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TAX & EXCHANGE CONTROL ALERT

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STATUS OF SARS INTERPRETATION NOTES

From time to time, the South African Revenue Service (SARS) issues interpretation notes. According to the SARS website (www.sars.gov.za), interpretation notes "are intended to provide guidelines to stakeholders (both internal and external) on the interpretation and application of the provisions of the legislation administered by the Commissioner".

PROCEDURE IS EVERYTHING: A WIN FOR THE TAXPAYER AND THE IMPORTANCE OF THE RIGHT TO JUST ADMINISTRATIVE ACTION

In recent times, taxpayers have often been unsuccessful in their disputes with the South African Revenue Service (SARS), especially where the dispute involved the interpretation or application of the substantive provisions of tax legislation. However, where disputes have involved compliance with the procedural requirements of tax legislation, taxpayers have generally had greater success. The judgment in *Mr A v The Commissioner for the South African Revenue Service* (Case No. IT13726) (as yet unreported), falls into the second category and is the subject of this article.

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STATUS OF SARS INTERPRETATION NOTES

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Interpretation notes do have important statutory implications for taxpayers.

To date, SARS has issued more than 90 interpretation notes, some of which have been withdrawn.

Previously, SARS issued practice notes. Most of the practice notes have been withdrawn. However, some important practice notes are still extant. Notably, for instance, Practice Note 31 dated 3 October 1994 is still around. Put simply, it states that, despite the fact that a taxpayer is not a moneylender by trade, the taxpayer may deduct interest incurred on borrowed money against interest incurred on money it has lent.

It appears as if SARS does not have specific powers to issue interpretation notes. The only references to the term '"interpretation note' in the Tax Administration Act, No 28 of 2011 (TAA) are the following:

- Section 89(3) of the TAA states that a "binding general ruling" may be issued as an interpretation note.
- The term "official publication" is defined in s1 of the TAA to mean "a binding general ruling, interpretation note, practice note or public notice issued by a senior SARS official or the Commissioner".

However, interpretation notes do have important statutory implications for taxpayers. A "practice generally prevailing" is "a practice set out in an official publication regarding the application or interpretation of a tax Act" (s1 of the TAA as read with s5(1) of the TAA).

A "practice generally prevailing" may come into play as follows under the TAA:

- The Tax Ombud may, among other things, not review SARS policy or a practice generally prevailing, other than to the extent that it relates to a service matter, or a procedural or administrative matter arising from the application of the provisions of a tax Act by SARS (s17 of the TAA).
- SARS may only settle a dispute with a taxpayer if, among other things, it is appropriate and to the best advantage of the State (s146 of the TAA). However, it is deemed to be inappropriate and not to the best advantage of the State to settle a dispute if in the opinion of SARS no circumstances in s146 exist and, among other things, the settlement would be contrary to the law or a practice generally prevailing and no exceptional circumstances exist to justify a departure from the law or practice (s145(a)(ii) of the TAA).

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STATUS OF SARS INTERPRETATION NOTES

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An interpretation note could set out a "practice generally prevailing" and, accordingly, could have a significant impact on the rights of taxpayers under the TAA.

- In terms of s99(1) of the TAA, SARS is barred from issuing an assessment if, among other things:
  - in the case of an additional assessment, the amount which should have been assessed to tax under the preceding assessment was, in accordance with the practice generally prevailing at the date of the preceding assessment, not assessed to tax; or the full amount of tax which should have been assessed under the preceding assessment was, in accordance with the practice, not assessed;
  - in the case of a reduced assessment, the preceding assessment was made in accordance with the practice generally prevailing at the date of that assessment; or
  - in the case of a tax for which no return is required, if the payment was made in accordance with the practice generally prevailing at the date of that payment.

So, an interpretation note could set out a "practice generally prevailing" and, accordingly, could have a significant impact on the rights of taxpayers under the TAA.

What impact do interpretation notes have on the interpretation of tax laws?

In the case of *Commissioner for SARS v Marshall NO 2017* (1) SA 114 (SCA), the Supreme Court of Appeal was called upon to interpret certain provisions of the Value-Added Tax Act, No 89 of 1991. In its judgment, the Court referred with approval to certain sections of SARS's Interpretation Note No 39 issued on 8 February 2013. The Court held as follows:

> These interpretation notes, though not binding on the courts or a taxpayer, constitute persuasive explanations in relation to the interpretation and application of the statutory provisions in question. Interpretation Note 39 has been in circulation for years and has not been brought into contention until now. (Footnote omitted.)

Courts of late have referred to the provisions of interpretation notes during the course of their judgments (see, for example, *Volkswagen South Africa (Pty) Ltd v Commissioner for SARS 2018* (1) SA 716 (SCA) where the Supreme Court of Appeal referred to certain provisions of SARS Interpretation Note 59, of 10 December 2010, to establish SARS's view on the nature of government grants).

Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory and Who's Who Legal: Corporate Tax – Controversy for 2017.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2017.

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STATUS OF SARS INTERPRETATION NOTES

CONTINUED

Suffice to say that both SARS and taxpayers should be very careful when relying on SARS interpretation notes.

The taxpayer in the *Marshall* case appealed to the Constitutional Court. The Court held as follows in relation to the use of interpretation notes in the interpretation of legislation (*Marshall NO and Others v Commissioner for SARS* (CCT208/17) [2018] ZACC 11 (25 April 2018) at page 6):

> Why should a unilateral practice of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? It might conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned, but not where the practice is unilaterally established by one of the litigating parties. In those circumstances it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts. It is best avoided. (Footnote omitted.)

Accordingly, it is now settled law that courts should not have regard to SARS interpretation notes when interpreting legislation, but may have regard to interpretation notes where the practice of SARS is evidenced by an interpretation note which has been recognised by SARS and the taxpayer. Conceivably, Practice Note 31 above would constitute such a note.

However, a few questions arise in light of the judgment:

- Do SARS interpretation notes serve any purpose?
- Is it possible for a SARS interpretation note to unilaterally set out a "practice generally prevailing" as defined and contemplated in the TAA, that is "a practice…regarding the application or interpretation of a tax Act"?

Suffice to say that both SARS and taxpayers should be very careful when relying on SARS interpretation notes.

Ben Strauss

PROCEDURE IS EVERYTHING: A WIN FOR THE TAXPAYER AND THE IMPORTANCE OF THE RIGHT TO JUST ADMINISTRATIVE ACTION

SARS did not accept that the lump sum payment was taxable as a retrenchment benefit and taxed it as "other" income instead.

In recent times, taxpayers have often been unsuccessful in their disputes with the South African Revenue Service (SARS), especially where the dispute involved the interpretation or application of the substantive provisions of tax legislation. However, where disputes have involved compliance with the procedural requirements of tax legislation, taxpayers have generally had greater success. The judgment in *Mr A v The Commissioner for the South African Revenue Service* (Case No. IT13726) (as yet unreported), falls into the second category and is the subject of this article.

SARS issued two additional assessments (Assessments) pursuant to its decisions and the taxpayer subsequently objected and appealed against the Assessments.

Facts

The taxpayer, Mr A, had been the chief executive officer of a company for just over 16 years, when his employment with the company ended in 2012. When the taxpayer's services came to an end, the company paid him R7,066,530 as an amount equal to a severance package calculated in accordance with the company's retrenchment policies. He declared the amount and described it as a "lump sum payment for separation package" in his 2012 income tax return. SARS did not accept that the lump sum payment was taxable as a retrenchment benefit and taxed it as "other" income instead. The taxpayer also traded as a cattle farmer and in his 2012 income tax return, he claimed farming expenses of R1,781,604 as a deduction, which SARS disallowed.

SARS issued two additional assessments (Assessments) pursuant to its decisions and the taxpayer subsequently objected and appealed against the Assessments. The parties agreed that only the following two issues would be argued before the Tax Court:

- As a point *in limine* (preliminary point), whether the audit conducted prior to the additional assessment was valid, and whether the subsequent additional assessment was valid; and
- Whether the lump sum payment received by the taxpayer at the termination of his employment was a "severance benefit" as defined in the Income Tax Act, No 58 of 1962 (Act).

The parties agreed that the issue pertaining to the deduction of farming expenses would stand over for argument at a later stage. In this article, we will focus only on the first issue argued before court, regarding the validity of the audit.

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PROCEDURE IS EVERYTHING: A WIN FOR THE TAXPAYER AND THE IMPORTANCE OF THE RIGHT TO JUST ADMINISTRATIVE ACTION

CONTINUED

In the Tax Court's view, s40 and s42 of the TAA give effect to the provisions of s33 of the Constitution.

Legal framework

In terms of s40 of the Tax Administration Act, No 28 of 2011 (TAA), SARS may select a person for inspection, verification or audit on the basis of any consideration relevant for the proper administration of a tax Act, including on a random or a risk assessment basis.

Section 42(1) of the TAA states that a SARS official involved in or responsible for an audit under Chapter 5 Part A of the TAA must, in the form and in the manner as may be prescribed by the Commissioner by public notice, provide the taxpayer with a report indicating the stage of completion of the audit.

In terms of s42(2) of the TAA, once the audit or criminal investigation has been concluded and it was inconclusive, SARS must inform the taxpayer of this within 21 business days. Alternatively, if the audit identified potential adjustments of a material nature, SARS must within 21 business days, or longer depending on the complexities of the audit, provide the taxpayer with a document containing the outcome of the audit, including the grounds for the proposed assessment or decision referred to in s104(2) of the TAA.

Section 42(3) states that once the taxpayer has received a document indicating the outcome of the audit and the grounds for the proposed assessment, he must respond within 21 business days of delivery of the document. The period of 21 business days may be extended upon request by the taxpayer and SARS may allow this based on the complexities of the audit.

Judgment

The taxpayer contended that in its Rule 31 Statement of Grounds of Assessment, SARS referred to a personal audit conducted in respect of the taxpayer and that this was the first time that he (taxpayer) had heard of such an audit. The Tax Court held that SARS was not permitted to rely on a procedurally flawed audit conducted without the taxpayer's knowledge as a new ground of assessment in its Rule 31 statement, as it would violate the principle of legality.

The Tax Court explained that an additional assessment constitutes administrative action as contemplated in s33 of the Constitution of the Republic of South Africa, 1996 (Constitution), which protects the right to administrative action that is lawful, reasonable and fair. The section also provides that everyone whose rights have been adversely affected by administrative action has the right to be given written reasons, meaning that an assessment that is procedurally flawed due to a lack of reasons or failure to give reasons, is inconsistent with the principle of legality.

In the Tax Court's view, s40 and s42 of the TAA give effect to the provisions of s33 of the Constitution. The breach of the legality principle was compounded by SARS's failure to comply with s42(1) of the TAA, as it did not keep the taxpayer informed of the status of the audit, made no written conclusions or findings at the end of the audit, did not discover any audit file for 2012 and failed to conduct a financial inspection prior to issuing an additional assessment. SARS also flouted s42(2)(b) of the TAA in that it deprived the taxpayer of the opportunity to respond to any of the issues raised

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This case re-iterates the rights of taxpayers in tax dispute resolution proceedings and is confirmation that a taxpayer can insist on SARS's compliance with the audit provisions of the TAA.

by SARS, particularly the question of the circumstances surrounding the taxpayer's resignation and the nature of the lump sum paid to him.

Interestingly, the Tax Court also held that if the taxpayer was afforded an opportunity to explain his position regarding the nature of the lump sum payment, he could have informed SARS that his services came to an end during a retrenchment process as contemplated in the definition of "severance benefit" in s1 of the Act. The Tax Court stated that if SARS had conducted the audit with due regard to s40, s41 and s42 of the Act, the outcome of the audit may have been very different. The same considerations apply to the farming expenses that were claimed as a deduction and disallowed.

The Tax Court concluded that as SARS's non-compliance with s40 and s42 of the TAA contravenes the Constitution and the principle of legality, SARS's decision to issue an additional assessment without notice must be set aside and the assessment is invalid (presumably the Tax Court meant that both Assessments should be set aside). The taxpayer's appeal was therefore upheld and SARS was ordered to pay the taxpayer's costs of the appeal.

Comment

The judgment sets out important principles regarding the relationship between SARS's compliance with the audit provisions of the TAA and the effect of an invalid audit on any subsequent assessment issued. This case re-iterates the rights of taxpayers in tax dispute resolution proceedings and is confirmation that a taxpayer can insist on SARS's compliance with the audit provisions of the TAA. Where SARS issues an assessment without complying with the provisions in s40 and s42 of the TAA, such an assessment can be set aside.

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