

INFORMATION GATHERING BY REVENUE AUTHORITIES - WHAT ABOUT THE COST?

The powers of the South African Revenue Service (SARS) to gather information were extended significantly in Chapters 4 and 5 of the Tax Administration Act, No 28 of 2011 (TAA) that took effect on 1 October 2012.

Greater powers were deemed necessary because "... too many requests for information by SARS result in protracted debates as to SARS's entitlement to certain information." (SARS Short Guide to the TAA, at p23)

Clearly information is central to the SARS business model: "By increasing and integrating data from multiple sources, SARS will increasingly be able to gain a complete economic understanding of the taxpayer and trader across all tax types and all areas of economic activity." (SARS Strategic Plan 2013/14 - 2017/18, at p25)

Information-gathering under the applicable TAA provisions is a costly exercise for SARS, taxpayers (both corporate and individuals) as well as for advisers. The cost-aspect is usually not addressed in legislation empowering information-gathering by revenue authorities. Despite this there is a strong need for 'cost-consciousness' relating to information requests – simply because of the compliance cost impact.

The SARS Strategic Plan specifically states, in order to achieve the objectives of the National Development Plan, SARS will promote effective government by "Reducing the cost of compliance and the cost of doing business in South Africa" (at p13). Hence, one of SARS's future initiatives would be to "Continue to implement the principles of a cooperative compliance approach to reduce compliance costs..." (at p34). SARS also acknowledges under "Small business and Cost of Compliance" that the "relatively high cost of compliance" might be a reason for non-compliance by small business (see at p43).

So how does a revenue authority inculcate a culture of "cost-consciousness" when it comes to information-requests by its officials?

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The Australian Tax Office (ATO) has gone down this road in its *Access and Information Gathering Manual*: Said Manual explains the law relating to the ATO's statutory information-gathering powers and indicates how ATO officials should exercise such powers. [The Manual is available on the ATO website].

The following reflects the ATO's philosophy on information-gathering (as communicated by the then Commissioner): "These guidelines are to assist my staff and ensure we apply a professional and, as far as possible, open approach to the exercise of our access and notice powers. These powers must be used with the utmost care and we aim only to fulfil my obligations under the legislation. A consultative approach to obtaining the information should be the norm. Consultation generally involves advance notice and flexibility in meeting reasonable requests."

It is, furthermore, important to the ATO that costs associated with information-gathering should be curtailed: "*In deciding whether to seek access, and in determining how much detail to seek, officers should always try to minimise the cost to the recipient of meeting access requests. Particularly in cases of seeking bulk data, request should be made only if there is a reasonable chance that there will be a substantial compliance impact relative to cost.* On occasions sampling may be required to determine the benefits of obtaining bulk data. Also where bulk data is requested, officers should try to fit in with the custodian's circumstances (for example seeking information from the custodian's IT systems at times when it will not disrupt operations) *and recognise the time and cost of obtaining such information.*" (emphasis added)

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The ATO then provides practical guidance to its officials considering an information request, alternatively where they intend accessing premises to obtain information/documentation. The ATO official is instructed to ask certain questions before requesting the information/accessing any premises. [The following is a summary of the guidance from the ATO Manual]:

- For what purpose and under which law do you require information?
The access provisions can only be used for the purposes of the Act. You must be clear on your reasons for seeking particular documents. You should be able to show a clear connection between the use of the access power and one of the purposes of the Acts. Like all statutory powers, you must exercise the right of access in good faith for the purposes for which it was conferred.
- What information do you already have?
You should ensure that the taxpayer or the third party has not already provided the documents to the ATO, eg in support of a request for a private ruling.
- What information do you need?
You should establish, as far as possible, what particular books, documents and papers are needed and whether the information they might contain is necessary for the purposes for which you are seeking access. Is it likely that the information will be located at the premises you propose to access or from the person you propose to give a notice to? Can you obtain relevant information from another source? Before using access powers, be reasonably sure that you are approaching the right person. *If the information is available from more than one source, you should consider the cost to each party and who might be the appropriate party to bear the cost. In the majority of cases, tax officers should try and obtain the information and documents from the taxpayer prior to contacting third parties, such as advisers and banks. The cost to the ATO, and whether the exercise is cost-effective, should also be considered.*
- Are you authorised to seek access?
You must be properly authorised to exercise access powers.
- Can you obtain access to the relevant information on an informal/cooperative basis?
If you think you can obtain the information by making telephone contact, sending an informal letter or *searching other sources, the access powers should not be used.* However, it is not necessary for all other avenues of enquiry to have been exhausted or to have used the notice powers

before resorting to the access powers. You should be able to conclude that the occasion is one that reasonably requires you to enter premises and inspect documents.

- Is it necessary to exercise formal access powers?
In circumstances in which privacy or confidentiality require that the formal access powers are used, consultation beforehand should encourage cooperation. Consultative procedures may include: giving the custodian reasonable notice of your intention to obtain access; liaising with the custodian about a convenient time to seek access, taking into account the workflow demands on the custodian; giving adequate information to ensure that custodians are fully aware of their rights and obligations in relation to access requests and so on.

Minister Gordhan, in his foreword to the SARS Strategic Plan (at p6), anticipates that over the next four years "... the demands on revenue collection growth will be between 10% and 11% per annum". For example, SARS would need to collect R1.09 trillion in revenue by 2015/16. To achieve those kinds of revenue targets probably means increasing levels of information-gathering.

Seeking to reduce the cost of compliance requires that locally 'cost-consciousness' must become part of the information-gathering equation - and that a way is found to limit, and hopefully reduce, the costs associated with information-gathering under the TAA.

Johan van der Walt

CAPITAL GAINS TAX, INFLATION AND AMNESIA

The South African capital gains tax (CGT) regime does not provide for indexation: it does not take into account the effect that inflation may have on capital profits over time.

Consider the following example: A company bought an asset on 1 January 2002 for R1 000. The company sold the asset on 1 January 2013. The inflation rate during that period was, for example, 6% compounded annually. The company realised a return of, for example, 10% compounded annually, that is, a return of 4% above inflation compounded annually. Accordingly, the company sold the asset for an amount of R2 853. The company realised a nominal profit of R1 853 (R2 853 – R1 000). But, taking into account the effect of inflation, the company achieved a real profit of R539 (R1 539 – R1 000).

The company distributed the nominal profit of R1 853 to its shareholders who are natural persons.

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The total amount of tax payable effectively borne by the shareholders, the ultimate investors, is determined as follows:

Step 1 – Determine CGT in the hands of the company:

Proceeds	R2 853
Base cost	(R1 000)
Capital gain	R1 853
Apply inclusion rate (66,6%)	R1 243
Apply corporate tax rate (28%)	R346

The CGT amounts to R346.

Step 2 – Determine dividends tax in the hands of the shareholders:

Profit before CGT	R1 853
CGT	(R346)
Profit after CGT	R1 508
Apply dividends tax rate (15%)	R226

The dividends tax amounts to R226.

The total tax effectively borne by the shareholders amounts to R572 (R346 + R226).

As mentioned above, the real net profit after taking into account the effect of inflation is R539. In other words, in real terms, the shareholders are paying more to the taxman (R572) than they are actually realising on their investment (R539).

When CGT was introduced in 2001, the National Treasury considered the issue of whether or not CGT should provide for indexation, that is, take into account the effect of inflation.

In a document entitled "Briefing by the National Treasury's Tax Policy Chief Directorate to the Portfolio and Select Committees on Finance Wednesday, 24 January 2001" the National Treasury considered the issue in detail. Among other things, it made the following statements:

- "The combined benefits of the 'low inclusion rate' and deferring accrued capital gains until realisation should more than compensate for the effects of inflation in a moderate-inflation environment".
- "...[T]he potential impact of inflation was one of a number of considerations (though not the primary factor) that informed the decisions to have moderate (low) 'inclusion rates' of capital gains in taxable income, thereby partially adjusting for inflation".
- "Assuming a constant pre-tax real return, constant inflation and *constant inclusion rate*, the effective tax rate would fall over time. This suggests that inflation compensation arising from a *constantly low inclusion rate* would increase with time" (emphasis added).

The "low" inclusion rate was only one of the reasons why the National Treasury did not provide for indexation. Notably, "administrative complexity" was one of the motivations.

When CGT was introduced with effect from 1 October 2001, generally speaking, the inclusion rate was set at 25% for natural persons and at 50% for other persons. However, with effect from years of assessment starting on or after 1 March 2012, the inclusion rate was increased to 33,3% and 66,6%, respectively.

In the Budget Speech of 22 February 2012 it was stated that the increase of the inclusion rate was necessary to "reduce the scope for tax arbitrage and broaden the tax base further". The 2012 Budget Tax Proposals stated (at page 3) that CGT: "was introduced in 2001 at relatively modest rates and has remained unchanged for the past 10 years. This reform has helped to ensure the integrity and progressive nature of the tax system. To enhance equity, effective capital gains tax rates will be increased." It appears that no substantive reasons were given for the change.

At the time, most commentators were surprised by the increase in the inclusion rates but there was not much resistance against the increase at the time.

It would appear that the inclusion rate was increased simply to collect more tax. The increase certainly had nothing to do with "equity". As noted above, in fact, when CGT was introduced the National Treasury implied that the inclusion rate was set at a 'low' rate for reasons of equity: to compensate for the effects of inflation. Further, it said that the inflation compensation would increase over time as a result of a constantly low inclusion rate, suggesting that the compensation would only work over a long period of time if the inclusion rate was kept steady. (It is noted that the corporate tax rate at the time was 30% compared to the current rate of 28%, but this does not materially affect the principle.)

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When the inclusion rates were increased in 2012, the National Treasury seems to have conveniently forgotten what it had said before about keeping the rates constant. The effect of the increase of the inclusion rate is of course exacerbated by the recent replacement of secondary tax on companies with the dividends tax and the increase of the rate from 10% to 15%.

It is manifestly apparent that the high rate of CGT combined with

the dividends tax is eroding the real returns of investors, and is not encouraging taxpayers to invest and save.

It is submitted that, to compensate for inflation, the National Treasury should at a minimum either reduce the CGT inclusion rates or provide for indexation.

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