DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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VOLUNTARY DISCLOSURE UNDER THE TAX ADMINISTRATION ACT

When should an applicant be 'aware' of being under 'audit or investigation' by SARS?

The Tax Administration Act, No 28 of 2011 (TAA) provides for a permanent Voluntary Disclosure Programme (VDP) in ss225 - 233 (part B of chapter 16). Following the success of the previous VDP that ran from November 2010 to October 2011, there should be a steady stream of applicants knocking on the doors of the VDP unit.

The provisions regarding the VDP under the TAA largely curtail SARS's discretion, making the VDP process fairly predictable for a prospective applicant. Follow the prescribed procedure in s227(f) and meet the requirements in s227 for a valid voluntary disclosure, and the applicant should be home and dry. The statutorily defined VDP relief cannot be denied because, "despite the provisions of a tax Act, SARS must" grant the applicable relief (s229).

Applicant aware of 'audit or investigation' into his affairs

One area where SARS does have discretion with regard to an applicant's access to the VDP is under s226(2). Section 226(1) provides that "a person may apply ... unless that person is aware of a pending audit or investigation into the affairs of the person seeking relief or an audit or investigation that has commenced, but has not yet been concluded." In such an instance s226(2) provides that a senior SARS official (SSO) "...may direct that a person may apply for voluntary disclosure relief." In exercising the discretion to allow the applicant into the VDP, the SSO must be of the view that the default would not have been detected during the audit or investigation; and the application would be in the interest of good management of the tax system and the best use of SARS' resources.

The above has two implications. Firstly, SARS effectively controls VDP access for an applicant under 'audit' or 'investigation'. Secondly, should the applicant get into the VDP, the relief would be limited to that in column 5 of the understatement penalty matrix in s223(1), being between 5 – 75% (as opposed to that in column 6, being between 0 – 10%).

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The differentiating factor is whether, at application stage, there is an awareness on the applicant's part of a pending "audit or investigation into the affairs of the person seeking relief", alternatively of an audit or investigation that has not yet been concluded. Importantly the VDP01 form to be e-filed when making a VDP application has a specific question regarding this aspect and the 'Yes' or 'No' box has to be ticked.

Meaning of '... unless that person is aware'

Section 226(3) deems there to be awareness of an audit or investigation under certain circumstances.

Ignoring the above, it would appear that '... unless that person is aware' requires that the prospective applicant should subjectively have knowledge of being the target of a SARS 'audit or investigation' before SARS's discretion under s226(2) would apply.

Meaning of 'audit' and 'investigation'

The problem is that the terms 'audit', 'investigation' and 'into the affairs' as found in s226 are not defined. They therefore take their ordinary meaning.

But what about a situation where SARS has merely requested information (eg under chapter 5 of the TAA), which the taxpayer subsequently provides, and then all goes quiet? Should such a person later decide to apply for the VDP, which box should be ticked? Does the earlier SARS interaction mean the taxpayer is (or should be) "...aware of a pending audit or investigation?" If

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that is the case, the SSO will decide on VDP access and, if granted, there will only be column 5 understatement penalty relief (ie 'after notification of audit' relief). Unfortunately, SARS' Short Guide to the TAA does not give clarity regarding the above-mentioned terms and how SARS would exercise its discretion regarding VDP access (refer paragraph 16.7.4).

The ordinary meaning of 'audit' includes "an official examination and verification of financial accounts." To conduct an audit means to 'review methodically and in detail' (The New Shorter Oxford English Dictionary). It is also defined as "a formal examination of an individual's or organization's accounting records, financial situation, or compliance with some set of standards" (Black's Law Dictionary). 'Investigation' is defined as "the action or process of investigating; systematic examination; careful research" (The New Shorter Oxford English Dictionary). 'Investigate' is defined as "to inquire into (a matter) systematically" (Black's Law Dictionary).

From the above it would appear that a prospective VDP applicant should have awareness that SARS is conducting a formal and systematic examination into their (tax) affairs before the discretion in s226(2) could come into play. Where the level of SARS's engagement with the taxpayer has not yet reached that level, the prospective applicant would be within his rights to tick the 'No' box on the VDP01 form, and should receive the column 6 relief.

Guidance from abroad

Entry into the VDP under s226(1), as opposed to s226(2), impacts accessibility (straight in or via SARS's discretion) as well as the available relief (s223(1) penalty matrix: column 6 vs column 5). The outcome is significant for a prospective VDP applicant; hence the consideration below of how the matter is dealt with in Australia.

As indicated above the South African VDP distinguishes on the basis of the applicant being 'aware ... of an audit or investigation', or not.

The Australian Tax Office (ATO) sets out its approach in Miscellaneous Taxation Ruling MT 2012/3. The ATO uses the concept of 'examination' (also not defined) rather than 'audit' or 'investigation'. The ATO approach could be summarised as follows:

- The ATO will notify a taxpayer that an 'examination ... into its affairs' is to be conducted (accordingly this is different from the 'awareness' test which applies locally);
- The concept 'examination' is very broad and covers not only traditional audits to ascertain an entity's tax-related liability, but covers any investigation of an entity's affairs;
- The examination must relate to a particular entity's affairs and thus excludes activities that are merely educational in nature (eg an ATO bulk mail-out giving guidance regarding limitations on certain tax deductions);
- The examination must involve more than the routine processing of forms or applications by the ATO;
- The examination must be on-going at the time the voluntary disclosure is made; and
- Because the concept of 'examination' is so broad, it could result in circumstances where it would be harsh to disallow the higher reduction in penalty. In such a case, the lower penalty percentage penalty would nevertheless be imposed.

Conclusion

The agenda pursued by SARS when initially engaging with a taxpayer could be unclear, ie the taxpayer might not have an exact idea what SARS is after, for what reason and on what basis. Sometimes the interaction is left 'hanging' ie SARS does not expressly indicate that it is satisfied with the information provided, nor does it unequivocally state that it is no longer pursuing a particular issue or line of questioning. Months (sometimes even years) could go by without communication between the parties due to, for example, SARS staff changes or the taxpayer hoping 'the problem will go away'.

A taxpayer contemplating a VDP application in respect of a hitherto undetected tax 'default' is consequently in a predicament: Will the application, once e-filed, be processed under s226(1)? Or would they receive a letter from SARS stating that the taxpayer is (or has been for some time) the subject of a SARS audit or investigation. That could mean the application will only be considered in terms of SARS's discretion under s226(2), and with the resultant lower level of relief.

A prospective VDP applicant should therefore be circumspect where there is an unresolved or 'open' SARS interaction, irrespective of how far it goes back. One should attempt to get official confirmation from SARS that a matter has been finalised and that there is no longer any live audit or investigation underway. This action could, in itself, have unintended consequences like restarting a process that had gone stale. Where the unresolved matter is immaterial in the bigger scheme of things, it might even be better to pay and simply clear the way for a s226(1) VDP application - thereby optimising the VDP relief.

It is important that a prospective VDP applicant understands whether a SARS interaction constitutes an 'audit' or 'investigation' taking into account the level of engagement between the parties. Entry into the VDP under s226(2) of the TAA (as opposed to the more advantageous s226(1)) entails both a more cumbersome process and less benevolent end-result.

Johan van der Walt

SEARCH AND SEIZURE: WITH OR WITHOUT A WARRANT?

While search and seizure procedures relating to general tax matters have recently received an overhaul by the introduction of the Tax Administration Act, No 28 of 2011, similar provisions in the Customs and Excise Act, No 91 of 1964 (Act) relating to search and seizure have remained static for a very long time.

A recent case in the Western Cape High Court has significant implications for SARS's power to conduct search and seizure operations in terms of the Act. The judgment in *Gaertner and others v Minister of Finance, the Commissioner of the South African Revenue Service and others (case no 12632/12)* was delivered on 8 April 2013. The facts were briefly as follows:

The taxpayer's business had bought (and imported) several consignments of milk powder from a Canadian company. The Canadian company sued the taxpayer's business for non-payment in respect of the sale. The invoices relating to the sale were attached to the summons. The Canadian company (potentially out of spite) also delivered a copy of the summons to the South African Revenue Service (SARS). SARS compared the invoices attached to the summons to the invoices presented by the taxpayer's business on importation for purposes of customs duty, and found that there were discrepancies. The discrepancies indicated that the taxpayer had under-declared the value of the imported milk powder, possibly by fiddling with the invoices.

SARS subsequently conducted certain searches at the taxpayer's business premises as well as at his private residence. SARS did so in terms s4(4) of the Act, which allows for such searches without a warrant or consent.

Between 20 and 30 officials arrived at the taxpayer's business premises (in batches) and informed the taxpayer that they were there to inspect his business's licenced warehouses. The taxpayer was under the impression that it was a routine search. The taxpayer was later informed that they were actually investigating under-declaration of customs values, but no further details were provided.

When the taxpayer asked whether the officials had a warrant they informed the taxpayer that it was a search in terms of s4(4) of the Act and that no warrant was required. The officials subsequently embarked on their search. They made copies of certain documents but did not provide the taxpayer with an inventory of what was copied. The officials accessed the business's computers and copied electronic data. The officials also removed the milk powder from the warehouse.

The next day officials returned and made mirror images of the server, various business computers, and the taxpayer's personal computer and iPad, among others. These computers obviously contained data beyond the scope of any investigation into fraudulent invoices. The officials refused to define the parameters of the search.

After not having found what they were looking for at the business premises, 14 officials conducted a search at the taxpayer's private residence. They did not provide the taxpayer with any reasons for the search nor did they inform the taxpayer of what they were looking for. They searched his entire home, went through his personal belongings and accessed his home computers.

The taxpayer applied to the Western Cape High Court for relief and asked for an order declaring that s4 of the Act is unconstitutional, that the searches were unlawful because of how they were conducted, and that SARS returns all items and electronic data taken or copied.

After instituting the said legal proceedings there was some bargaining between the taxpayer and SARS and SARS offered to return the items and electronic data taken or copied (which it did) and also to pay the taxpayer's legal costs. However, SARS did not concede (at least not at that time) on the issue of s4 of the Act. The matter therefore proceeded to court.

Section 4 of the Act provides that:

(4)(a) An officer may, for the purposes of this Act:

(i) without previous notice, at any time enter any premises whatsoever and make such examination and enquiry as he deems necessary;

(ii) while he is on the premises or at any other time require from any person the production then and there, or at a time and place fixed by the officer, of any book, document or thing which by this Act is required to be kept or exhibited or which relates to or which he has reasonable cause to suspect of relating to matters dealt with in this Act and which is or has been on the premises or in the possession or custody or under the control of any such person or his employee;

(iii) at any time and at any place require from any person who has or is believed to have the possession or custody or control of any book, document or thing relating to any matter dealt with in this Act, the production thereof then and there, or at a time and place fixed by the officer; and

(iv) examine and make extracts from and copies of any such book or document and may require from any person an explanation of any entry therein and may attach any such book, document or thing as in his opinion may afford evidence of any matter dealt with in this Act.

(b) An officer may take with him on to any premises an assistant or a member of the police force.

(5) Any person in connection with whose business any premises are occupied or used, and any person employed by him shall at any time furnish such facilities as may be required by the officer for entering the premises and for the exercise of his powers under this section.

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(6)(a) If an officer, after having declared his official capacity and his purpose and having demanded admission into any premises, is not immediately admitted, he and any person assisting him may at any time, but at night only in the presence of a member of the police force, break open any door or window or break through any wall on the premises for the purpose of entry and search.

(b) An officer or any person assisting him may at any time break up any ground or flooring on any premises for the purpose of search and if any room, place, safe, chest, box or package is locked and the keys thereof are not produced on demand, may open such room, place, safe, chest, box or package in any manner.

It is quite evident that these provisions give SARS officials an unrestricted power to enter any premises without warrant and without consent for purposes of administration of the Act. The provisions clearly have the potential of severely infringing on a person's right to privacy, and also other rights such as dignity. For example, they allow for a SARS official to enter a taxpayer's private home in the middle of the night, without a warrant and without prior notice, and if a police officer is present, to enter the premises by force.

By the time the matter was heard in court, SARS had effectively conceded that the provisions could be constitutionally invalid but the extent of such invalidity remained disputed. SARS insisted that it should have unrestricted powers to perform warrantless searches at designated premises (such as customs warehouses), whether those searches are routine searches (to generally check compliance) or non-routine searches (targeted searches based on suspicion).

The taxpayer contended that in the case of a non-routine search a warrant should always be obtained. The court agreed that non-routine searches without a warrant are generally unacceptable but held that such searches will be justifiable where designated premises (such as warehouses and rebate stores) are concerned, and only to the extent that the search concerns the licensed business activities at the designated premises.

The taxpayer did not specifically pursue the issue of routine searches, but the court held that warrantless routine searches will be justifiable where registered persons and licensees under the Act are concerned.

It further also appears that it was conceded that a warrantless non-routine search of someone's private home would not be justifiable.

Having come to the above conclusions, the court found it necessary to provide officials with guidelines as to how to conduct warrantless searches in a manner that would balance a taxpayer's right to privacy with SARS's interest in the administration of the Act.

The court offered the following guidelines –

- Entry should take place during ordinary business hours, unless the matter is urgent on reasonable grounds;
- The persons in charge of the premises should be informed whether it is a routine or non-routine search. If it is a non-routine search for which no warrant is required, the official must inform the person in writing of the purpose of the search. Where the matter is urgent on reasonable grounds and the person cannot be informed in writing the person must be informed orally;
- Only those officials whose presence is reasonably necessary to conduct the search should enter the premises (presumably to curb any display of 'rampant triumphalism');
- The person in charge should be entitled to be present and observe all aspects of the search;
- If anything is removed from the premises the person in charge is entitled to an inventory of the items so removed and if anything is copied the person is entitled to a list of all such material copied; and
- Decency and order should be strictly observed during the search.

The court did not make any order as to the unlawfulness of the particular searches conducted at the taxpayer's business premises and his private home because the parties had already effectively settled the matter out of court. SARS returned the items and electronic data taken or copied and offered to pay the taxpayer's legal costs.

The court did however declare that s4(a)(i) and (ii), s4(4)(b), s4(5) and s4(6) of the Act are inconsistent with the Constitution and invalid. This declaration of invalidity was not made retrospective and the court gave the legislature 18 months to remedy the defective provisions. As a temporary measure, the court's conclusions and suggested guidelines have to be read into the Act.

Heinrich Louw

DLA CLIFFE DEKKER HOFMEYR

CONTACT US

For more information about our Tax practice and services, please contact:

Emil Brincker
Director
National Practice Head
T +27 (0)11 562 1063
E emil.brincker@dlacdh.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@dlacdh.co

Johan van der Walt
Director
T +27 (0)11 562 1177
E johan.vanderwalt@dlacdh.com

Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@dlacdh.com

Andrew Lewis
Senior Associate
T +27 (0)11 562 1500
E andrew.lewis@dlacdh.com

Danielle Botha
Associate
T +27 (0)11 562 1380
E danielle.botha@dlacdh.com

Heinrich Louw
Associate
T +27 (0)11 562 1187
E heinrich.louw@dlacdh.com

Tessmerica Moodley
Associate
T +27 (0)21 481 6397
E tessmerica.moodley@dlacdh.com

Carmen Moss-Holdstock
Associate
T + 27 (0)11 562 1614
E carmen.moss-holdstock@dlacdh.com

Nicole Paulsen
Associate
T + 27 (0)11 562 1386
E nicole.paulsen@dlacdh.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

JOHANNESBURG

1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg

T +27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN

11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town

T +27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com

www.cliffedekkerhofmeyr.com