TAX

When can you set your mind at ease? Tax and the prescription issue

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SARS is generally prohibited from challenging income tax assessments that are over three years old, unless it can prove that the taxpayer was not correctly assessed as a result of fraud, misrepresentation or the non-disclosure of material facts on the part of the taxpayer.

For SARS to assess after the three-year prescription period, two requirements must be met: (1) there must be fraud, misrepresentation or non-disclosure by the taxpayer; and (2) the fraud, misrepresentation or non-disclosure must have been the reason why the full amount of tax was not assessed – in other words, there must be a causal link between the taxpayer's conduct and the incorrect assessment. If either of these requirements are not met, SARS is not entitled to make adjustments to your income tax assessments that are over three years old.

It is often difficult to determine whether a taxpayer has made a "misrepresentation" which could give SARS licence to overlook the three-year prescription period. This often turns on whether the taxpayer merely asserted a genuinely held legal opinion (which should not override prescription, even if the opinion is ultimately found to be incorrect), or whether the taxpayer actively misrepresented the relevant facts that resulted in the incorrect assessment. For example, is it a "misrepresentation" to claim a deduction for an expense that was genuinely incurred and which you think is a permissible deduction, even if SARS disagrees?

The recent decision by the High Court in *Commissioner for the South African Revenue Service v Meiring Citrus (Pty) Limited* ("**Meiring**") demonstrates that there can be a fine line between simply taking a legal position that SARS believes is incorrect, and making a factual misrepresentation.

The Meiring case concerned the deduction of a premium paid by the taxpayer under a contract. SARS disallowed the deduction more than three years after it was claimed, but argued that prescription did not apply because the taxpayer had made a misrepresentation "in relation to the characterisation of the premium as a deductible expense".

According to the Tax Court, SARS was essentially taking the point that the taxpayer had made a "misrepresentation" by claiming a deduction that SARS believed was not legally permissible, and on this basis alone SARS argued that it could override prescription. Clearly, it would completely defeat the point of prescription if a difference in opinion as to a legal point could be regarded as a "misrepresentation" that allows SARS to reopen prescribed assessments. Recognising this, the Tax Court found against SARS. It reasoned that, in claiming the deduction, the taxpayer expressed a legal opinion which, even if found to be incorrect, could not be regarded as a misrepresentation of fact that overrides prescription.

The case was taken on appeal, and in the recently released Meiring judgment the High Court overturned the Tax Court's findings. The High Court found that, although the taxpayer expressed a legal opinion in claiming the deduction, that legal opinion had to be based on a set of facts, being the terms and conditions of the contract. The court found that, on the facts, there had been a "misrepresentation" because the taxpayer did not bring the relevant factual information to the attention of SARS when it submitted its initial tax return, and it had initially neglected to submit a copy of the contract to SARS after its tax return was selected for verification and additional information was requested.

It appears from the High Court's reasoning that the "characterisation of the premium as a deductible expense" was regarded as a "misrepresentation" in this case because it was accompanied by a failure to disclose the terms and conditions of the contract on which the deduction was based. Based on this understanding of the judgment, the High Court's characterisation of the taxpayer's behaviour as a "misrepresentation" is somewhat perplexing, as it appears that the real issue was in fact the "non-disclosure" of the terms and conditions of the contract.

Had the taxpayer provided SARS with a copy of the contract when it was required to do so, it is questionable that it could still be regarded as having made a "misrepresentation" in claiming the deduction in its tax return.

The takeaway from the judgment is that SARS does not have free rein to reopen old assessments simply because it disagrees with the legal position taken by the taxpayer – for example, that a particular expense is deductible. However, taxpayers should take care to make full and accurate disclosure to SARS to ensure that there is no justification for revisiting historical tax assessments.

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