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TAX ALERT

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WHEN IS VOLUNTARY REALLY VOLUNTARY?

The Voluntary Disclosure Programme (VDP), which ran from November 2010 until October 2011, allowed taxpayers to regularise past tax defaults.

This programme effectively served as a pilot for the permanent VDP instituted in terms of sections 225 to 233 of the Tax Administration Act, No 28 of 2011 (TA Act). Word is that the permanent VDP could come into operation during the last quarter of this 2012.

According to the Short Guide to the TA Act (Short Guide) published by the South African Revenue Service (SARS) the main purpose of the permanent VDP is "...to enhance voluntary compliance in the interest of the good management of the tax system and the best use of SARS's resources. It seeks to encourage taxpayers to come forward and avoid the future imposition of understatement penalties, other administrative penalties and interest".

Section 227 of the TA Act sets out the requirements for valid voluntary disclosure. The first requirement is that the disclosure must be 'voluntary' – that sounds quite obvious. On second thought, the issue whether a disclosure to SARS would qualify as voluntary might not be that simplistic. Unfortunately the Short Guide provides no guidance in this regard.

The recent Canadian case of *Worsfold v The Queen (2012 FC 644)* specifically decided the issue of whether a disclosure to the Canada Revenue Authority (CRA) was indeed voluntary. The Federal Court (Ontario, 25 May 2012) held that the disclosure was 'voluntary', despite the fact that the CRA had initiated enforcement action against a related party. Since the Canadian and South African VDP's both require the disclosure to be 'voluntary' the reasoning of the Federal Court could be important in the local context.

According to the CRA Information Circular on its VDP the concept 'voluntary' requires that the disclosure must be initiated by the taxpayer and must not "have been made with the knowledge of an audit, investigation, or other enforcement action that has been initiated by the CRA...".

In that case, Mr Worsfold had moved to Canada in 2001. He had not filed tax returns since October 2005. In September 2006, Worsfold completed an on-line tax amnesty form so that an assessment could be done regarding his need and eligibility for voluntary disclosure. Following the appraisal, an in-depth discussion was arranged for 5 October 2005 to address Worsfold's anticipated voluntary disclosure to the CRA. A 'no-name disclosure' was lodged that same day. However, on 3 October 2005 a CRA auditor had called a company 'S' to inform it of an upcoming CRA audit. Worsfold was that company's sole director and shareholder. Worsfold's named voluntary disclosure was subsequently submitted to the CRA.

During 2007, Worsfold was informed by the CRA that his disclosure was "Not voluntary – CRA had initiated enforcement actions against a related taxpayer prior to the date of voluntary disclosure". This resulted from the fact that the CRA auditor had contacted company 'S' on 3 October, which was prior to

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Worsfold's 5 October 2005 meeting during which the no-name disclosure was first made. The CRA's unwillingness to entertain Worsfold's disclosure was thus based on a view that said disclosure had been prompted by the CRA's envisaged audit of company 'S'.

The Federal Court analysed the facts in great detail including the chronology of events pertaining to Worsfold's disclosure. In the end the finding was that Worsfold (and his family members who made simultaneous disclosures) had no knowledge of the company 'S' audit when they filed their disclosures.

The end-result was that the application for judicial review was allowed, that is, the requests by Worsfold and his co-applicants for penalty and interest relief under the VDP had to be reconsidered. The case confirms that the nexus between the enforcement action and the applicant's disclosure is crucial -- and not merely whether the parties are somehow connected.

This Canadian judgment shows that the requirement of being 'voluntary' could be intricate where the applicant's urge to make disclosure follows closely on the revenue authority's action in respect of a related party or entity.

The CRA has developed in-depth Information Circulars and internal VDP Processing Guidelines in regard to its VDP process. These set out in detail the decision-making process to be followed when deciding whether or not an applicant gets into the VDP.

It should be expected that the local permanent VDP would attract a substantial number of applicants – especially in light of SARS's ever increasing compliance initiatives. Guidance by SARS on the VDP decision-making process, along the lines of the CRA model, would be welcome.

Johan van der Walt

CONSEQUENCES OF USING A TRUST FOR ESTATE PLANNING

A well-known estate planning technique is this: A person sells a growth asset to a trust on loan account. The asset that remains in the person's estate is the loan account, the value of which is pegged at a fixed amount. The growth of the asset is in the hands of the trust, which falls outside the seller's estate for estate duty and capital gains tax purposes.

From a tax perspective, the plan may work. But it should also be borne in mind that the transfer of an asset to a trust has other consequences. This was shown graphically in the recent Supreme Court of Appeal case of *Raath v Nel [2012] ZASCA 86.*

The facts of the case were briefly the following. Mr Nel, a successful businessman, sued Dr Raath, an anaesthetist, for damages in respect of the consequences of a failed intubation prior to a back operation which Mr Nel was scheduled to undergo. Among other things, Mr Nel claimed damages for the loss suffered as a consequence of his inability, due to the failed intubation and its consequences, to attend to the same extent as before to the affairs of one of his companies. This resulted in the company making reduced profits for the period 1 May 2000 (when the failed intubation occurred) and March 2003 (when Mr Nel had recovered sufficiently to attend fully to the business again).

Mr Nel was the sole shareholder of the company. However, on 1 April 2001, for estate planning and estate duty considerations, he sold his shares and loan account in that company (and all his other business assets) to a trust. Mr Nel was not a capital beneficiary of the trust but he was, in the discretion of the trustees, a potential income beneficiary of the trust.

Dr Raath's defence to the claim for the loss suffered was that any loss was incurred not by Mr Nel personally, but by the company and the trust.

The court upheld the defence. It considered certain cases and reaffirmed the principle that "a trust estate, comprising of an accumulation of assets and liabilities, is a separate entity, albeit bereft of legal personality". The court concluded that "the separateness of the trust estate must be recognised and emphasised, however inconvenient and adverse to [Mr Nel] it may be". In other words, the court held that, from the date that Mr Nel had transferred his assets to the trust, the benefits and losses in relation to those assets accrued to the trust, and not to Mr Nel. And so, from that date, Mr Nel had no claim for losses suffered by his company.

What the case illustrates is that a person who transfers an asset to a trust must understand clearly that, while the scheme may have a tax benefit, it may have other practical consequences. The asset is no longer that of the person and the risk and reward passes to the trust. Also, the person may lose control of the asset that vests in the trustees.

Persons should be careful when using trusts in estate planning and should, in addition to the tax implications, also consider the practical implications of setting up a trust.

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