lodge an objection out of time, and ask SARS to condone the lateness of the lodgement? Should he claim a deduction of the two arbitrated amounts on the basis that they had become “bad debts” which would now not be paid? And was the arbitrator’s ruling that the taxpayer had never been “entitled” to the amounts in question binding on SARS – given that SARS was not a party to the arbitration.

In the event, the taxpayer lodged an objection and asked SARS to consent to its being lodged out of time. SARS gave its consent.

The matter then came before the Pretoria Tax Court. The facts were not in dispute between SARS and the taxpayer, and a statement of agreed facts was laid before the court.

The court said that whether a person was “entitled” to an amount is a question of law; the subjective belief of that person that he was entitled to the amount was not the test.

The issues

The issues before the Tax Court centred on whether there had been an accrual to the taxpayer in respect of the invoiced amounts of R19 million and R13 million.

The court held that the factual findings of the arbitrator provided a basis on which the relevant legal principles could be applied, but that it was for the court to determine the law and apply the law to the facts.

The court said that whether a person was “entitled” to an amount is a question of law; the subjective belief of that person that he was entitled to the amount was not the test.

The court ruled that the effect of the arbitrator’s award was not to novate the taxpayer’s rights (in other words, the award did not extinguish the original rights of the taxpayer and replace them with the terms of the arbitrator’s award) but merely confirmed and reinforced those original rights.

The court held that, on the facts found by the arbitrator and agreed by the parties as being correct, the contractual amounts in question had never become “due” to the taxpayer by the client.

It followed, said the court that those debts could not become “bad debts”; the debts had never existed, so there was nothing to go bad. Hence, it was not open to the taxpayer to put matters

right by claiming a deduction under the bad debts allowance provided for in section 11(j) of the Income Tax Act.

The relief to which the taxpayer was entitled therefore had to take the form of an order that the amounts in question had never “accrued” to the taxpayer, and that the amounts in question must therefore be excluded from the assessment for the 2001 tax year.

In effect, therefore SARS would have to reissue a revised assessment for that year.

Will SARS take this lying down?

While this approach is to be welcomed, it should be compared with the approach of the Supreme Court of Appeal in *MP Finance Group CC (in liquidation) v C:SARS* (SCA 41/06). In that matter, the CC was a vehicle for an illegal pyramid scheme, and its operators had duped gullible investors into parting with considerable amounts of money. The SCA held that the relationship between the victims and the operators was irrelevant. The matter was between the scheme and the fiscus and the sole question was whether the amounts were accepted by the operators for their own benefit.

Notwithstanding that the operators must have known that the amounts were fraudulently obtained, the SCA held that

they fell within the requirements of gross income and were taxable.

In principle, the issue of an invoice would indicate that the taxpayer considered that it was entitled to be remunerated for its services. It only subsequently conceded that it was not so entitled. In principle, it is in a worse position than the fraudsters in the SCA matter, who knew from the outset that they were not legally entitled to the money for their own benefit. There is therefore a risk that this matter may be overturned if SARS has determined to appeal the decision.

The Australian Tax Office warns against hiding funds in tax havens

There have recently been revelations of the widespread practice amongst EU residents of hiding funds in Liechtenstein and other tax havens in order to avoid tax in their home countries.

Investigations are now under way in a number of European states to expose such secret accounts with a view to taking action against residents who have been understating their income and assets.

Liechtenstein has, for decades, been attracting funds from investors around the world.

Australia begins its own investigations

In February of this year, the Australian Tax Office began investigating tax evasion by Australian taxpayers who have been using Liechtenstein as a tax haven.

The Australian Tax Office has now issued a taxpayer alert, warning Australian taxpayers against hiding their income or assets offshore.

Australia, like South Africa, has a residence-based tax system, and the Commissioner of the ATO has made clear that Australian residents are required to declare their world-wide income, including interest and other income generated in tax havens.

In Australia, “taxpayer alerts” are intended as an early warning to taxpayers and their advisers of significant tax planning issues or arrangements that the Tax Office is reviewing under its risk assessment programme.

The Commissioner of the ATO has warned that –

“People who use offshore structures to deliberately hide assets or income in tax havens, such as Liechtenstein, can face serious penalties including criminal prosecutions. We are also concerned about circumstances where documentation supporting transactions with offshore legal structures is absent, incomplete or falsified.”

Australia is currently collaborating with tax administrations in Canada, France, Italy, New Zealand, Sweden, the United Kingdom and the United States of America – all member countries of the OECD’s Forum on Tax Administration – to investigate Liechtenstein accounts being used for tax avoidance and evasion.

The Commissioner has said in this regard that –

“We have increased our scrutiny of the misuse of tax havens, with increased information sharing with tax administrations in other countries and the use of more sophisticated analytical tools – meaning there is no safe place to hide undisclosed income. However, taxpayers who contact us before they are the

“Taxpayer alerts” are intended as an early warning to taxpayers of significant tax planning arrangements that the Tax Office is reviewing.



Nowhere to hide

subject of an audit may be entitled to substantial reductions in shortfall penalties under our offshore voluntary disclosure initiative.”

The Australian Tax Office has indicated that its practice is that, where a taxpayer makes a voluntary disclosure that reveals a possible criminal offence, the Commonwealth Director of Public Prosecutions will give favourable consideration to granting an indemnity

from criminal prosecution in relation to the taxpayer’s involvement in the scheme where –

the case does not exhibit a significant degree of criminality;

the taxpayer provides information about how the arrangements worked, including the role and identity of the promoter;

the taxpayer co-operates with the investigation and consequential proceedings; and

the taxpayer co-operates with the investigation and consequential proceedings.

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