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# TAX & EXCHANGE CONTROL **ALERT**

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### The section 163 preservation order – ‘innocence’ is immaterial

In *Commissioner for the South African Revenue Service v Raphela and Others* (2091/2021) [2021] ZAGPPHC 191 (29 March 2021), the High Court confirmed the provisional preservation order granted to the applicant, the Commissioner for the South African Revenue Service (CSARS) against the third respondent, Mrs Mdlulwa (Mdlulwa).

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# The section 163 preservation order – 'innocence' is immaterial

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**In *Commissioner for the South African Revenue Service v Raphela and Others* (2091/2021) [2021] ZAGPPHC 191 (29 March 2021), the High Court confirmed the provisional preservation order granted to the applicant, the Commissioner for the South African Revenue Service (CSARS) against the third respondent, Mrs Mdlulwa (Mdlulwa).**

Section 163 of the Tax Administration Act 28 of 2011 (TAA) empowers a senior SARS official to authorise an *ex parte* application to the High Court for a preservation order to prevent the disposal or removal of any realisable assets, which may frustrate the collection of tax. In terms of this provision the preservation order can be obtained in respect of:

- the full amount of tax that is due or payable; or
- the amount of tax which to the satisfaction of the SARS official may, on reasonable grounds, be due or payable.

In anticipation of the application for a preservation order, SARS may in terms of the TAA seize the assets of a taxpayer or *'other person'* and appoint a *curator bonis* to preserve the assets, pending the outcome of the application for a preservation order.

## Background

The second respondent, PSR Solutions (Pty) Ltd (the Taxpayer) was awarded a tender to supply facemasks for use by the South African Police Service. The tender was valued at R45 million and in terms of the Value Added Tax Act 89 of 1991, the Taxpayer was required to charge VAT on the supply and pay it over to SARS. Due to a lack of funds on the part of the Taxpayer and its sole director (i.e. the first respondent, Mrs Raphela), Mdlulwa was approached by a third party (Third Party) for funding. Mdlulwa advanced the amount of ±R19,9 million to the suppliers of the facemasks and after the completion of the tender, the Taxpayer paid Mdlulwa ±R33 million, with the result that Mdlulwa made a profit in excess of R13 million. In addition, the Taxpayer made several payments to or on behalf of Raphela in excess of R4million and a payment of R1 million to the Third Party. The Taxpayer did not at any point, disclose the VAT due to SARS. In terms of SARS' provisional calculation, the total VAT liability, late-payment, and non-disclosure penalties amounted to R14,5 million which remained unpaid and continued to accrue.

Considering these facts, the CSARS applied on an urgent basis to the High Court for a preservation order, which was granted provisionally, and in terms of which a *curator bonis* was appointed.

Upon investigation, the *curator bonis* found that the Taxpayer and Raphela had funds well below the Taxpayer's tax liability. As a result, Mdlulwa's account which contained funds of ±R24 million was frozen, on the basis that the majority of the funds which could have been utilised by the Taxpayer to settle the tax debt had been dissipated to Mdlulwa. At this stage, it is worth noting that Mdlulwa resided in Spain and had emigrated for exchange control purposes.

# The section 163 preservation order – 'innocence' is immaterial*...continued*

Although Mdlulwa attempted to claim hardship, the court concluded that the claims were vague as the required information had not been disclosed.

### Mdlulwa's submissions

Mdlulwa argued, *inter alia*, that her funds ought to have been released on the basis that:

1. she had obtained the requisite approval to expatriate the funds to Spain;
2. there was a difference between the extent of the tax liability of the Taxpayer and the funds in the frozen account; and
3. only the account of any other person who "*knowingly assisted the taxpayer in dissipating*" assets should be frozen.

In considering Mdlulwa's submissions, the court concluded that:

1. It was irrelevant that the expatriation of funds had occurred in compliance with the Exchange Control Regulations, 1961, as those funds were no longer recoverable and the funds which came from the Taxpayer to Mdlulwa and which were in South Africa, indicated a "*practical utility*" of a preservation order.
2. The Taxpayer's tax liability of R14.5 million continued to attract penalties and interest. Moreover, the Taxpayer's income tax liability had not yet been determined, which also had the potential to attract interest and penalties. It was also considered that the amount preserved would possibly not be enough to cover the Taxpayer's tax liability at the time that it becomes due.

The court noted that in instances where hardship has materialised because of a preservation order, section 163(7)(d) of the TAA provides for a variation of the preservation order and empowers the court to make ancillary orders regarding how the assets must be dealt with. Usually, the court will consider this in light of various circumstances, such as the reasonable living expenses of the person against whom the preservation order is granted, as well as those of his or her legal dependants. Although Mdlulwa attempted to claim hardship, the court concluded that the claims were vague as the required information had not been disclosed.

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# The section 163 preservation order – 'innocence' is immaterial*...continued*

When there is a concern that a taxpayer may dissipate assets, which could have been used to settle that taxpayer's tax liability, the CSARS may apply to the High Court for an order to preserve such assets.

3. Mdlulwa's strict interpretation of section 163 of the TAA could not be accepted, on the basis that section 163 does not require the CSARS to prove the intention of such *'other person'* as contemplated in the provision. Therefore, the court concluded that there does not need to be an element of collusion between the Taxpayer and such person whose assets are seized and preserved in terms of a preservation order and clarified that the aim of the section is to prevent the dissipation or further dissipation of assets by the taxpayer, which if not preserved, could lead to the tax being unrecoverable.

## Comment

When there is a concern that a taxpayer may dissipate assets, which could have been used to settle that taxpayer's tax liability, the CSARS may apply to the High Court for an order to preserve such assets. As it appears, the application is likely to succeed where there is no basis for the disposal or removal of the assets (much like the excess profit which the Taxpayer paid to Mdlulwa in this case), and the disposal or removal of those assets would hinder the collection of tax. It appears that the intention or innocence of the recipient of the assets is irrelevant for purposes of the section 163 preservation order, as the provision does not require that the CSARS prove the intention of that *'other person'* whose assets may be preserved for purposes of settling the taxes due.

*Ursula Diale-Ali*

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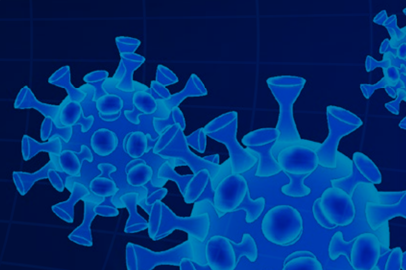

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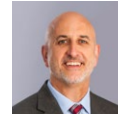

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