DLA CLIFFE DEKKER HOFMEYR

TAX

ALERT

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IN THIS ISSUE

SUPREME COURT OF APPEAL ADDRESSES ADMINISTRATIVE FAIRNESS IN RAISING ASSESSMENTS AND DISPUTES BEFORE THE TAX COURT

An interesting judgment was handed down in the Supreme Court of Appeal (SCA) on 12 June 2014 in the matter of Commissioner for the *South African Revenue Service v Pretoria East Motors (Pty) Ltd (291/12) [2014] ZASCA 91.*

The taxpayer operated a car dealership in Pretoria. The South African Revenue Service (SARS) conducted an audit on the taxpayer in respect of its 2000 to 2004 years of assessments, and as a result raised various additional assessments in respect of, *inter alia*, income and value-added tax (VAT). SARS also imposed punitive additional tax of 200%. The taxpayer objected to the additional assessments, but SARS disallowed the objection and the taxpayer appealed to the Tax Court. The Tax Court found in favour of SARS in respect of some of the issues in dispute, but found in favour of the taxpayer in respect of other. The Tax Court also confirmed the imposition of the additional tax. SARS then appealed to the SCA, and the taxpayer similarly cross-appealed.

Whereas the substantive issues in dispute between the parties were numerous, the significance of the judgment relates to the approach that SARS adopted in respect of the audit and in raising the assessments, and the SCA's criticism thereof.

The audit involved a comparison of the taxpayer's accounting records and other information available to SARS.

The SCA noted that SARS did not try to familiarise itself with the taxpayer's accounting system, even though it was clear that it was a customised system. For example, some transactions that were reflected as 'sales' on the system were internal transactions relating to movements of stock between branches or movements from sale stock to demonstration stock. SARS completely ignored this fact, even though it was clear that the transactions were internal.

The approach adopted by SARS was that, where there was any discrepancy that it did not understand, SARS raised additional assessments and left it to the taxpayer to prove in the Tax Court that SARS was wrong.

The SCA reprimanded SARS by indicating that:

> "*[SARS's] approach was fallacious. The raising of an additional assessment must be based on proper grounds for believing that, in the case of VAT, there has been an under declaration of supplies and hence of output tax, or an unjustified deduction of input tax. In the case of income tax it must be based*

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on proper grounds for believing that there is undeclared income or a claim for a deduction or allowance that is unjustified. It is only in this way that SARS can engage the taxpayer in an administratively fair manner, as it is obliged to do. It is also the only basis upon which it can, as it must, provide grounds for raising the assessment to which the taxpayer must then respond by demonstrating that the assessment is wrong … In addition, as a matter of routine, all the additional assessments raised by [SARS] were subject to penalties at the maximum rate of 200 per cent, absent any explanation as to why the taxpayer's conduct was said to be dishonest or directed at the evasion of tax."

It appears that SARS mainly relied on s82 of the Income Tax Act, No 58 of 1962 and s37 of the VAT Act, No 89 of 1991 (now s102 of the Tax Administration Act, No 28 of 2011) in that, where tax disputes are concerned, the taxpayer carries the burden of proof. The SCA acknowledged that the taxpayer carries the burden of proof, but remarked:

"*That, however, is not to suggest that SARS was free to simply adopt a supine attitude. It was bound before the appeal to set out the grounds for the disputed assessments and the taxpayer was obliged to respond with the grounds of appeal and these delineate the disputes between the parties.*"

The taxpayer, to discharge the onus, called witnesses. The court recognised that the taxpayer's evidence under oath and that of its witnesses cannot be disregarded simply as being self-serving and therefore unreliable, but emphasised that it must be given full consideration along with all other evidence, and the credibility of the witnesses must be tested just as it is in any other matter before a court.

SARS insisted that the evidence of the witnesses were insufficient and that the taxpayer was obliged to provide documentary evidence to discharge the onus.

However, even before the matter came before the Tax Court, SARS insisted that insufficient proof had been provided by the taxpayer. The taxpayer provided SARS with relevant records, and even put all its ledger accounts in a van and had it delivered to SARS's offices. SARS refused to inspect the documents. On several further occasions the taxpayer tendered the documents to SARS. In the Tax Court counsel for SARS questioned the taxpayer's witnesses and asked them to provide source documents proving that SARS was wrong, without indicating which specific documents it required.

In this regard the SCA made it clear that:

"*That approach was untenable, for, it left the taxpayer none the wiser as to what was truly in issue and what needed to be produced in order for it to discharge the burden of proof that rested upon it. The taxpayer thus adopted the general approach that as [SARS] had misunderstood the accounts and ignored the provisions in particular of the VAT Act, it sufficed for it to demonstrate that through the evidence of [witnesses]. That was a perfectly proper approach … The taxpayer was not alerted to any other issue and was certainly not called upon to produce every underlying voucher or invoice or to reconstruct its accounts from scratch for the Tax Court.*

In these circumstances the submissions … that the original vouchers had not been produced or that [the witness's] explanations were to be ignored because they were based on hearsay, cannot be sustained. … Where, for example, the SARS auditor has based an assessment upon the taxpayer's accounts and records, but has misconstrued them, then it is sufficient for the taxpayer to explain the nature of the misconception, point out the flaws in the analysis and explain how those records and accounts should be properly understood. That can be done by a witness … If there are underlying facts in support of that explanation that SARS wishes to place in

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dispute, then it should indicate clearly what those facts are so that the taxpayer is alerted to the need to call direct evidence on those matters. Any other approach would make litigation in the Tax Court unmanageable, as the taxpayer would be left in the dark as to the level of detail required of it in the presentation of its case. It must be stressed that SARS is under an obligation throughout the assessment process leading up to the appeal and the appeal itself to indicate clearly what matters and which documents are in dispute so that the taxpayer knows what is needed to present its case."

It is clear that the SCA placed much emphasis on the fact that, for the sake of fairness and proper court procedure, SARS must clearly state the grounds on which it bases its assessments and make it clear to the taxpayer what it disputes so that the taxpayer can know what is required from it to discharge the onus of proof.

In this regard it is alarming that the latest draft rules for dispute resolution, which is expected to be promulgated soon, has inverted the order in which the parties must produce their pleadings for purposes of proceedings in the Tax Court.

Currently it is required that SARS first produces a statement of grounds of assessment to which the taxpayer must reply by producing a statement of grounds of appeal. The statement of grounds of assessment allows a taxpayer to understand what SARS's case is and to prepare an answer thereto. Together these pleadings delineate the issues in dispute between the parties.

However, the draft rules provide that the taxpayer must first produce a statement of grounds of appeal, without SARS being obliged to first state its case. The taxpayer will therefore be forced to blindly defend itself from undefined contentions by SARS, while at the same time carrying the burden of proving that such contentions are wrong. Only after the taxpayer has provided its defence will SARS be obliged to provide a statement of grounds opposing the taxpayer's appeal.

While it is accepted that the taxpayer will have the right to request reasons for any assessments made by SARS, it is submitted that SARS is not required to automatically furnish such reasons, and for purposes of proceedings in the Tax Court, SARS should be obliged to first make out a proper case for having assessed the taxpayer. This case provides authority for the view that the proposed dispute resolution rules fall foul of the principles of administrative fairness and are not in the interest of proper court procedure.

Heinrich Louw

TAX EXEMPTION ON FOREIGN EMPLOYMENT INCOME

In terms of current practice, remuneration derived from services rendered outside of South Africa is, subject to certain requirements, exempt from normal tax in South Africa in terms of s10(1)(o)(ii) of the Income Tax Act, No 58 of 1962 (Act).

The general rule is that income earned by a tax resident of South Africa from the rendering of services anywhere in the world will be included in 'gross income' as defined in s1 of the Act. Notwithstanding the general rule above, certain exemptions are provided for, inter alia, in s10(1)(o) of the Act in respect of remuneration which would likely have been subject to the deduction of employees' tax under normal circumstances.

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The exemption provided under s10(1)(o)(ii) of the Act will apply in respect of services rendered outside South Africa for or on behalf of any employer, as long as the individual is outside South Africa for a period or periods exceeding 183 full days (calendar, not working days) in aggregate, during any twelve month period commencing or ending during a tax year. In addition, the exemption will only apply if, during the 183 day period, there was at least a 60 day continuous period of absence from South Africa.

The onus is on the taxpayer to prove his absence from South Africa for a period and/or periods complying with the requirements of s10(1)(o)(ii) of the Act, as well as the fact that such absence was attributable to him rendering services outside of South Africa. But what about periods spent voluntarily abroad, even where the individual was in full time employment? A situation that often arises is where employees render services on a rotation cycle, for example two weeks offshore and two weeks onshore having regard to the specific type of industry the employer operates in. The employer may require, due to health and safety concerns, that employees take time off (outside of normal leave days), which the employees may decide to spend offshore rather than returning to South Africa. In spending the voluntary days offshore, the employee may ensure that the 60 day continuous period, under s10(1)(o)(ii) of the Act, is met.

Interpretation Note 16 (IN16) specifically provides that "weekends, public holidays, vacation and sick leave spent outside the Republic are considered to be part of the days during which services were rendered during the 183 day and 60 day periods of absence". On the basis that the aforementioned interpretation is correct in calculating the 183 day or 60 day continuous periods, it should be irrelevant as to whether an affected individual decides to spend a voluntary period abroad and, in so doing, complies with the requirements of s10(1)(o)(ii) of the Act. Any rest period (whether voluntary or compulsory) will be deemed to be included in the calculation of the 183 day or 60 day continuous periods for purposes of s10(1)(o)(ii) of the Act.

A contrary application of s10(1)(o)(ii) of the Act, for example some form of apportionment methodology for time spent in and outside South Africa on rotation, would likely be incorrect and also against 'practice generally prevailing', having regard to IN16. Taxpayers making use of the exemption under s10(1)(o)(ii) of the Act are reminded to exercise caution in ensuring that all requirements are met and possible future changes are taken cognisance of.

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