Synopsis
Tax today

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A monthly journal published by PwC South Africa providing informed commentary on current developments in the tax arena, both locally and internationally. Through analysis and comment on new law and judicial decisions of interest, it assists business executives to identify developments and trends in tax law and revenue practice that might impact their business.

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Taxpayer learns the hard and expensive way

The perils of self-representation

SARS is in the business of maximising tax collections. It is under no obligation to protect a taxpayer's interests by giving him advice (although a notice of assessment must provide a summary of the procedure for lodging an objection to a tax assessment; see section 96(1)(g) of the Tax Administration Act 28 of 2011) and – once a dispute arises – will usually deal with a taxpayer on an adversarial basis.

Once a taxpayer disputes the correctness of an assessment to tax that he has received from SARS, he should, without delay, take professional advice. The advice that he receives will relate not only to the substance of the disputed tax liability – that is to say, whether the amount of tax has been correctly calculated by SARS – but will also to critically important aspects of the process to be followed in objecting to the assessment and contesting the matter in the Tax Court.

Errors in process may be fatal to a taxpayer's objection

A taxpayer who has a strong case in a dispute with SARS for arguing that he is not liable for the amount of tax reflected in the assessment may find that the merits of his case never come up for consideration by the court and that the court dismisses his objection to the assessment on the basis of a procedural error he has made in bringing the matter before the court or on the basis of some flaw in the documents he has filed in the course of the dispute.

The latest instance of a taxpayer who has learned this lesson the hard and expensive way is the recent decision of the Supreme Court of Appeal in HR Computek (Pty) Ltd v CSARS [2012] ZASCA 178 where judgment was handed down on 29 November 2012.

Confined to the grounds put forward in notice of appeal

At the heart of the process of objection and appeal in relation to a disputed tax assessment is a simple principle, laid down in the Rules provided for in section 107A of the Income Tax Act 58 of 1962 and section 103 of the Tax Administration Act.

Rule 4 provides that an objection to an assessment must –

"be in writing, specifying in detail the grounds upon which it is made"

and Rule 12 says that –

"The issues in any appeal to the [Tax] Court will be those defined in the statement of the grounds of assessment read with the statement of the grounds of appeal."

In the *Computek* case, the taxpayer seems to have taken it on himself to draft the all-important notice of appeal to the Tax Court, for he expressed the grounds on which he was appealing against a VAT assessment in loose, layman's terms as follows –

"1 Unfair imposition of 200% additional tax.

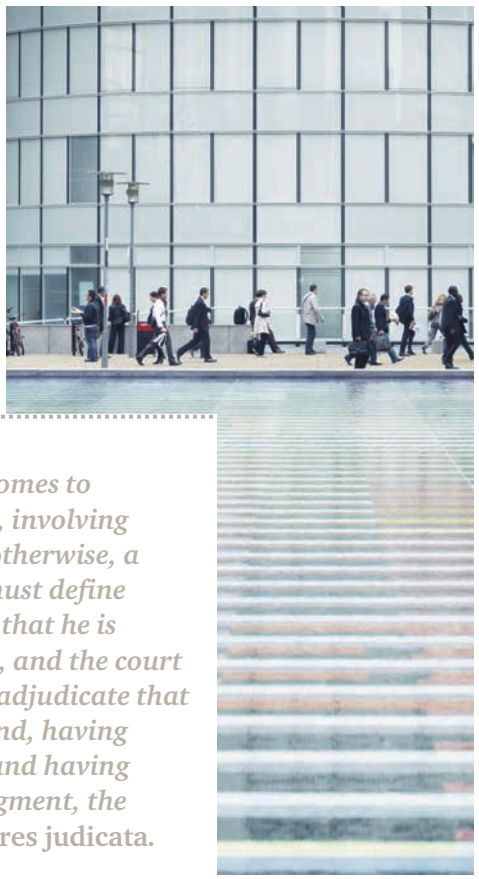
2 Unfair imposition and incorrect penalty.

3 Unfair imposition and incorrect interest charge.

4 Unfair tax procedural matters."

In fact, as later transpired, the crux of what the taxpayer really wanted to contest was the capital amount (the turnover) on which the VAT

assessment had been calculated. His contention was that the turnover attributed to him was, in reality, the turnover of a related, but different legal entity, which was accordingly liable for the VAT in question.



Neither the taxpayer's formal notice of objection nor his self-drafted notice of appeal, quoted above, gave any hint that the taxpayer was disputing the VAT assessment on those grounds. The taxpayer raised the real grounds of his objection too late

When it comes to litigation, involving SARS or otherwise, a litigant must define what it is that he is disputing, and the court will then adjudicate that dispute and, having done so, and having given judgment, the matter is res judicata.

A month or so later, the taxpayer filed a statement under Rule 11, which for the first time, raised the contention that, in calculating his VAT liability, SARS had included the turnover figures of a related, but different trading entity.

When the matter came to trial in the Tax Court, the judge ruled that the taxpayer had not contested the capital amount of the VAT assessment, and was now debarred from raising that issue. On that basis alone, the taxpayer's objection to the assessment failed.

The taxpayer then appealed to the Supreme Court of Appeal, but that court upheld the decision of the Tax Court, saying –

'The taxpayer has sought, on appeal, to assail the conclusion of the tax court: '. . . that the notice of objection and the letter accompanying it does not cover the issue which the appellant now wishes to raise, namely, that the capital amount levied for VAT is wrong'. In my view, for the reasons that follow, the conclusion of the tax court is unassailable. In its notice of objection read together with the letter that accompanied it (both dated 24 March 2004), it is quite clear that the taxpayer did not object to the capital amount. . . . It follows that not having raised an objection to the capital assessment in its notice of objection, the taxpayer was precluded from raising it on appeal before the tax court. '

The taxpayer was out of time to lodge a fresh objection

The Supreme Court of Appeal went on to say, in effect, that the only way in which the taxpayer could contest the capital amount on which VAT had been calculated was by filing a new objection. However, the time limit, laid down in the Rules, for objecting to an assessment had expired and the Value-Added Tax Act laid down in section 31A that SARS is not permitted, of its own accord, to issue a reduced assessment once three years have elapsed since the date of the assessment.

So, even if the taxpayer were able to convince SARS, outside of the court proceedings, that the VAT assessment was erroneous, SARS would be statutorily barred from issuing a reduced assessment.

In short, all avenues were now closed to the taxpayer to contest the assessment, which had become final and the amount of tax reflected in the assessment thus had to be paid.

Legal disputes must achieve finality

A moment's reflection reveals that the fundamental concepts underlying the *Computek* decision are not merely sound, but indispensible in any legal system.

As Cloete JA said in *CSARS v Brummeria Renaissance (Pty) Ltd* 2007 (6) SA 601 (SCA) –

"It is obviously in the public interest that the Commissioner should collect tax that is payable by a taxpayer. But it is also in the public interest that disputes should come to an end – interest reipublicae ut sit finis litium . . . – memories fade; witnesses become unavailable; documents are lost."

In other words, the public interest demands that legal disputes must have an end.

And, when it comes to litigation, involving SARS or otherwise, a litigant must define what it is that he is disputing, and the court will then adjudicate that dispute and, having done so, and having given judgment, the matter is *res judicata*. That is to say, it is a matter on which the courts have made a determination, and a disappointed litigant cannot have a second bite at the cherry. He may have a right to appeal against the judgment to the higher court, but the appeal court will adjudicate the self-same issue, and the litigant cannot introduce new issues.

SCA places taxpayers at an unfair disadvantage in tax appeals

The judgment in* HR Computek (Pty) Ltd v CSARS *referred to in the previous article raises serious questions whether taxpayers are afforded a level playing field when contesting issues with SARS.

The Supreme Court of Appeal (Ponnan JA, who delivered the judgment in which all five Justices of Appeal concurred) ruled that a taxpayer may not in his statement of grounds of appeal filed under Rule 11 of the rules regulating the conduct of objections and appeals raise any ground not included in the notice of objection.

The justification for this conclusion was found in the following statements from the judgment in *Matla Coal Ltd v CIR* 48 SATC 223 (A) at 243 – 234:

"Section 81(3) of the Act provides that every objection shall be in writing and shall specify in detail the grounds upon which it is made. And in terms ofs 83(7)(b) the appellant in an appeal against the disallowance of his objection is limited to the grounds stated in his notice of objection. This limitation is for the benefit of the Commissioner and may be waived by him …

It is naturally important that the provisions ofs 83(7)(b) be adhered to, for otherwise the Commissioner may be prejudiced by an appellant shifting the grounds of his objection to the assessment in issue. At the same time I do not think that in interpreting and applying s83(7)(b) the Court should be unduly technical or rigid in its approach. It should look at the substance of the objection and the issue as to whether it covers the point which the appellant wishes to advance on appeal must be adjudged on the particular facts of the case."

Ponnan JA continued (at [11]):

"Here, although we do not have a similar statutory provision to that encountered in Matla Coal, I can conceive of no reason why the principle that is established there should not apply with equal force to an objection and appeal under the VAT Act."

We have a position in which the Supreme Court of Appeal has ruled that an appellant in the Tax Court must rely on the grounds of objection filed under Rule 4 and not the grounds of appeal filed under Rule 11. On the other hand, the Tax Court has granted the Commissioner the power to raise issues not canvassed in the objection.

The reasoning of the honourable Justice of Appeal is patently defective. The Court found that a repealed statutory provision should apply as a common law principle. This is an incomprehensible and unjustifiable leap of logic.

In the *Matla Coal* decision, the Court applied a statutory provision and explained the principle supporting its enactment. In the *HR Computek* decision, Ponnan JA conceded that there was no such statutory provision in the law, but applied it anyway.

There is a cogent reason why the "principle" should not apply. Principles of natural justice require that parties have an equal right to be heard: section 83(7) no longer exists and a litigant is entitled to the same rights as his adversary to have his case heard.

Is the playing field level?

In *Income Tax Case 1843 72* SATC 229, the boot was on the other foot.

SARS had raised an assessment after considerable correspondence with the vendor. Based on the correspondence, the vendor had objected to the assessment and the objection had been disallowed. The vendor appealed against the disallowance.

SARS filed the statement of reasons for assessment in terms of Rule 10 of the rules governing the conduct of objection and appeal proceedings. In this statement it included as its reason for assessment a reason that had not been debated in the correspondence preceding the issue of the assessment – effectively a new reason for the assessment of which the vendor had been unaware when noting objection.

The Tax Court rejected the application of the vendor to have the new reason excised from the pleadings. CJ Claassen J, found that the relevant rule was couched in the present tense and that this was to be interpreted as allowing the Commissioner to state the grounds on which he "relies" for his disallowance and not the grounds that he relied on when the disallowance was made:

"On a pure linguistic interpretation according to the 'golden rule', the present tense would indicate that the statement is to set out the current grounds and material facts as at the date of its filing and not the grounds as at the date when the disallowance took place."

Compare this with the statement of Ponnan JA in the *HR Computek* judgment:

"It follows that not having raised an objection to the capital assessment in its notice of objection, the taxpayer was precluded from raising it on appeal before the tax court." (Emphasis added)

Non-compliance with the VAT Act - two recent cases highlight potential consequences

***Everyone ought to pay the tax for which they are liable under the Income Tax Act, the Value-Added Tax Act and other tax legislation. That is simply an aspect of being a responsible citizen, but it is of course also a legal obligation, backed up by draconian penalties*.**

Two judgments handed down in 2012 have highlighted the potential consequences for taxpayers who do not comply with their obligations in terms of the Value-Added Tax Act 89 of 1991.

Maximum additional tax imposed

The first judgment in this regard is that of the North Gauteng Tax Court in ITC 1861 (2012) 74 SATC 383, which concerned liability under the Value-Added Tax Act.

Before the judgment itself is examined, it is worthwhile bearing in mind that VAT is a tax where SARS can unmask non-compliance more readily than in the case of other taxes. A major reason for this is the paper trail created by the parties to a VAT-able transaction – the output tax charged by the VAT vendor (and reflected in the VAT invoice that he is obliged to issue) and the input tax that will be claimed by the person to whom the supply was made and be reflected in his tax returns.

An unscrupulous VAT vendor may be able to doctor his own records in relation to a taxable supply, but will seldom be able to manipulate the

SCA places taxpayers at an unfair disadvantage in tax appeals

This begs the question – what is the purpose of Rule 11? It can't be merely to replicate the statement filed under Rule 4.

Rule 11, like rule 10, requires the appellant to state the material facts and legal grounds upon which he relies for such appeal. Applying the reasoning in ITC 1843, the grounds relied upon in the objection do not have status as pleadings - the grounds in the Rule 11 notice upon which the appellant relies should be considered on appeal.

We therefore have a position in which the Supreme Court of Appeal has ruled that an appellant in the Tax Court must rely on the grounds of objection filed under Rule 4 and not the grounds of appeal filed under Rule 11. On the other hand, the Tax Court has granted the Commissioner the power to raise issues not canvassed in the objection.

Apparently SARS can run with the hares and hunt with the hounds, whereas the beleaguered taxpayer cannot!

Administrative process and judicial process

Objection is an administrative process, in which SARS adjudicates objections against its own decisions. On disallowance of an objection, the taxpayer has the right to institute judicial proceedings by filing a notice of appeal. The matter then passes out of the hands of SARS into the hands of the Tax Court.

The process of appeal requires that SARS states the reasons for the relevant assessment (Rule 10) and that the taxpayer then files a notice of grounds of appeal (Rule 11). In effect, these are the pleadings on which the issues between the litigants are identified and contested. Rule 12 cannot be more clear:

"The issues in any appeal to the Court will be those defined in the statement of the grounds of assessment read with the statement of the grounds of appeal." (Emphasis added)

Rule 12 does not state that the issues are those defined in the notice of objection. It requires a court to determine the issues by reference to the statement of grounds of appeal. Rule 11 does not confine a taxpayer to the issues raised in the grounds of objection.

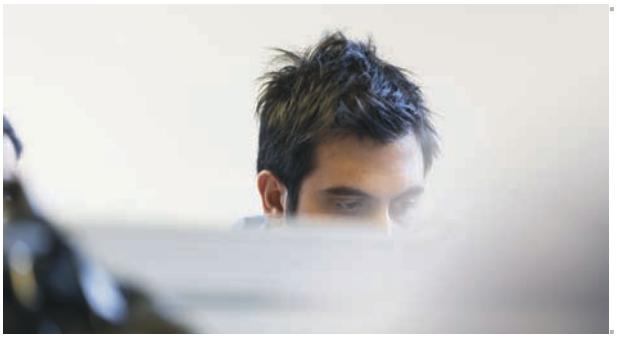
It is clear that the decision of the Tax Court against which the *HR Computek* appeal was brought did not apply Rule 12. On that basis, the judgment of the Supreme Court of Appeal should have been to refer the matter back to the Tax Court to hear the matter on the issues defined in the statement of grounds of objection read with the statement of grounds of appeal.

It is vital for taxpayers that there is a clear distinction between the administrative process and the judicial process. The effect of the *HR Computek* decision has been to ignore the separation. The result is that, in future disputes, the Tax Court is bound to apply a principle that the statement of grounds of appeal is of no effect to the extent that it raises any issue not raised at the objection stage.

Non-compliance with the VAT Act - two recent cases highlight potential consequences

VAT records and returns of the other party.

The temptation facing an unscrupulous VAT vendor is of course to charge and collect VAT when making a supply, and then not pay the VAT over to SARS. With justification, SARS regards this as nothing less than theft, and a vendor who engages in this practice risks not only the heavy penalties provided for in the Value-Added Tax Act, but criminal prosecution as well.



This attempt to fiddle the VAT system resulted in the vendor being liable for the original VAT, the 200% additional VAT, and the legal expenses involved in contesting the matter in the Tax Court.

In ITC 1861 (2012) 74 SATC 383 a close corporation, that was a registered VAT vendor, had issued three tax invoices in January and March and April 2004, totalling about R1 million, for the supply of seafood products. These invoices were duly paid by the purchaser.

The appellant thereafter submitted a nil VAT return for the relevant VAT periods. Its suspicions aroused, SARS conducted an audit and those VAT invoices came to light.

Fictitious tax invoices

Painted into a corner, the VAT vendor (represented by its sole member) admitted issuing the tax invoices in question but claimed that they were "fictitious" in the sense that the supplies they professed to record had never been made. It was not disputed that the vendor had been paid in terms of the invoices and had later refunded the purchaser the amounts in question.

When pressed as to why fictitious invoices had been issued, the close corporation's sole member said that he had been "forced or badgered" by a customer to do so in order to enable the latter to show those invoices to his bank and thereby secure a loan for the purchase of trading stock for a business. The customer, the judgment goes on to say, had then "bolted" and left the vendor to answer to SARS.

Additional assessment

As a result of the appellant's failure to account for output tax in respect of the supplies recorded in the tax invoices, SARS raised an additional assessment in terms of section 31 of the Value-Added Tax Act and levied 200% additional tax in terms of section 60 of that Act.

When the objection to the assessment was dismissed, the vendor appealed to the tax court, but the judge had had little difficulty in dismissing the appeal on two grounds.

Firstly, the court held that the sole member of the vendor close corporation could not be believed when he testified that he had derived no personal gain from the irregularity. The court said that, since he was an accountant who understood the VAT Act, the inference was irresistible that he had participated in the fraud for some personal gain. Secondly, even on that individual's own version of the facts, the close corporation was liable to account for VAT on the transactions in question since every VAT vendor must account to SARS for the VAT reflected in an invoice.

In his judgment, Hiemstra AJ said that SARS "is not concerned with any skullduggery between the parties to the transactions giving rise to the tax liability. It can only act on tax returns and documents submitted to it".

In the result, this attempt to fiddle the VAT system turned out to be a very expensive exercise, with the vendor being liable for the original VAT, the 200% additional VAT, and the legal expenses involved in contesting the matter in the Tax Court.

But, as the next judgment shows, a worse fate can befall a non-compliant taxpayer than having to pay SARS a large sum of money.

Non-compliance with the VAT Act - two recent cases highlight potential consequences

A minority judgment of the SCA takes the view that a senior counsel who fails to register for and charge VAT should be disbarred

The decision of the Supreme Court of Appeal, handed down on 29 November 2012 in *General Council of the Bar of South Africa v Geach; Pillay v Pretoria Society of Advocates; Bezuidenthout v Pretoria Society of Advocates* [2012] ZASCA 175 concerned, inter alia, an eminent senior counsel who had failed, over a period of many years, to register for VAT or to add VAT to his professional fees.

The judgment highlights how seriously the courts view such conduct on the part of a member of the professions.

This decision concerned thirteen practising advocates at the Pretoria bar. One of the advocates, whose misdemeanours are dealt with at length in the judgment, was a senior counsel who, on his own admission and over a period of nearly twenty years, failed to register as a vendor, though obliged to do so in terms of the Act. The court pointed out that, in failing to register, Geach had committed an offence.

The major interest of the reported decision lies in the minority judgment and the harsh view it took of a failure, on the part of a practising advocate, to register as a VAT vendor where he was obliged to do so, and of his failure to charge VAT in respect of his fees.

The minority judgment would have ordered removal from the roll of advocates

By way of background, it is significant that the General Council of the Bar had intervened in the High Court proceedings and had sought an order striking the name of the senior advocate from the roll of advocates – thus indicating serious view taken by the professional controlling body of fiscal misconduct by a member.

... a warning to all members of the practising professions that failure to comply with their tax obligations can result in more than just the imposition of additional tax. Their professional organisation may also take action against them ...

In his minority judgment, Wallis JA (with whom Leach JA concurred) also took the view that removal from the roll of advocates was the appropriate sanction. Wallis JA said that the advocate had–

"... failed to register for, or to pay, VAT from its inception in 1992 until 2010. That was a sustained course of dishonesty for which he gave a dishonest explanation. … When he was required to make his books of account available for inspection he disclosed what would have been apparent from them, namely that he had never registered as a vendor in terms of the Value Added Tax Act notwithstanding the fact that he had for many years earned considerably more than the statutory threshold at which such registration is mandatory. Nor had he accounted for VAT on his fees. His non-compliance with s 23(1) of the VAT Act was an offence in terms of s 58(c) of the VAT Act and rendered him liable on conviction to a fine or a sentence of imprisonment of up to two years. In addition for the reasons explained in the following paragraphs his non-payment of VAT caused a loss to the fiscus and was potentially detrimental to his clients. … His non-registration does not mean that he did not have to charge VAT on his fees and pay it to SARS."

Defrauding the revenue is no less serious than defrauding a client or the public

Wallis JA went on to quote from a decision of the Australian courts which rejected the proposition that defrauding the revenue authorities for personal gain is less serious than defrauding a client or a member of the public. Both categories of conduct, it was said, involve an unfitness to be trusted.

Further, Wallis JA said, the conduct, which spanned many years, had caused substantial losses to the public purse; moreover, he did not avoid paying VAT because of personal or financial stress, and "the only possible explanation was personal financial advantage". And there had been no recognition on his part of the seriousness of his misconduct.

Wallis J said –

'At the least what was required was a full and frank disclosure to the court of his position with regard to the payment of VAT and the arrangements he made with SARS to remedy his position. That was not forthcoming. When that is taken together with his other misconduct and the absence of any exceptional circumstances either mitigating that misconduct or demonstrating reform, in my view the only possible sanction is that his name should be removed from the roll of advocates.'

By way of comment, it is fair to say that the order of the court, favoured by this minority judgment (but not endorsed by the majority judgment) that the senior advocate ought to be removed from the roll of advocates – for his VAT misdemeanours coupled with other professional misconduct – has

caused shock waves within and outside the legal profession.

It is not clear in what sense Wallis JA believed that the advocate had derived a "personal financial advantage". It was not the case that the latter had charged and collected VAT and then put it in his own pocket. Nor is there any indication that his fees had been inflated to the extent of the VAT that should have been charged.

The lack of contrition or acknowledgement of the seriousness of the misconduct

It is difficult to avoid the impression, on reading the minority judgment, that it was Geach's lack of contrition on the VAT issue and his attempt to make light of his transgressions in this regard that rankled with Wallis and Leach JJA.

The minority judgment – and the view of the General Council of the Bar that being struck off the roll was the appropriate sanction – stands as a warning to all members of the practising professions that failure to comply with their tax obligations can result in more than just the imposition of additional tax. Their professional organisation may also take action against them, in which event they risk losing their livelihood through loss of their professional accreditation.

In short, if the minority judgment of the Supreme Court of Appeal had prevailed, the consequence for this particular taxpayer of not registering for VAT (and not adding VAT to his fees and collecting the funds for the fiscus) would have been that he would be barred from practising his profession indefinitely.

The financial loss over the remainder of a working lifetime (let alone the reputational damage) for any high-earning professional is scarcely calculable.

SARS Watch
20 December 2012 - 20 January 2013

Legislation		
21 Dec	Taxation Laws Amendment Act	The Act was promulgated in Gazette 36036.
Binding Rules		
14 Jan	Binding Private Ruling 131 – Vesting date of a restricted equity instrument	This ruling deals with the vesting date of a restricted equity instrument acquired by employees in respect of their employment.
14 Jan	Binding Private Ruling 132 - Disposal of a business as a going concern by a trust to a company in exchange for shares in the company	This ruling deals with the disposal of a business as a going concern by a trust to a company, in exchange for shares in the company, and whether the transaction will qualify for the relief provided for under section 42 of the Act.
15 Jan	Binding Private Ruling 133 - Transfer of a residence out of a company to a natural person	This ruling deals with the capital gains tax and transfer duty consequences, for both the transferor and transferee, in respect of a residence to be transferred out of a company to a natural person who is a qualified transferee for purposes of the relief measures provided for under the relevant legislation.
Case Law		
20 Dec	F-CC v CSARS VAT 789	This case concerns the exercising of the Commissioner's powers in terms of section 20(5) not being subject to objection and appeal and indicating that any review of that application should be launched in the High Court.