South African Institute of Tax Professionals

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RE: ANNEXURE C 2016 PROPOSAL: VOLUNTARY DISCLOSURE UNDER THE TAX ADMINISTRATION ACT

The following submission relates to the pending Taxation Laws Administration Amendment Bill. At issue is the "awareness" standard when taxpayers apply for the "Voluntary Disclosure Programme" ("VDP"). This issue also has significance in relation to the special VDP relating to "Voluntary Disclosure Programme" ("VDP") of undisclosed foreign assets and income.

1. 2016 Budget Legislative Proposal

A taxpayer seeking to make a VDP application, cannot do so if the prospective applicant is subject to a "pending audit" or "investigation". Annexure C to the 2016 Budget Review states that the concept of "pending audit or investigation" will be clarified.

2. Background

The Tax Administration Tax Act provides for a permanent Voluntary Disclosure Programme ("VDP"). The terms and conditions for the VDP are fairly predictable and transparent for prospective applicants so that these applicants can be guaranteed sufficient security to proceed. All that is required is to follow the prescribed procedure (sec 227(f)) and to meet the requirements for a valid voluntary disclosure (sec 227). Statutorily

defined VDP relief cannot be denied because *"despite the provisions of a tax Act, SARS must"* grant the applicable relief (sec 229).

One important qualification is whether the applicant is "aware" of an "audit or investigation" by SARS into the taxpayer's affairs. More specifically, section 226 of the Tax Administration Act provides:

> 226. Qualification of person subject to audit or investigation for voluntary disclosure.—
>
> (1) A person may apply, whether in a personal, representative, withholding or other capacity, for voluntary disclosure relief, unless that person is aware of—
>
> (*a*) a pending audit or investigation into the affairs of the person seeking relief, which is related to the 'default' the person seeks to disclose; or
>
> (*b*) an audit or investigation that has commenced, but has not yet been concluded, which is related to the 'default' the person seeks to disclose.
>
> (2) A senior SARS official may direct that a person may apply for voluntary disclosure relief, despite the provisions of subsection (1), where the official is of the view, having regard to the circumstances and ambit of the audit or investigation, that . . . ."

From the above, it is clear that SARS has some discretion in relation to the VDP to allow access despite this awareness based on the "circumstances and ambit" of the audit or investigation. In exercising this discretion, SARS must be of the view that: (i) the audit or investigation relates to the "default" the person seeks to disclose: (ii) the "default" would not otherwise have been detected during the audit or investigation, and (iii) the application would be in the interest of good management of the tax system and the best use of SARS's resources.

The above has two implications. Firstly, SARS effectively controls VDP access for an applicant under *"audit"* or *"investigation"*. Secondly, should the applicant obtain VDP access, the relief would be limited to that in column 5 of the Understatement penalty matrix (sec 223(1)), i.e. between 5 – 75% (as opposed to that in column 6, i.e. between 0 – 10%).

3. Problem language (“*unless that person is aware")*

Ignoring the above, it would appear that the terms *"unless that person is aware"* require that the prospective applicant should not have subjectively knowledge of being the target of a SARS *"audit or investigation".* It is this awareness that places the VDP process in potential peril. Because the terms of *“pending”*, *“audit"*, *"investigation"* and *"into the affairs"* (as found in sec 226) are not defined, these terms must accordingly take their ordinary meaning.

The ordinary meaning of *"audit*" includes *"an official examination and verification of financial accounts"* and to conduct an audit means to *"review methodically and in detail"* (The New Shorter Oxford English Dictionary). It is also defined as *"a formal examination of an individual's or organization’s accounting records, financial situation, or compliance with some set of standards"* (Black's Law Dictionary).*"Investigation"* is defined as *"the action or process of investigating"; systematic examination; careful research"* (Shorter Oxford). *"Investigate"* is defined as *"to inquire into (a matter) systematically"* (Black's). One must concede that these terms are vague, especially from a taxpayer’s perspective lacking insight into internal SARS processes.

In practice, what happens if SARS has merely requested information (e.g. under Chapter 5) and then all goes quiet after the information has been provided? If the taxpayer subsequently decides to apply for VDP, which box should be ticked? Does the earlier SARS interaction mean the taxpayer is (or should be) *"...aware of a pending audit or investigation"*?

From the above, it would appear that a prospective VDP applicant should have awareness that SARS is conducting a formal and systematic examination into his (tax) affairs before the discretion in sec 226(2) could come into play. In the example above, SARS's engagement with the taxpayer seems not yet to have reached that level, meaning that the prospective applicant would be within his or her rights to tick the "No" box on the VDP01 form and obtain the column 6 relief. Nonetheless, the applicant must take great care before proceeding with the VDP given the underlying uncertainty involved.

The above circumstance is not uncommon. The agenda pursued by certain SARS officials when initially engaging with a taxpayer often appears to be unclear (at least to the taxpayer anyway). Many SARS requests simply contain demands for factual information without stating the underlying reason. Interactions are left "hanging" and follow-up requests are often delayed for extended periods, leaving taxpayers uncertain whether the issue is still being pursued. These delays are aggravated when taxpayers hunker down in the hope that "the problem will go away..."

A taxpayer contemplating a VDP application in respect of a hitherto undetected tax "default" is consequently in a predicament: Will the application be processed under sec 226(1) or could there possibly come a SARS letter stating that the taxpayer is (or has already been) the subject of a SARS audit / investigation?

In addition, section 40 of the Tax Administration Act refers to an “inspection, verification” or audit. Query whether the terms inspection or verification falls within the prohibition. How all these terms in respect of the VDP is not readily apparent.

4. Guidance from abroad (Australia)

The Australian Tax Office ("ATO") sets out its approach in Miscellaneous Taxation Ruling MT 2012/3. The ATO uses the concept of *"examination"* (also not defined) rather than *"audit"* or *"investigation"*. The ATO approach could be summarised as follows:

- The ATO will notify a taxpayer that an *"examination ...into its affairs"* is to be conducted (accordingly this is different from the "awareness" test which applies locally);
- The concept "examination" is very broad and covers not only traditional audits to ascertain an entity's tax-related liability, but covers any investigation of an entity's affairs;
- The examination must relate to a particular entity's affairs and thus excludes activities that are merely educational in nature (e.g. an ATO bulk mail-out giving guidance regarding limitations on certain tax deductions);
- The examination must involve more than the routine processing of forms or applications by the ATO;
- The examination must be ongoing at the time the voluntary disclosure is made;

- Because the concept of "examination" is so broad, it could result in circumstances where it would be harsh to disallow the higher reduction in penalty and, in such a case, the lower penalty percentage penalty would nevertheless be imposed.

5. Possible recommendation

At a theoretical level, we fully understand the need for the “awareness” limitation. The VDP process should not be used as a means of reducing violations that have already been discovered by SARS. The point of the VDP is to obtain voluntary disclosure only when SARS remains unaware of the violation so as to save SARS time and resources of further investigation.

Unfortunately, the current approach is overly subjective and no clear dividing line exists. Taxpayers are often unsure as to whether the SARS documentation presented is still part of a ‘risk identification’ process or whether an investigation or audit is being conducted. A clear dividing line between the ‘risk identification’ process and what follows after should be inserted into the Tax Administration Act to avoid doubt. Taxpayers should not come forward for VDP relief when these taxpayers are already under SARS scrutiny (i.e. when an audit or investigation is underway and not merely an information gathering exercise).

In essence, the focus of the limitation is impractical and, at this stage, subjective. How can a court determine the genuine awareness of a taxpayer’s subjective understanding of the SARS audit or investigation process? SARS has many internal policies and procedures that are not available to taxpayers (and nor should they be). That being said, objectivity in the process that is presented publically, would avoid doubt as to the position a taxpayer could find himself, whether it be ‘risk identification’ or audit / investigation stage. This awareness is further complicated by the often open-ended nature of the audit or investigation.

The limitation should instead be based on clear guidance from SARS that the issues pertaining to a SARS letter, investigation or audit are no longer eligible for the VDP. A statement to this effect could be made by a Senior SARS Official under the auspices of the Tax Administration Act. This notification should be contained within the SARS communication itself with the taxpayer remaining ineligible only once SARS provides formal notification that the matter has been dropped. This form of notification is fully within SARS’s control.

6. Secondary Issue: When is an application voluntary for VDP purposes?

Certain VDP applications are also denied on the basis that the applicant's VDP application is not "voluntary" (i.e. because the taxpayer has been on SARS' radar and hence the taxpayer felt pressure to do a VDP). We believe that this restriction has the net effect of extending the audit or investigation concept even further, adding to taxpayer uncertainty. Both concepts must be stabilised in favour of one clear objective dividing line.

We also note that the Canada courts have taken the position that the VDP requirement of "voluntary" should not be restricted unduly. In *Worsfold v. The Queen* (2012 FC 644) (Ontario, 25 May 2012), the Federal Court held that the disclosure was "voluntary", despite the fact that the Canadian Revenue Authority had initiated enforcement action against a related party.

In the case, Mr Worsfold moved to Canada in 2001 without filing tax returns for several years thereafter. In September 2006, Mr Worsfold completed an on-line tax amnesty form so that an assessment could be done regarding his need and eligibility for voluntary disclosure. Following an appraisal by the Canadian Revenue Authority, an in-depth discussion was arranged for 5 October 2005 to address Worsfold's anticipated voluntary disclosure. A "no-name disclosure" was lodged that same day. However, on 3 October 2005 (two days before_, a Canadian Revenue auditor called a company that was wholly owned a controlled by Mr Worsfold of an upcoming CRA audit. Mr Worsfold subsequently submitted his voluntary disclosure to the Canadian Revenue Authority.

Although the Canadian Revenue Authority disallowed the request, the Federal Court held that the request should be allowed based on the belief that the taxpayer had no knowledge of the company audit when filing his disclosure. The case confirms that the nexus between the enforcement action and the applicant's disclosure is crucial - and not merely whether the parties are somehow connected.

It should also be pointed out that the Canadian Revenue Authority has developed in-depth Information Circulars and internal VDP Processing Guidelines in relation to its VDP process. According to the Canadian Revenue Authority Information Circular, the disclosure must be initiated by the taxpayer and must not "have been made with the knowledge of an audit, investigation, or other enforcement action that has been initiated

by the CRA..." Hence, the Canadian Revenue Authority correctly links the two processes without extending the concept of voluntary" into a further level of unnecessary subjectivity.

We appreciate the fact that the Annexure C of the Budget Review recognises the importance of the above matter and await the release of the 2016 Tax Administration Legislation.

Yours sincerely

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