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SARS: Misrepresenting Misrepresentation

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As every taxpayer knows, SARS has extremely wide powers under the various fiscal Acts to enforce and collect tax. One of the protections given to taxpayers is that, in the case of income tax, an additional assessment may not be raised after three years, while in the case of self-assessed taxes, such as PAYE and VAT, SARS is given five years within which it may raise additional assessments, after which it is prohibited from doing so. This statutory time limit is colloquially known as "prescription", a term I will use here.

However, this protection is limited in that there are circumstances where SARS may disregard prescription. In the case of income tax it is if the full amount of tax was not assessed due to fraud, misrepresentation or non-disclosure of material facts. In particular as regards misrepresentation, this could be deliberate or innocent. In the case of self-assessed taxes the law prescribes that the misrepresentation must be intentional or negligent before an assessment may be raised after five years.

This article deals only with SARS's misunderstanding at many levels of what misrepresentation involves.

Misrepresentation

Shortly stated, misrepresentation means a false statement of fact. It has nothing to do with a legal point or a particular tax position adopted by a taxpayer.

So, for example, whereas generally speaking, if shares in a South African company are held for more than three years the proceeds are deemed to be of a capital nature. If they are held for less than three years, they are ***not*** deemed to be of a revenue nature, but the ordinary, common law rules apply in determining the capital or revenue nature of the receipts and, hence, whether the profit should be taxed as ordinary income or be subject to CGT. If a taxpayer indicates that it has held the shares for more than three years when, in reality, the shares were held for less than three years, on the assumption that this was not done fraudulently it would certainly amount to misrepresentation.

It is well-known that generally the burden of proof is on the taxpayer to show whether an amount is taxable or not, or is deductible or not. But not everything so falls upon the taxpayer's shoulders. In this case the onus of proof that there is misrepresentation falls upon SARS. Moreover, it is not enough to show that there is misrepresentation in order to disregard prescription – SARS must also show that it was the misrepresentation that was the cause of the taxpayer not being taxed within the three-year (or five-year) period.

The problem

The first problem is that SARS generally does not take its obligation to prove the causality too seriously. Generally if it is in the position to allege that there has been fraud or misrepresentation or non-disclosure of material facts that, in and of itself, is sufficient in its view to disregard prescription. It is almost as if they consider it self-evident that if there has been one of these factors then it must mean that, but for this, SARS would have taxed within three years. Of course, nothing could be further from the truth.

But that is not the main thrust of this article. What is more concerning is SARS's misunderstanding of what misrepresentation means in these circumstances.

Take the example given above in relation to a sale of an asset and whether the proceeds are of a capital or revenue nature. The courts have determined a number of tests, and possibly the most important test is whether or not the asset was acquired with a view to resale in a scheme of profit-making. This involves very much the intention of the taxpayer, which is also a question of fact, and also various other criteria. The courts will not lightly disregard the taxpayer's evidence as to its intention, but at the same time the courts will look carefully at all of the

surrounding objective facts and circumstances in determining whether or not the profit is of a revenue or capital nature. And the courts have consistently stated that interpreting and drawing inferences from these facts in order to arrive at the conclusion of whether it is capital or revenue, is a matter of law.

Assume that a taxpayer purchases an asset and after, say, eighteen months sells that asset at a considerable profit. Having regard to his or her subjective intentions and views, and possibly also having taken advice, the taxpayer decides to reflect the profit as a capital gain, subject to CGT, rather than as a revenue profit subject to ordinary income tax.

In such case, if SARS seeks to raise an assessment after three years it is not uncommon in circumstances such as these that SARS relies on misrepresentation. And this is despite the fact that every question in the tax return has been correctly answered and all the information required in the tax return has been fully and properly provided. The only difference between the taxpayer's and SARS's versions is that the profit was reflected as a capital gain rather than as a revenue profit.

In such case SARS will argue that it is relying on misrepresentation because the taxpayer misrepresented the profit as being of a capital nature rather than of a revenue nature. And here is the very problem: whether or not, based on the facts, a profit is of a capital or revenue nature is not a question of fact – it is a question of law, as the courts have stated. Therefore a taxpayer cannot misrepresent the law to SARS – the latter is as capable of interpreting the law as is the taxpayer. The only question is whether there are any incorrect facts in the tax return which supported the taxpayer's tax position, which facts, if properly stated, would have pointed to the contrary position. If SARS cannot point to incorrect statements of fact in the tax return, they cannot rely on the taxpayer's categorisation of the profit as being capital rather than revenue as constituting misrepresentation – there has simply not been a misrepresentation of fact, but only a difference of view as to what the tax position, ie the legal position, was in relation to those facts. SARS's defence is that if that is the case, how can they ever rely on misrepresentation. Well, one can ask the question the other way around: if that is not the case, when can the taxpayer ever rely on an absence of misrepresentation?

Conclusion

Unfortunately, a view such as this is quite pervasive within SARS, at any rate at those levels that deal directly with taxpayers, such as at the audit level and also involving the committees that decide issues such as whether or not to allow an objection and what rate of penalty should be imposed.

It is not as if I have faced this sort of problem on the odd occasion – in fact, to the contrary, I have difficulty recalling a single case where SARS relied on misrepresentation and where I could objectively agree with them.

There are two lessons to be learned from this: first, and very importantly, I think it behoves SARS properly to educate and train its auditors and the related structures within SARS as to the precise ambit of "misrepresentation". Secondly, and equally importantly, taxpayers must vigorously resist such an incorrect application of the law.



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