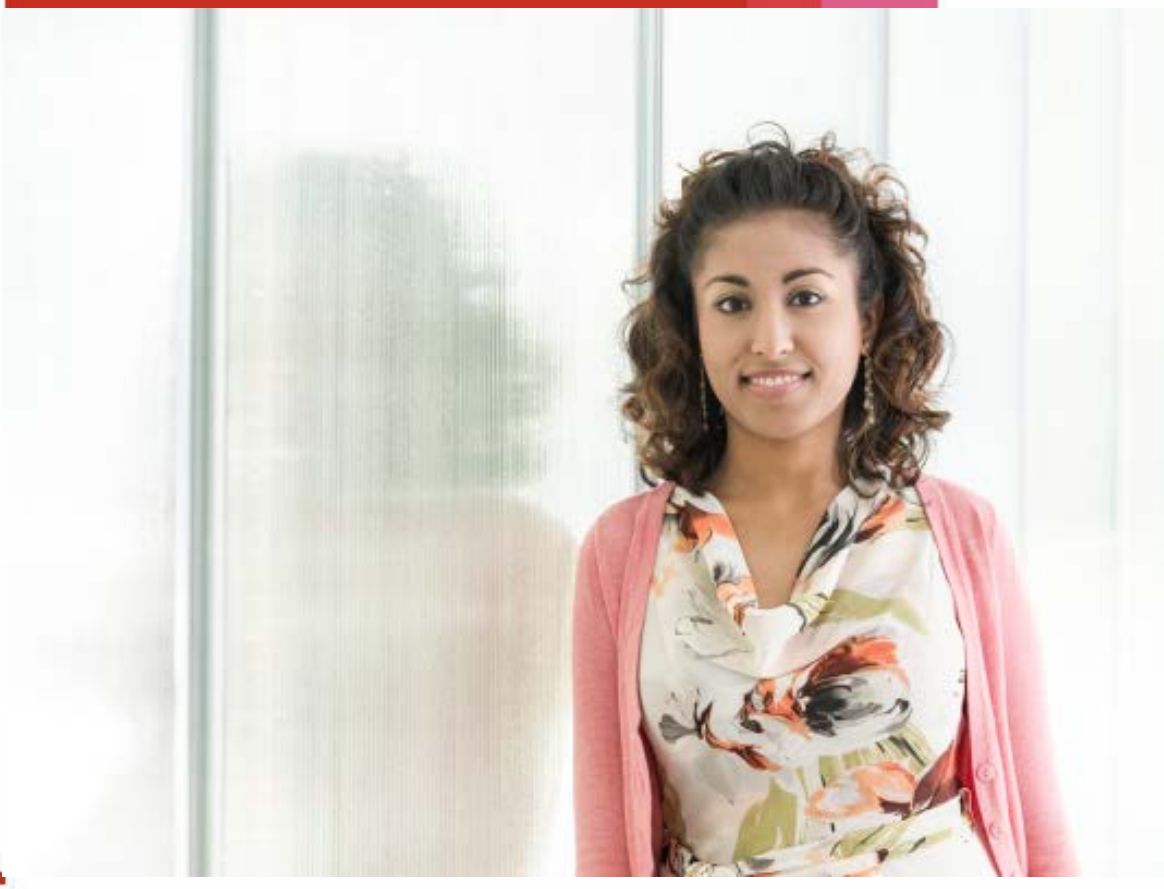
Synopsis

Tax today

September 2011

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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Tax administration in South Africa – prepare for change

The Tax Administration Bill (Bill No. 11 of 2011) was introduced into Parliament on 23 June 2011. It proposes the consolidation in a single statute of the law relating to the administration of the majority of the taxes administered by SARS. Much of this issue is devoted to an examination of implications of this legislation.

Objection and appeal under the Tax Administration Act

A taxpayer's right to object to an assessment and appeal to the Tax Board or the Tax Court if the objection is disallowed is the lynchpin of taxpayers' rights under fiscal legislation.

The problem is that the objection and appeal provisions of the Income Tax Act, for example, have been scattered throughout the Act, although an effort has been made to collate them into section 3(4). A second problem has been uncertainty as to whether "decisions" by the Commissioner which impact adversely on the taxpayer, can be the subject of objection and appeal.

The Tax Administration Bill, which may be enacted in the near future, addresses both of these problems.

Simultaneously with the coming into force of the Tax Administration Act, almost all the objection and appeal provisions of the Income Tax Act will be deleted in the latter Act and relocated to the Tax Administration Act, section 104(1) of which will state that any taxpayer who is aggrieved by an assessment is entitled to object to it.

Section 104(2) goes on to stipulate which "decisions" by the Commissioner (as distinct from assessments) can be the subject of objection and appeal. These comprise a decision not to extend the period for lodging an objection, a decision not to extend the period for lodging an appeal, a decision not to authorise a refund, and "any other decision that may be objected to or appealed against under a tax Act".

A challenge to the merits of an assessment as distinct from a challenge to fairness and rationality

Objection and appeal is the process whereby a taxpayer challenges an assessment on the merits, in other words, where he argues that the assessment is based on incorrect facts or wrongly applies the law.

Simultaneously with the coming into force of the Tax Administration Act, almost all the objection and appeal provisions of the Income Tax Act will be deleted in the latter Act and relocated to the Tax Administration Act.

By contrast, disputes as to the *fairness and rationality* of administrative action by SARS (which is an argument about due process, as distinct from the merits) may be challenged in terms of the Promotion of Administrative Justice Act 3 of 2000.

The Tax Administration Bill draws a clear distinction between an *assessment,* which it defines in section one as *"the determination of the amount of a tax liability or a refund" and a* decision by the Commissioner. All assessments can be challenged by way of objection and appeal, but only a limited range of *decisions* can be so challenged.

However, other decisions by the Commissioner – provided they constitute administrative action and provided they meet the further criteria for reviewability laid down in section 6 of the Promotion of Administrative Justice Act, may be brought under judicial review in terms of that Act.

In this regard, as Kriegler J observed in *Metcash Trading Ltd v CSARS* 2001 (1) SA 1109 (CC) at 1130 –

'[t]he Commissioner is not a judicial officer and assessments and concomitant decisions by the Commissioner are administrative, not judicial, actions; from which it follows that challenges to such actions before the Special Court [now called the Tax Court] or Board are not appeals in the forensic sense of the word. They are proceedings in terms of a statutory mechanism specially created for the reconsideration of this particular category of administrative decisions - and appropriate corrective action - by a specialist tribunal.'

The Tax Administration Bill leaves intact the remedy, available to a taxpayer in appropriate circumstances, to challenge the conduct of the Commissioner and his officials in terms of the Promotion of Administrative Justice Act.

Can SARS disclose information about a taxpayer's tax affairs to the state prosecuting authorities?

If taxpayers cannot rely on SARS to treat the information they furnish in their tax returns as secret, the integrity of the tax system would be seriously undermined.

After all, taxpayers may reveal information in their tax returns that they may be keeping secret from everyone else – including their spouses, their employers, their trade competitors and other organs of state. And, of course, taxpayers may disclose in their tax return income that they have received from illegal activities – such as bribes, backhanders, secret and irregular commissions, the proceeds from the sale of illegally imported goods or from insider trading, or contraventions of exchange control regulations.

It makes sense for the taxpayer to make such disclosures in his tax return (provided he is confident that they will be kept secret) for at least he need then not fear that he will be subject to reprisals from the South African Revenue Service if his misdemeanours come to light.

The secrecy of information contained in tax returns cannot, however, be absolute. Some derogations from secrecy are uncontroversial, such as where SARS provides anonymised statistical information to National Treasury or to the Statistician-General.

The secrecy provisions of the Tax Administration Act

The Tax Administration Bill seeks to bring clarity and certainty to the more controversial aspects of revealing taxpayer information to other departments of state,

Thus, the Act will provide in section 71(1) – (2) that, if so ordered by a judge in chambers on an *ex parte* application by a senior SARS official (if the latter is of the opinion that SARS has information critical to the prosecution of the offence in question and that the disclosure would not seriously impair a civil or criminal tax investigation), such an official must disclose certain information to the National Commissioner of the South African Police Service or to the National Director of Public Prosecutions, namely, information that may reveal evidence that an offence, other than a tax offence, has been or may be committed for which a sentence of more than five years could be imposed, or information which may reveal evidence that may be relevant to the investigation or prosecution of such an offence.

In terms of section 70(4) the National Commissioner of the South African Police Service, the National Director of Public Prosecutions, or a person acting under their respective direction and control (if carrying out an investigation relating to an offence or a public safety or environmental risk and if of the opinion that SARS may have relevant information) may apply *ex parte* to a judge in chambers for an order requiring SARS to disclose information that an offence, other than a tax offence, has been committed for which the sentence could be imprisonment for more than five years.

Such an application requires prior notice to SARS of at least ten business days unless the judge, on the basis of urgency, allows a shorter period. Section 70(5) provides that SARS may oppose such an application on the basis that such disclosure would seriously impair or prejudice a civil or criminal tax investigation or other enforcement of a tax Act by SARS.

Self-incrimination

In terms of s 72 of the Tax Administration Bill, an admission by the taxpayer of the commission of an offence under a tax Act that is contained in a return, application, or other document submitted by him to SARS or is obtained from a taxpayer under chapter 5 of the Act (which deals with information gathering) is not admissible in criminal proceedings against the taxpayer unless a competent court directs otherwise.

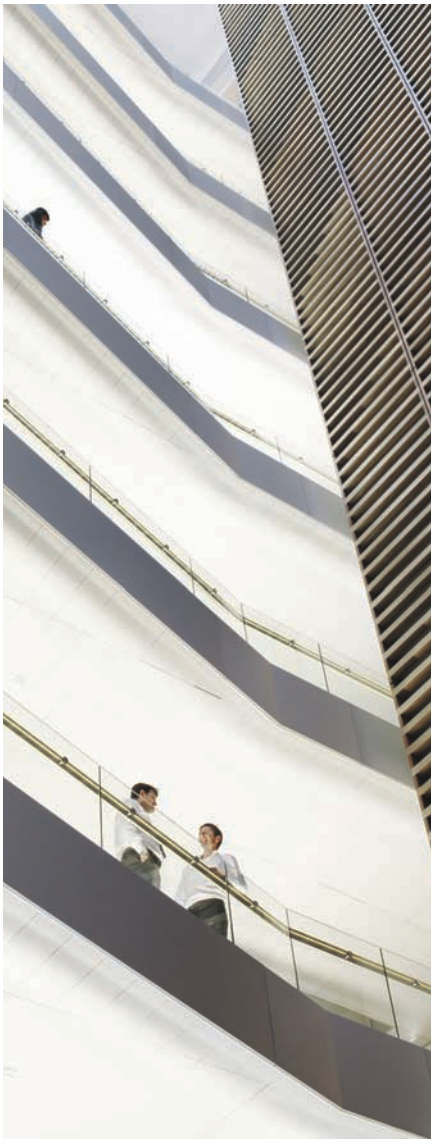
Disclosure to taxpayer of his own records

The Tax Administration Bill provides in section 73(1) that a taxpayer or his duly authorised representative is entitled to obtain a copy of an assessment or certain stipulated "decisions" relating to him.

A taxpayer is also entitled in terms of section 73(2) to access to information submitted by SARS by the taxpayer or by a person on the latter's behalf, but a request for such information must be made in terms of the Promotion of Access to Information Act.

Additional tax, administrative penalties and criminal penalties

Chapter 15 of the Tax Administration Bill distinguishes between* administrative penalties *which are imposed for particular forms of non-compliance with its provisions which have, however, not been criminalised and penalties by way of a fine or imprisonment for* criminal offences *which are dealt with in chapter 17. Criminal offences relating to tax evasion are separately provided for in section 235.



Additional assessments

This Act provides in section 92 that if, at any time, SARS is satisfied that an assessment does not reflect the correct application of a tax Act to its prejudice or that of the fiscus, SARS "must" make an additional assessment to correct the prejudice.

It is clearly implicit that such an "additional" assessment merely corrects an error in the original assessment and does not involve the levying of any tax or penalty over and above the amount of tax properly payable. Moreover, SARS has no discretion not to make such an additional assessment once an error is discovered, nor does it have the power to remit the tax payable in terms of such an additional assessment

Percentage-based penalties

In terms of section 213 of the Act, the Commissioner "must" levy a "penalty" *equal to a percentage of the unpaid tax* where a taxpayer did not pay an amount of tax as and when required. This is merely an *administrative penalty* (imposed by the Commissioner, not by a court) for forms of non-compliance that do not constitute a criminal offence.

However, even though the Act says that he "must" levy such a percentage-based penalty, the Commissioner has been given the power under section 215 to remit the penalty on application by the taxpayer. In determining whether to remit the tax, the Commissioner must apply the principles laid down in sections 216 –218. The intent of the Act is to lay down objective criteria in this regard, and not leave the issue to the discretion of the Commissioner. An assessment to a penalty or a decision by the Commissioner not to remit a penalty in whole in part has been specifically made subject to objection and appeal in terms of section 230.

All of the above brings welcome clarity to what has hitherto been an untidy situation under the Income Tax Act.

The confusion between additional tax and penalties under the Income Tax Act

In the context of the Income Tax Act, as it is, prior to the coming into force of the Tax Administration Act, so-called "additional tax" (which was levied in terms of the to-be-repealed section 76 of the Income Tax Act on a taxpayer who had made default in rendering a return or who had omitted amounts from his return or had made an incorrect statement in his return) was often colloquially called "penalty tax", although the latter was not an expression used in the Act.

The terminology was confusing – such "additional tax" was in fact not an amount of "tax" at all, but

was a penalty for non-compliance with the taxpayer's statutory obligations.

Moreover, to refer to such additional tax as "penalty tax" (as was commonly done) added to the confusion, because this label (wrongly) suggested that it was imposed for the commission of a criminal offence when, in reality, it was merely a non-criminal administrative penalty imposed on account of the taxpayer's default, omission or misstatement.

The distinctions now drawn by the Tax Administration Act

The distinction now explicitly drawn by the Tax Administration Bill between the imposition under section 213 of a *non-criminal administrative "percentage-based penalty"* where tax was not paid as and when required and a *criminal penalty* imposed under section 234 in the form of a fine or imprisonment for particular forms of non-compliance and misconduct that the Act criminalises, should eradicate the prior confusion.

Personal liability for company tax debts

A company or close corporation is a legal entity in its own right, and debts incurred by the entity are its responsibility. As a general rule, the directors and shareholders of a company and the members of a close corporation are not personally liable for the entity's tax and other debts if the entity turns out to be unable to pay them.

Personal liability for the entity's debts will be incurred only where there is a piercing of the corporate veil, either at common law, or under statute.

The Tax Administration Bill contains several provisions in terms of which directors, shareholders and members of companies and close corporations can incur personal liability for its tax debts.

Section 180 of the Tax Administration Act

The most far-reaching of these provisions is section 180 which reads as follows:

Aperson is personally liable for any tax debt of the taxpayer to the extent that the person's negligence or fraud resulted in the failure to pay the tax debt if—

(a) the person controls or is regularly involved in the management of the overall financial affairs of a taxpayer; and

(b) a senior SARS official is satisfied that the person is or was negligent or fraudulent in respect of the payment of the tax debts of the taxpayer.

It will be no easy matter for SARS to establish that all the elements for personal liability in terms of section 180 have been fulfilled.

There several significant points about this provision:

personal liability is not limited to income tax, but extends to "any tax debt". The Act does not define the phrase "tax debt" but defines *tax* as including "a tax, duty levy, royalty, fee contribution, penalty interest and any other moneys imposed under a tax Act". In essence, this embraces tax due under any tax legislation except under the Customs and Excise Act;

the trigger for such personal liability is "negligence or fraud";

The role of the doctrine of stare decisis

As has been evident from commentaries published in Synopsis *over the past year, the law relating to income tax in South Africa is in a state of unprecedented uncertainty on several fundamental issues.*

Such uncertainty creates great difficulties for tax consultants, for their clients expect them to give clear advice on the tax consequences of particular transactions, whether those have already been implemented or are still in the planning stage.

Giving tax advice is particularly difficult where there are conflicting decisions on the point in issue by the various courts, from the Tax Court through to the High Court, the Supreme Court of Appeal and the Constitutional Court.

Judgments of the Tax Court and the Tax Board are not precedents

In this regard, it needs to be borne in mind that (as was pointed out by the Constitutional Court in *Metcash Trading Ltd v CSARS* 2001 (1) SA 1109 (CC) at 1130) an appeal to the Tax Court or the Tax Board against the rejection of an objection to an assessment is not an appeal in the strict sense of the word, but a "statutory form of revision of an administrative decision according to a special procedure". From this it follows that decisions of the Tax Court and the Tax Board are not judicial precedents and are not binding on any other court and, indeed, are not even binding on the Tax Court or the Tax Board in later cases involving similar facts.

The doctrine of stare decisis

When considering apparently conflicting judgments on a particular tax issue, it is of course necessary to take account of the doctrine of *stare decisis,* that is to say, the principle that courts must abide by and give effect to principles laid down in earlier judicial decisions in accordance with the hierarchical authority of the various courts in our legal system.

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such negligence or fraud must have *resulted in* (in other words, been the cause of) the failure to pay the tax debt;

potential personal liability extends to any person who "controls or is regularly involved in the management of the overall financial affairs of a taxpayer";

a senior SARS official must be "satisfied" of such negligence or fraud on the part of the person in question.

Objection and appeal against such an assessment

Any assessment that imposes such personal liability can be contested by way of objection and appeal. It is probably safe to say that it will be no easy matter for SARS to establish that all the elements for personal liability in terms of section 180 have been fulfilled.

"Fraud" (that is to say, deliberate and conscious dishonesty) is very difficult to prove.

"Negligence", which in essence means falling short of a reasonable standard of care, is easier to prove, but precisely what the yardstick will be in this context is difficult to say. Certainly, in company law, there have been very few reported judgments in which the courts have been prepared to hold that a director's conduct in the management of the company, fell short of what could be expected of him and was consequently negligent.

Establishing the necessary causal link between the particular individual's fraud or negligence and the failure to pay the tax debt will be difficult where the company in question had a board of directors and a management structure where responsibility for its financial affairs was spread amongst several individuals.

But perhaps the most difficult element of all to prove will be that the individual in question "controls or is regularly involved in the management of the overall financial affairs" of the entity in question. Save in the case of a one-man company, it is seldom that one individual will "control" the entity. And, apart from the chief financial officer (if there is one) there may be no one who was "regularly involved in the management of the overall financial affairs" of the company or close corporation.

The fraudulent and reckless trading provisions of the Companies Act

In many circumstances, SARS may have a better prospect of persuading a court to impose personal liability for a company's unpaid tax debts on its managers or directors by way of a claim under section 424(1) of the Companies Act of 1973 (which remains in force despite the coming into operation of the Companies Act of 2008) in terms of which a court can declare a person to be personally liable for a company's debts if he or she was party to the "reckless" carrying on of business.

In principle it is arguably "reckless" for a company's directors and managers to allow a company to incur a tax liability without taking reasonable steps to ensure that funds will be available for payment.

It is odd that there has, to date, not been any reported judgment in which SARS has invoked section 424(1) of the Companies Act of 1973 (or its counterpart in the Close Corporations Act, namely section 64) to recover tax that the entity was unable to pay.

Thus, decisions of the Constitutional Court are binding on all other courts, and decisions of the Supreme Court of Appeal are binding on the High Court and the Tax Court.

The binding element of a judicial decision is confined to the *ratio decidendi*, that is to say, the rationale or basis of the decision, for mere *obiter dicta* (things said by the way, and which were not strictly necessary in order to decide the particular matter) have persuasive authority but are not binding.

The Constitutional Court has expressed concern that proper respect is not being accorded to the doctrine of *stare decisis*.

The task of the tax adviser is made more difficult by the fact that* obiter dicta *by the Supreme Court of Appeal, while not technically binding on lower courts, have great persuasive force and are likely to be followed.

In *Camps Bay Ratepayers' and Residents' Association v Harrison* [2010] ZACC 19 at [28] the Court said that the underlying rationale of stare decisis is –

formulated extensively by Hahlo and Kahn [Hahlo & Kahn, The South African Legal System and its Background (Juta, Cape Town 1968) 214-5]. What it boils down to, according to the authors, is: "certainty, predictability, reliability, equality, uniformity, convenience: these are the principal advantages to be gained by a legal system from the principle of stare decisis." Observance of the doctrine has been insisted upon, both by this Court and by the Supreme Court of Appeal. ... The doctrine of precedent not only binds lower courts but also binds courts of final jurisdiction to their own decisions. These courts can depart from a previous decision of their own only when satisfied that that decision is clearly wrong. Stare decisis is therefore not simply a matter of respect for courts of higher authority. It is a manifestation of the rule of law itself, which in turn is a founding value of our Constitution. To deviate from this rule is to invite legal chaos.

Earlier, the Constitutional Court had said in E*x Parte Minister of Safety and Security: In Re S v Walters* [2002] ZACC 6; 2002 (4) SA 613 (CC); 2002 (7) BCLR 663 (CC) at [60] – [61] that –

courts are bound to accept the authority and the binding force of applicable decisions of higher tribunals. ...High Courts are obliged to follow legal interpretations of the Supreme Court of Appeal, whether they relate to constitutional issues or to other issues, and remain so obliged unless and until the Supreme Court of Appeal itself decides otherwise or this Court does so in respect of a constitutional issue.

Of course, it is trite that the binding authority of precedent is limited to the *ratio decidendi* (rationale or basis of deciding) and that it does not extend to *obiter dicta* or what was said "by the way". But the fact that a higher court decides more than one issue in arriving at its ultimate disposition of the matter before it does not render the reasoning leading to any one of these decisions *obiter*, leaving lower courts free to elect whichever reasoning they prefer to follow. It is tempting to avoid a decision by higher authority when one believes it to be plainly wrong. Judges who embark upon this exercise of avoidance are invariably convinced that they are "doing the right thing". Yet, they must bear in mind that unwarranted evasion of a binding decision undermines the doctrine of precedent and eventually may lead to the breakdown of the rule of law itself. If judges believe that there are good reasons why a decision binding on them should be changed, the way to go about it is to formulate those reasons and urge the court of higher authority to effect the change.

Distinguishing between what is ratio and what is obiter

It is, however, not always an easy task to determine which aspect of a judgment is the *ratio decidendi* and which passages are merely *obiter dicta*.

Thus, for example, it is strongly arguable that the novel criteria laid down by the Supreme Court of Appeal in *CSARS v NWK Ltd* [2010] ZASCA 168 which the court said must be applied to determine whether a transaction was "simulated", namely, that it is necessary to ask in relation to the transaction in question, not only whether the parties intended it to have effect according to its tenor, but also "does it have any commercial substance or make business sense?" were merely obiter.

The task of the tax adviser is made more difficult by the fact that *obiter dicta* by the Supreme Court of Appeal, while not technically binding on lower courts, have great persuasive force and are likely to be followed.

Where *obiter dict*a of the High Court or the Supreme Court of Appeal are to the advantage of SARS, the Commissioner and his officials tend, in practice, to assess taxpayers as though such *obiter dict*a conclusively and authoritatively lay down the law.

And, since most taxpayers are not prepared to engage in litigation with SARS on disputed points of law, the practice of the revenue authorities (that is to say, SARS's view of how tax legislation ought be interpreted) is, in most instances, a significant consideration for a tax consultant in advising a client on the tax consequences of a transaction.