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SEARCH AND SEIZURE: THE EXTENT OF SARS's POWERS

In order to give effect to the information gathering powers of the South African Revenue Service (SARS), SARS may apply to a magistrate or a judge to issue a search and seizure warrant so as to, unannounced, enter premises where relevant material is being kept, conduct a search of a person's premises and seize relevant material.

Section 59 of the Tax Administration Act, No 28 of 2011 (TAA) provides that in obtaining the search and seizure warrant, SARS must make an *ex parte* application to a judge, which application must be supported by information supplied under oath or solemn declaration, establishing the facts upon which the application is based.

Section 60 of the TAA further provides that a judge or magistrate may issue the warrant if there are reasonable grounds to believe that a person has failed to comply with its obligations under a tax Act or committed a tax offence and further that relevant material is likely to be found on the premises specified in the application and that such material may provide evidence of the failure by the person to comply with its tax obligations or the actual commission of the offence.

In the recent case of *Huang and Others v The Commissioner for the South African Revenue Service* (High Court, Gauteng Division, Pretoria, Case no: SARS 1/2013, as yet unreported), the court was asked to reconsider the granting of a search and seizure warrant in favour of SARS.

By way of background, on 18 April 2013, SARS brought an *ex parte* application in terms of s59 and s60 of the TAA to obtain a search and seizure warrant against the current applicants, being Mr Huang, Mrs Huang, and Mpisi Trading 74 (Pty) Ltd (Applicants). The *ex parte* application was successfully granted in favour of SARS and essentially authorised SARS to, inter alia, search the premises of the Applicants and to seize documentation and relevant material. On 26 April 2013, the warrant was executed at two premises and material alleged to be relevant was seized.

The warrant was issued on the strength of the allegations that there were reasonable grounds to believe that the Applicants had failed to comply with their duties in terms of the Income Tax Act, No 58 of 1962, the Value-Added Tax Act, No 89 of 1991 and/or the TAA (relevant Acts) or on the basis that there were reasonable grounds to believe that the Applicants had committed certain offences in terms of the relevant Acts.

Subsequent to the search and seizure warrant being granted, the Applicants approached the High Court with an application for the reconsideration of the search and seizure warrant that was granted to SARS. The application was based on the following submissions:

- the warrant application did not satisfy the requirements of an *ex parte* application;
- the main application did not satisfy the

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requirements of the TAA; and

- the *ex parte* application was an abuse of the court process.

Accordingly, the Applicants requested the court to determine, inter alia:

- whether the warrant ought to be set aside on the basis of material non-disclosure and misrepresentation in the *ex parte* application brought by SARS;
- whether the warrant ought to be set aside on the basis that the jurisdictional requirements of s59 and s60 of the TAA were not satisfied in the *ex parte* application brought by SARS; and
- whether the warrant ought to be set aside on the basis that the *ex parte* application brought by SARS constituted an abuse of the court processes.

Material non-disclosure and misrepresentation

The Applicants contended that not all the material facts were disclosed to the judge hearing the warrant application and some of the facts provided were irrelevant, vexatious and were aimed to influence the judge to issue the warrant. The Applicants further contended that if the judge was provided with all the material facts and the correct information, the warrant would not have been issued.

SARS contended that the disclosure of certain information was relevant insofar as it served as an introduction and no malice was intended by the inclusion of this information nor was any conclusion drawn in this regard.

Having regard to the submissions of both SARS and the Applicants, the court held that an *ex parte* application is a serious departure from the ordinary principles applicable to civil proceedings to seek an order in the absence of notice to the respondent party. As per normal court practice an *ex parte* procedure should be invoked only where there is good cause or reason for the procedure such as when the giving of notice would defeat the very object for which the order is sought. It is, therefore, our law that an applicant in an *ex parte* application bears a duty of utmost good faith in placing before the court all the relevant material facts that might influence a court in coming to a decision.'

The court further held that the Applicants had to show that SARS, as an applicant in the *ex parte* application, withheld material facts which might have influenced the court in coming to a decision. In this regard, the court held that the Applicants' submissions had no merit because there could be no clear distinction between facts which are material and those which are not in complex cases such as the present. An applicant has to make a judgment call as to which facts might influence the judicial officer in reaching its decision and which are not sufficiently relevant to justify inclusion.

The court confirmed that what was in issue in the present matter is whether SARS disclosed all the material facts within its knowledge and whether those facts established reasonable grounds to believe that the Applicants had failed to comply with or had committed offences under the relevant Acts. The court confirmed in this regard that the facts disclosed by SARS in its founding affidavit were sufficient and met the requirements of s59 of the TAA.

Alleged failure to plead sufficient jurisdictional facts

The Applicants further submitted that SARS did not establish the jurisdictional requirements of s59 and s60 of the TAA in the *ex parte* application. The Applicants' submission was based on the fact that most of the allegations were not reasonable grounds as envisaged in the TAA simply because the facts on which the *ex parte* application was based were unduly contorted to create an atmosphere of suspicion.

SARS's contention was that the warrant application disclosed reasonable grounds which led to the belief that the Applicants transgressed the relevant Acts. Further, it was not necessary for SARS to confirm or prove the commission of an offence due to the fact that s60(1) of the TAA merely required the establishment of reasonable grounds to believe that a transgression was committed and that evidence of the transgression would likely be found at the premises sought to be searched.

The court held that in accordance with s60 of the TAA, a judge may issue a warrant if it is satisfied that there are reasonable grounds to believe that a person failed to comply with an obligation imposed under a tax Act or committed a tax offence and that relevant material likely to be found on the premises specified in the application may provide evidence of the failure to comply or the commission of the offence.

Whether such belief is reasonable is an objective question which will be answered by the facts before the court. A judicial officer must be satisfied that, on the facts, there are reasonable grounds to believe that a person failed to comply with an obligation imposed under a tax Act or committed a tax offence.

The court held in this regard that SARS managed to set out reasonable grounds in support of its contention that it had reason to believe that the Applicants failed to comply with obligations imposed under the relevant Acts or committed tax offences.

What is clear from the decision of the court is that SARS

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is required to set out reasonable grounds in support of its contention that a taxpayer failed to comply with an obligation imposed under a tax Act or committed a tax offence and that relevant material likely to be found on the premises specified in the application may provide evidence of the failure to comply or commission of the offence. Once the court is satisfied, a warrant may be issued.

Therefore, when considering whether a warrant should be set aside, a court must determine firstly whether objective jurisdictional facts were present and secondly, whether the discretion to grant the application for the warrant was exercised judicially. It is important to note that once objective jurisdictional facts have been established, a court is not obliged to issue a warrant as it must first exercise its discretion whether or not to grant the warrant. Such discretion must be exercised in good faith, rationally and not arbitrarily.

Two jurisdictional facts must be satisfied before a judge can issue a warrant for search and seizure. The judge issuing the warrant must be satisfied that there were reasonable grounds to believe, firstly that a person failed to comply with an obligation imposed under a tax Act, or committed a tax offence. Secondly, that there are reasonable grounds to believe that relevant material to be found on the premises specified may provide evidence of the failure to comply or the commission of the offence.

If a court approached to set aside a warrant issued against a taxpayer, finds that the abovementioned jurisdictional facts were not present at the time of issuing of the warrant, such court may set aside the warrant. However, if the jurisdictional facts were present, the court will have to consider the exercise of the discretion by the judicial officer who issued the warrant. Such a court may not interfere with the discretion simply because it would have reached a different conclusion to that reached by the judicial officer who issued the warrant. It may only set aside the warrant if it is found that the discretion had not been exercised judicially.

Abuse of court process

Lastly, the Applicants contended that SARS abused and manipulated the legal process by bringing an *ex parte* application. This contention by the Applicants was based on the argument that SARS brought an *ex parte* application on the basis that the alleged transgressions are income tax and value-added tax offences. However, the Applicants argued that the alleged transgressions constituted offences under the Customs and Excise Act, No 91 of 1964 and therefore did not fall under the ambit of s59 and s60 of the TAA.

The court in this regard held that, based on the evidence before it, certain obligations that the Applicants are alleged not to have complied with, are covered by the Income Tax Act, No 58 of 1962 and the Value-Added Tax Act, No 89 of 1991. Accordingly, it could not be argued that SARS abused the court process by applying for the warrant to search the Applicants' premises and to seize relevant material as SARS was entitled to apply for the warrant in accordance with its mandate to administer the relevant Acts.

The Applicants' further argument was that the omission by SARS to bring to the court's attention a highly relevant and material consideration that would likely have had an influence on the court's decision, constitutes an abuse of the court process. The court held in this regard that based on the facts before it, this argument was in fact a non-issue.

The court in this matter concluded its argument by confirming that the mere fact that a taxpayer feels that it is being 'targeted' by SARS, does not constitute valid grounds to approach a court to reconsider a warrant.

Having regard to all of the above it should be noted that this judgement is important as it highlights certain procedural matters pertaining to *ex parte* applications brought by SARS for a search and seizure warrant and further gives an indication of the extensive information gathering powers afforded to SARS under the TAA.

Nicole Paulsen and Gigi Nyanin

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EXPENDITURE RELATING TO DEFERRED ACCRUALS

The tax court recently handed down judgment in the case of *ABC (Pty) Ltd v Commissioner for the South African Revenue Service (case number 13410, as yet unreported).*

Background

The taxpayer operated a mine. Firstly, it would extract mineral ore from the earth, and secondly, by smelting and other processes, it would extract a concentrate (containing the minerals) from the ore.

The taxpayer sold the concentrate to a subsidiary company. In terms of the agreement with the subsidiary, and in respect of the sale of concentrate in any particular month, the purchase price would only be finally determined five months later.

Section 24M of the Income Tax Act, No 58 of 1962 (Act) allows a taxpayer to include in its gross income an amount accruing to it in a particular tax year only in the tax year that the amount is finally determined.

Section 24M of the Act therefore applied to the sales made by the taxpayer in the last four months of each tax year, as the purchase price of those sales would only be determined in the following tax year.

Accordingly, in the 2007 to 2009 tax years, the taxpayer deferred the inclusion in its gross income of the purchase price for concentrate (in respect of the last four months of each year) to the following tax year. However, the expenditure incurred in respect of such sales was claimed as a deduction by the taxpayer under s11(a) of the Act in the tax year that it was incurred, and not in the tax year that the relevant amounts were included in the taxpayer's gross income. The expenditure consisted of costs relating to the extraction of the ore from the soil, costs relating to the concentrate process, audit fees, administration fees and costs relating to the drying of the concentrate.

The South African Revenue Service (SARS) assessed the taxpayer and disallowed the deduction of the said expenses in the year that it was incurred, in proportion to the amounts of gross income deferred.

SARS was of the view that s23F(2) of the Act applied, which provides that expenditure relating to the 'acquisition' of 'trading stock' (which is generally deductible), must be disregarded to the extent that any amounts relating to the disposal of that trading stock do not accrue during the same year that the expenditure is incurred.

SARS also imposed 50% additional tax under s76(1)(c) of the Act.

Judgment

The taxpayer argued that the ore and concentrate did not constitute 'trading stock' and there was no 'acquisition' of such ore or concentrate. Section 23F(2) of the Act could therefore not apply.

Paragraph (a)(i) of the definition of 'trading stock' in s1 of the Act provides that trading stock is anything:

> 'Produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purpose of manufacture, sale or exchange by him or on his behalf.'

The parties did not rely on the other parts of the definition of 'trading stock'.

The court found that the ore could not constitute trading stock, apparently because the ore was mined from the earth, and not intended for manufacture, resale or exchange but for extracting minerals therefrom, which also constitutes mining. However, the concentrate did constitute trading stock.

The court also had to interpret the meaning of the word 'acquisition' as used in s23F(2) of the Act.

The taxpayer argued that the word 'acquisition' as used in s23F(2) refers to acquiring 'ownership'. Because the taxpayer became the owner of the minerals (keeping in mind that the concentrate consists of the minerals) at the time the ore was severed from the land, it could not be said that the costs relating to the extraction of the concentrate from the ore constituted expenditure incurred in respect of the 'acquisition' (or becoming owner) of the concentrate.

The court held that the ore, when passed through the concentrator, is transformed into a product with a higher value, and becomes trading stock. Also, once the ore is transformed into concentrate, it can be said that there has been an 'acquisition' of the concentrate.

The court thus held that s23F(2) may only be applied in respect of expenditure relating to the extraction of the concentrate from the ore, but not the extraction of the ore from the land. Both processes are however mining processes for tax purposes.

For s23F(2) to apply in respect of expenditure relating to concentrate, there must be a causal connection between

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the expenditure and the ‘acquisition’ of the concentrate. In the current matter the court held that the audit fees, administration fees and costs relating to the drying of the concentrate could not be disregarded under s23F(2) of the Act because there was no causal connection between these costs and the acquisition of the concentrate – these costs were incurred after the concentrate had already been produced. The other costs relating to the concentrate process would however be subject to s23F(2) of the Act.

The court ordered the assessments to be sent back to SARS for reconsideration.

Cost order

Another interesting feature of this case was that, as part of the capturing, processing and administrative process, arithmetical errors were made by SARS in the assessments in the amount of approximately R160 million. During the time leading up to the trial, SARS had consistently refused to correct the errors. The court noted that:

> '[42] The capturing, processing and administrative errors attracted negative business consequences, reputation risks, recurring negative reporting in the annual reports of the Appellant, and cast a dark pall over the management efficacy of the appellant. They also required the Appellant to report contingent liabilities and raise provisions in their financial statements. This is an unfortunate situation with very grave consequences to the future viability of the appellant, and to the reliance that future investors would place on the financial statements of the Appellant. This potential impairment on the reputation of the Appellant should be brought to the Respondents attention for correction.
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> …
>
> [51] In my view there was an inordinate delay by the respondent to deal with the error of some R160 million. This is a large amount and reflects negatively on the Appellant’s financial profile in the annual financial statements. The Appellant was forced to raise it in correspondence and in the grounds of appeal. The respondent failed to deal with it in the statement of appeal'

As a result, the court ordered SARS to pay 50% of the taxpayer’s costs up to the date of the pre-trial conference.

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