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TAX AND EXCHANGE CONTROL ALERT

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AN UNCOMPROMISING STANCE – THE DISPUTE BETWEEN SARS AND JULIUS MALEMA CONTINUES

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CRITICISM ON SARS'S APPROACH TO THE INTERPRETATION OF LEGISLATION

On 29 April 2016 the High Court of South Africa (Gauteng Division, Pretoria) handed down judgment in an application brought by Julius Malema (Applicant) against the Commissioner for the South African Revenue Service (SARS). The matter concerned a compromise agreement concluded between them in terms of s205 of the Tax Administration Act, No 28 of 2011 (TAA).

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The Applicant objected to the assessments and alleged that the amounts in question constituted donations or dividends in respect of which the Applicant could not be assessed to tax.

The High Court (Gauteng Division, Pretoria) recently handed down judgment in the case of *Malema v Commissioner for the South African Revenue Service* (76306/2015) [2016] ZAGPPHC 263 (29 April 2016). The issue before the court was whether the South African Revenue Service (SARS) was bound to a compromise agreement entered into between the Malema (Applicant) and SARS as a result of alleged non-disclosures and misstatements made by the Applicant, who expressly warranted the truth of the facts furnished by him. The compromise agreement was concluded in accordance with the provisions of s205 of the Tax Administration Act, No 28 of 2011 (TAA).

SARS contended that it was no longer bound by the Agreement as the Applicant had not, as was required by the Agreement, made full, verifiable and complete disclosure of all material facts nor kept his tax affairs current.

Facts

The dispute mainly pertains to assessments raised by SARS against the Applicant for the 2005 to 2011 years of assessment, totalling the amount of R18,192,295.36 including interest. The Applicant objected to the assessments and alleged that the amounts in question constituted donations or dividends in respect of which the Applicant could not be assessed for tax. The Applicant requested a compromise from SARS on four occasions. Following three failed attempts to conclude a compromise agreement, the Applicant and SARS finally concluded such an agreement on 21 May 2014 (Agreement). The final date to comply with the Agreement was 30 November 2014.By 1 December 2014, the Applicant had paid the amount stipulated in the Agreement and thus complied with his payment obligations.

On 13 March 2015 SARS contended that it was no longer bound by the Agreement as the Applicant had not, as was required by the Agreement, made full, verifiable and complete disclosure of all material facts nor kept his tax affairs current. It is also important to note that the Applicant was provisionally sequestrated on 11 February 2014 - between his second and third attempts to conclude a compromise agreement.

Judgment

Section 205 of the TAA states that SARS is not bound by a compromise if:

a) the debtor fails to disclose a material fact to which the compromise relates;

b) the debtor supplies materially incorrect information to which the compromise relates;

c) the debtor fails to comply with a provision or condition contained in the compromise agreement; or

d) the debtor is liquidated or the debtor's estate is sequestrated before the debtor has fully complied with the conditions contained in the compromise agreement.

With these considerations in mind, SARS argued that it was no longer bound by the Agreement as the Applicant had failed to:

- identify the donor who offered to donate R4 million to the Applicant to use as payment towards the amount in the Agreement and to ensure that donations tax was declared and paid on this amount; and

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SARS further argued that the Applicant had unequivocally accepted liability for the 2011 and 2012 assessments.

- keep his tax affairs current and paid up to date in that he, among other things, failed to ensure that donations tax was paid on the part of the compromise amount being paid by way of donation and failed to make payment of the previously acknowledged liability for the (additional) 2011 and 2012 assessments and subsequently proceeded to object to the assessments and failed to declare donations received by his attorney, Brian Khan.

The Applicant further made misstatements in the request for the compromise, for instance that he was the beneficiary of the JSM Trust which had failed to keep its tax affairs in order. In addition he failed to disclose an alleged interest in a certain property (Bendor property).

SARS further argued that the Applicant had unequivocally accepted liability for the 2011 and 2012 assessments. The Applicant disputed this, stating that the amounts were not taxable as income in his hands as they were dividends or donations.

The Applicant's main arguments can be summarised as follows:

- SARS's decision to no longer be bound by the Agreement was unlawful;
- the Applicant could have treated the matter as unlawful administrative action but elected to treat it as a matter of private law and not public law;
- SARS had to conform to the provisions of the Constitution and the Applicant's rights to human dignity, freedom of trade, occupation and profession, and property, and administrative action had to be complied with by SARS; and
- the issue whether the JSM Trust's tax affairs were regularised or otherwise had nothing to with the Applicant's rights and obligations under the Agreement.

The court stated that the real dispute between the parties was how the dividends and donations received should be classified. The Applicant argued that the donations were made out of generosity or disinterested benevolence and that the dividends were not taxable, whereas SARS argued that the donations and dividends were income. The dispute appeared to be a purely factual one and it was difficult to assess whether the Applicant had not made a full and frank disclosure as alleged by SARS. The court made the following observations regarding applicable provisions in the TAA and their interpretation:

- in terms of s192 of the TAA, a compromise of a debt can only take place when the liability to pay the debt is not disputed by the debtor;
- the effect of s192 is that, under a compromise, the taxpayer loses his right to object and appeal against an assessment, meaning that SARS cannot be allowed to enter into a compromise with a taxpayer only to later deny its validity based on unwarranted grounds;

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The court appeared to disagree with SARS's argument that any misstatement or failure to make a disclosure would automatically be material.

- SARS is obliged to secure the highest net income from a tax debt and to enter into compromises on an informed basis, which is why s100(4) of the TAA entitles senior SARS officials to require that an application for compromise be supplemented by further information;
- in terms of s200(4) of the TAA, once a senior SARS official and a debtor have signed a compromise agreement, SARS must give an undertaking that it will not pursue recovery of the balance of the tax debt;
- only if any of the circumstances in s205 of the TAA referred to above are present will SARS not be bound to the agreement; and
- in order to determine whether a term is 'material' to a contract, one must assess whether it was a vital term, as decided in *O'Connell v Flischman* 1948 (4) SA 191 (T).

The court accepted SARS's argument that the alleged non-disclosure regarding the Bendor property was intentional and that such fraud is material, but questioned why SARS had still entered into the Agreement even though it was aware of the Applicant's interest in the property. The court appeared to disagree with SARS's argument that any misstatement or failure to make a disclosure would automatically be material.

The court finally held that, because of the factual disputes, the necessity for SARS to justify its argument regarding materiality by proving the facts that were attendant when the Agreement was entered into and because of the fact that one cannot decide the issue of fraud on affidavit, the matter should be referred to trial. The court indicated that it did not wish to express an opinion on which interpretation of s205 is correct.

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CRITICISM ON SARS'S APPROACH TO THE INTERPRETATION OF LEGISLATION

The issues which emerged from the case are relevant to matters which extend beyond the mere application or interpretation of s205 of the TAA.

On 29 April 2016 the High Court of South Africa (Gauteng Division, Pretoria) handed down judgment in an application brought by Julius Malema (Applicant) against the Commissioner for the South African Revenue Service (SARS). The matter concerned a compromise agreement concluded between them in terms of s205 of the Tax Administration Act, No 28 of 2011 (TAA). The Applicant sought a declaratory order that SARS was bound by the compromise agreement. SARS, in turn, argued that it was no longer bound by the compromise agreement due to the alleged non-disclosures and misstatements made by the Applicant (who warranted the truth of the facts furnished by him).

The arguments made by SARS point to a disregard by SARS for the circumstances of the taxpayer when interpreting legislation.

This case is of great importance for the following reasons:

- the issues which emerged from the case are relevant to matters which extend beyond the mere application or interpretation of s205 of the TAA;
- the arguments made by SARS point to a disregard by SARS for the circumstances of the taxpayer when interpreting legislation; and
- the judgment provides some indication as to the judiciary's view on SARS's approach.

One of the important issues discussed in the judgment is the interpretation of the word 'material' in the context of s205 of the TAA. In terms of the compromise agreement, SARS would not be bound by the agreement if the Applicant, among other things, failed to make a "full, verifiable and complete disclosure of all material facts to which the compromise relates" or if he supplied "materially incorrect information to which the compromise relates".

Section 205(a) and (b) of the TAA states that "SARS is not bound by a 'compromise' if:

(a) the 'debtor' fails to disclose a material fact to which the 'compromise' relates; or

(b) the 'debtor' supplies materially incorrect information to which the 'compromise' relates"

The TAA itself does not define the word 'material'. Nor is there mention in s205 of the words "full, verifiable and complete disclosure" and this simply appears to have been a contractual term. From the judgment it appears that SARS argued that the word 'material' within the context of s205 meant that anything not disclosed by the Applicant would be material. Therefore, any misstatement or failure to make a disclosure would automatically be material. In the court's view, if SARS's argument was followed to logical conclusion, the word "material" would have no effect as any form of non-compliance with a compromise agreement, no matter how insignificant, would result in a breach of that agreement. It is then not clear why the word 'material' is necessary or used in s205. This is irrespective of whether or not an omission

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At what point can a taxpayer legitimately cease to furnish SARS with documents and information which in the taxpayer's view is unnecessary?

or misrepresentation actually caused SARS to enter into the compromise agreement. According to the court, the word 'material' properly construed within s205 appears to state that the misrepresentation or omission must, to a significant extent, induce SARS to enter into the compromise agreement or reject it. The court referred to the judgment of *O'Connell v Flischman* (1948) 4 SA 191 (T) where it was stated that, whether a term is material to a contract may be assessed by how vital the term is.

In this case SARS appears to have argued for absolute liability, regardless of the circumstances. But what happens in a case where the taxpayer is unaware of certain facts and the taxpayer or SARS only ascertains them after conclusion of the compromise agreement? What happens if there was no intention by a taxpayer to misrepresent or omit the facts, or the misrepresentation or omission was not caused by negligence on the part of the taxpayer? These are issues that the court grappled with. In the court's view, logic would dictate that any non-compliance with the terms of the compromise agreement is not necessarily material as it would depend on the facts upon which the compromise agreement was entered into.

The matter was unfortunately referred to trial and no final judgment was therefore delivered on these aspects. However, we have come across many similar issues, in particular with regard to the interpretation of s227 of the TAA. Section 227 of the TAA contains a similar provision to the disclosure requirement in s205, only in s227 the disclosure relates to the requirements for a valid voluntary disclosure in terms of the Voluntary Disclosure Programme (VDP).

The requirements for a valid voluntary disclosure include that the disclosure must be voluntary and be "full and complete in all material respects". Again the word 'material' is used.

This raises the question as to what would constitute a full and complete disclosure within the context of s227. At what point can a taxpayer legitimately cease to furnish SARS with documents and information which in the taxpayer's view is unnecessary? At what point can a taxpayer be confident that its disclosure in terms of the TAA has been full and complete in all material respects? In our view the word 'material' in this context is crucial, as it provides the taxpayer with some way of legitimately narrowing down the information to be provided to SARS as a taxpayer surely cannot provide SARS with all the irrelevant information at its disposal. It would further keep taxpayers from having to move mountains in order to obtain irrelevant information which SARS would not need in order to calculate the taxpayer's tax liability.

If SARS's argument that any non-disclosure or misstatement is automatically material succeeds, then it is unlikely that any VDP application would comply with the disclosure requirements of s227. This would certainly defeat the purpose for which the VDP was introduced, especially in the context where one is regularly dealing with taxpayers who voluntarily and for bona fide purposes wish to regularise their tax affairs. Hopefully we will get clarity on this issue if the case proceeds to trial.

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