TAX & EXCHANGE CONTROL
ALERT

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CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

IN THIS ISSUE

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SARS' power to collect taxes: High Court judgment on the necessity of issuing a final demand for third party notices

The power of the South African Revenue Service (SARS) to collect tax from a taxpayer by way of issuing a notice to a third party holding assets belonging to a taxpayer, such as a bank holding a taxpayer's funds, is provided for in section 179(1) of the Tax Administration Act 28 of 2011 (TAA).

SARS may only issue the notice if it complies with the requirement in section 179(5) of the TAA, which is that it must deliver to the tax debtor (the taxpayer) a final demand for payment which must be delivered at least 10 business days before the notice is issued. Importantly, the demand must contain the following:

- It must set out the recovery steps that SARS may take if the tax debt is not paid and the available debt relief mechanisms under the TAA, including in respect of recovery steps that may be taken under section 179.
- If the tax debtor is a natural person, the demand must state that the tax debtor may, within five business days of receiving the demand, apply to SARS for a reduction of the amount to be paid to SARS under section 179(1), based on the basic living expenses of the tax debtor and his or her dependants.
- If the tax debtor is not a natural person, the demand must state that the tax debtor may, within five business days of receiving the demand, apply to SARS for a reduction of the amount to be paid to SARS under section 179(1), based on serious financial hardship.

However, section 179(6) of the TAA states that SARS need not issue a final demand under section 179(5) if a senior SARS official is satisfied that to do so would prejudice the collection of the tax debt. This provision, which has not been the subject of much interpretation by our courts, had to be considered in the judgment in *CRRC E-Loco Supply (Pty) Ltd v Commissioner for the South African Revenue Service* (37766/2021) [2022] ZAGPPHC 527 handed down on 18 July 2022.

FACTS

CRRC E-Loco Supply Pty Ltd (taxpayer) was the subject of a tax audit conducted by a specialist unit of SARS that concluded there was *prima facie* evidence that the taxpayer had overstated the price of locomotives sold to Transnet as part of what has since become known as "*State Capture*". As a result of the audit, the taxpayer had an assessed tax debt exceeding R3,6 billion, which had not been satisfied and only partial payment was achieved by SARS through the recovery of funds pursuant to the third-party notices issued by SARS in terms of section 179 of the TAA.

SARS issued the third-party notices and recovered the funds in question without first issuing a final demand, as it submitted that section 179(6) of the TAA applied. This was done pursuant to a decision made by the head of SARS' Criminal and Illicit Economic Activities Division, who is a senior SARS official. He did this

SARS' power to collect taxes: High Court judgment on the necessity of issuing a final demand for third party notices

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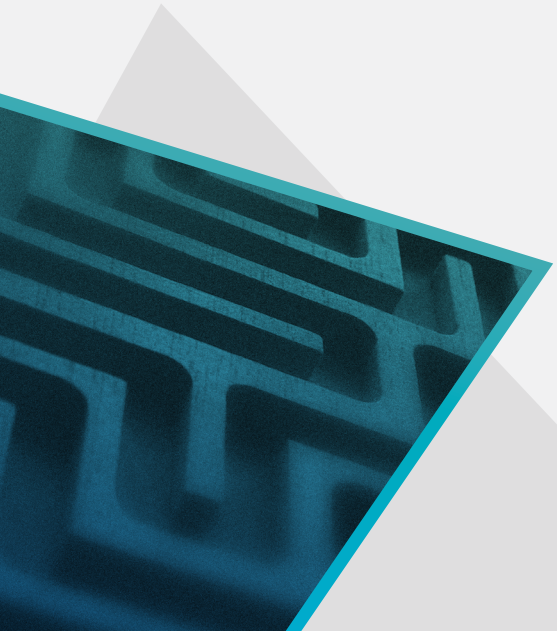

after considering a memorandum from SARS' Illicit Economy Unit. The total amount paid over to SARS in terms of the notices was in excess of R630 million.

The taxpayer brought a review application before the High Court, seeking to have SARS' decision to issue the third party notices set aside on the basis that SARS did not comply with section 179(5) of the TAA and was not entitled to rely on section 179(6) in the current instance.

PARTIES' ARGUMENTS AND JUDGMENT

SARS gave a number of reasons for its decision to issue a third-party notice in terms of section 179(6), that is, without first issuing a final demand, which the court considered.

SARS submitted that it was dealing with a dishonest taxpayer, relying on the *prima facie* evidence of large-scale corruption committed by the taxpayer in its dealings with Transnet as part of the reasons for its conclusion. SARS also alleged that there was *prima facie* evidence of tax fraud in excess of R4 billion on the part of the taxpayer based on the taxpayer substantially understating its tax liability in its returns for the 2013 to 2018 tax years, with the taxpayer also allegedly not giving adequate responses when information was requested in the course of the tax audit. SARS further alleged that the taxpayer reneged on its commitment to issue guarantees. Specifically, this relates to a blocking order by the South African Reserve Bank that was lifted and SARS obtained a preservation order in respect of the blocked funds, but for them to be released if the agreed guarantees were furnished.

SARS further alleged that the taxpayer was not prejudiced by the recovery of funds in light of the preservation order and as the taxpayer was not trading. Furthermore, it argued that it had a duty to recover taxes and that the taxpayer had an opportunity to be heard in accordance with the *audi alteram partem* principle, in light of the ongoing correspondence between the parties.

In response, the taxpayer's attorneys argued in an affidavit that the reasons for SARS' decision in this instance did not constitute reasonable grounds and that without such grounds, the decision was not rational and open to review. The court noted that the taxpayer did not provide any direct evidence in support of its application, but only by way of its attorneys' affidavit. In the court's view, SARS' allegations regarding dishonesty, tax fraud and breach of guarantee commitments were largely left uncontroverted and the taxpayer failed to demonstrate a *bona fide* dispute in respect of these allegations. The court found that the risk or jeopardy of a tax debt by a delinquent taxpayer who might transfer the funds abroad creates such a reasonable fear that it justifies an avoidance of the risk by having the third party's banks pay the funds over to SARS.

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The court found that SARS' reliance on specific parts of the judgment in *Hindry v Nedcor Bank Ltd and Another* 1999 (2) SA 757 (W) was correct, as they were relevant to the current dispute, despite that decision dealing with section 179 of the TAA's predecessor. As such, the court found that the taxpayer's complaint of unfairness and alleged non-application of the *audi alteram partem* principle was not justified.

In conclusion, the court found that the senior SARS official authorising the third party notices had sufficient grounds to justify the decision to issue the notices without a final demand as contemplated in section 179(6) of the TAA.

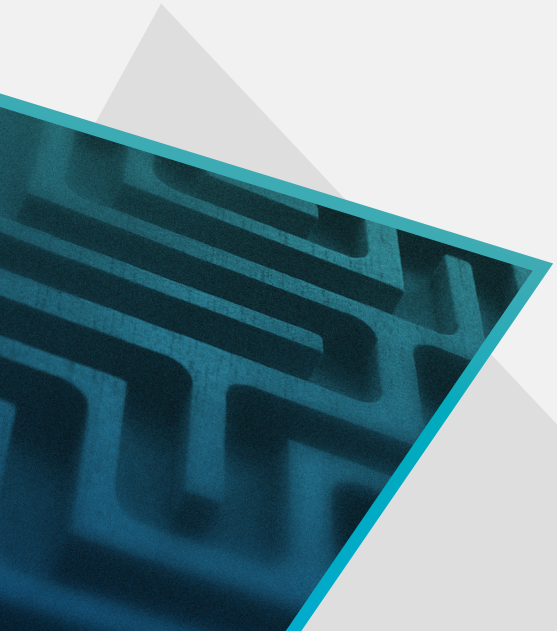
COMMENT

The judgment is important as it gives valuable insight into the interpretation of section 179(6) of the TAA. Considering the facts of the case, it is clear that the alleged conduct of the taxpayer was serious enough to justify SARS' decision and for the court to find that it complied with section 179(6) of the TAA. It seems reasonable for the section to be applicable in the face of such serious alleged unlawful conduct on the part of a taxpayer.

While it is understandable that SARS has the power to issue a third-party notice under section 179(1) of the TAA, generally speaking, the power to issue one under section 179(6) without a final demand (and collect tax) is arguably a power that should not be too easily exercisable, considering the potentially devastating impact it can have on a taxpayer's business. The judgment seems to suggest that it must be clear that issuing a final demand first would prejudice the collection of a tax debt, so that it would lead the taxpayer to, for example, attempt to withdraw funds from his bank account or transfer them to avoid implementation of the subsequent third party notice issued.

The case under discussion is an exception in that most of the reported judgments on section 179 of the TAA have dealt with SARS' failure to adhere to the final demand requirement in section 179(5) of the TAA. Readers who are interested in this can read our Tax and Exchange Control Alerts of 14 May 2020 and 17 September 2020 where we discuss judgments involving section 179 of the TAA decided in favour of the taxpayers in question.

LOUIS BOTHA



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