Publication: BUSINESS DAY - BUSINESS LAW & TAX REVIEW
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Title: SARS wins reasons ruling
Publish Date: 13 November 2017
AVE: 107736.8
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BUSINESS LAW & TAX

SARS wins reasons ruling

● *Income Tax Court held that SARS had met case requirements*

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The Income Tax Court recently handed down judgment in ITC 0032/2016 and ITC 0033/2016, two identical applications dealing with taxpayers' requests for reasons.

In both cases, the taxpayers sought an order in terms of rule 6 of the dispute resolution rules that the South African Revenue Service (SARS) be ordered to provide them with adequate reasons as determined by the court to enable them to formulate objections to the additional assessments.

The taxpayers had been issued notices in terms of section 80J of the Income Tax Act 58 of 1962 setting out the audit finding the General Anti-Avoidance Rule (GAAR) applied to arrangements entered into by them and the reasons for this finding.

The transactions that were the subject of the GAAR finding in the case appear to be as follows:

- The taxpayers subscribed for preference shares in respect of which they received exempt dividends and secondary tax on companies (STC) credits;
- Proceeds of the subscription were ultimately used by entities in the group to purchase interest-bearing linked notes from a bank; and
- The interposition of two entities in the group and various transactions among the taxpayers and these intermediary companies resulted in the interest from the notes flowing back to the taxpayers as exempt dividends.

The audit findings in the notice were that the intervening transactions created income tax benefits for the taxpayers as the interest on the notes would have been subject to income tax if the taxpayers had received taxable interest directly from the notes instead of exempt dividends. There were STC tax benefits for the taxpayers.

The taxpayers stated they were neither aware of, nor party to, the transactions and agreements referred to in the notices. SARS requested additional information, which the taxpayers provided.

SARS issued assessment letters and additional assessments providing for adjustments to the taxpayers' assessments for "exempt dividend income recharacterised as taxable income".

The taxpayers requested reasons in terms of rule 6 for the additional assessments.

The requests sought to identify the "transaction, operation, scheme, agreement or understanding" which was included in each "arrangement" relied on by SARS in the assessment and also how each relevant "arrangement" satisfied the "abnormality" requirement of an impermissible tax avoidance arrangement.

SARS stated that the reasons in the assessment letter contained sufficiently clear and detailed reasons for the additional assessments. The taxpayers submitted that it was essential for them to have clear reasons to draft the objections to avoid potential prejudice at the appeal stage as taxpayers cannot raise new grounds on appeal. The Tax Court disagreed.

SUCH A BURDEN

/123RF — Justyna Pszczolka

The court held that "it is apparent [from the preparation for trial procedure] that a taxpayer is afforded an opportunity to request further particulars".

The rules (rule 32(3)) provide that an appellant may not include a new ground against a part or amount of the disputed assessment in the appeal, which was not included in its objection.

We submit that the taxpayers were concerned that they would not be able to include all possible grounds in their objections (given the limited reasons given) and would not be able to include "new grounds" should the dispute proceed to appeal. The taxpayers were not concerned with requesting further particulars on existing grounds or facts, but with ensuring that they had all the necessary information in order that all grounds which should be included are included in their objections. The court's decision on this point is therefore unclear.

The taxpayers further argued that the commissioner's reasons were inadequate and that they required clear and precise reasons to formulate the objections as the right to reasons was a cornerstone to fair administrative action.

The Tax Court relied on the principles established in the Minister of Environmental Affairs and Tourism v Phambili Fisheries Supreme Court of Appeal judgment as to whether adequate reasons had been provided to the taxpayers. The principle established in Phambili is that the party whom the decision has been taken against, must be given adequate reasons in order that this party understands why the decision went against it.

Phambili furthermore established that the decision-maker is required to set out (i) his understanding of the relevant law; (ii) the findings of fact on which his conclusions depend; and (iii) the reasoning process which led him to his conclusions. Reasons should be properly informative. They must explain why the decision was taken.

The court held that SARS had met all three requirements set out in Phambili.

The court agreed with counsel for SARS that the assessment letter had to be read with previous correspondence (as held in the Sprigg judgment). The taxpayers had submitted a detailed response to the notice in which it denied the main conclusions and had also gone to great lengths to provide the additional information requested by SARS following the response.

The Tax Court held that it was apparent from these responses that the taxpayers understood which "arrangements" were referred to in the notice. The Tax Court further held that the requests for reasons were delaying tactics and awarded costs against the taxpayers.

THE TAXPAYERS STATED THEY WERE NEITHER AWARE OF, NOR PARTY TO, THE TRANSACTIONS AND AGREEMENTS REFERRED TO

The decision suggests the courts will not lightly intervene and order SARS to provide reasons under the rules where SARS has satisfied the Phambili requirements by indicating its understanding of the relevant law and the findings of fact on which its conclusions depend.

The court's decision on this point is unclear as the taxpayers had denied knowledge of or being party to the transactions and agreements in the notice. It is uncertain how the negative responses to the notice (and provision of information requested) could be inferred to mean that the taxpayers had adequate reasons as to why GAAR applied to the transactions.

Further, the requests for reasons in rule 6 can only be made for an assessment, not for a decision in a letter of audit finding. Naturally, the request for reasons can only be made after a taxpayer has responded to requests for additional information or letters of audit findings. These responses should not be inferred to mean that a taxpayer had adequate reasons for an assessment, otherwise the remedy in rule 6 would be no remedy at all as the rule 6 request can only be made for an assessment

The decision underscores the importance of involving tax advisers as early as possible in the dispute process.

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