NOTES ON SELECTION FOR AUDIT BY SARS

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The legislature confers extensive and penetrating powers of information gathering to SARS in Chapter 5 of the Tax Administration Act.[1] Particularly invasive provisions are undoubtedly section 40 and section 46 of the TAA. These provisions read as follows:

"40. SARS may select a person for inspection, verification or audit on the basis of any consideration relevant for the proper administration of a tax Act, including on a random or a risk assessment basis.

[…]

46.SARS may, for the purposes of the administration of a tax Act in relation to a taxpayer, whether identified by name or otherwise objectively identifiable, require the taxpayer or another person to, within a reasonable period, submit relevant material (whether orally or in writing) that SARS requires.

These provisions work in tandem in the event that SARS selects a taxpayer for audit since 'relevant material' will often be requested in order for SARS to satisfy itself that the taxpayer's tax liability is correctly calculated. S46 must be read together with the definition of 'relevant material' in the section 1 of the TAA, wherein it is defined as ""relevant material means any information, document or thing that in the opinion of SARS is foreseeably relevant for the administration of a tax Act as referred to in section 3" (I will elaborate on

[1] Act 28 of 2011.

what 'the administration of a tax Act entails below). This definition was amended in 2014 by the insertion of the words "in the opinion of SARS", thereby predicating the determination of relevancy on a subjective discretion which, as a jurisdictional fact, is a very low and vague threshold. The effect of this is that the failure to provide the "relevant material" pursuant to a request under s46 amounts to a failure to submit a "return" to SARS, which in turn happens to constitute a criminal offence under section 234(1)(c) of the TAA.

One commentator, Ronel de Kock, describes these provisions as 'Orwellian', bringing to mind the dystopian world in his novel *1984.*[2] However, ours is a State that prides itself on the Constitutional values of freedom, democracy, equality and dignity - the polar opposite of the totalitarian world depicted in Orwell's book. What then are our rights and obligations as taxpayers when it comes to Chapter 5 of the TAA? More specifically, is it possible that- in a constitutional state like ours- the revenue collection machinery of state can *randomly* invade its citizens privacy and interfere with their proprietary rights? Does the word 'random' invite SARS to conduct themselves in such a manner that is arbitrary, capricious and unreasonable?

[2] R de Kock "SARS' Information Gathering Powers, the Amended Definition of "Relevant Material" and George Orwell" https://www.thesait.org.za/news/212759/SARS-Information-gathering-powers-the-amended-definition-of-relevant-material-.htm (accessed on 24/02/20).

Random Audits and section 33 of the Constitution

The answer to the question posed at the end of the last paragraph is a definite 'no'. When SARS administers the relevant legislation, their conduct remains subject to section 33 of the Constitution which guarantees the right to just, lawful and procedurally fair administrative action.[3] In *First National Bank of SA Ltd t/a Westbank v Commissioner, SARS & Another: First National Bank of SA Ltd t/a Wesbank v Minister of Finance*, Ackermann J held that "…even fiscal statutory provisions, no matter how indispensable they may be for the economic well-being of the country – a legitimate governmental objective of undisputed high priority – are not immune to the discipline of the Constitution and must conform to its normative standards".[4] What tempering effect then does the Constitution exert on the interpretation of section 40?

Relevant to the Administration of a Tax Act

Section 40 states that SARS may select a person for inspection, verification or audit on the basis of "any consideration relevant for the proper administration of a tax Act, including on a random or risk assessment basis". In order to understand this provision, one must take cognizance of section 3(2), which explains what "administration of a Tax Act" means. This section states that, *inter alia,* that the aforementioned involves:

> *2)(a) obtain full information in relation to-*

[3] The Constitution of the Republic of South Africa, 1996.
[4] [2001] JOL 9760 (CC) 24-25.

(i) anything that may affect the liability of a person for tax in respect of a previous, current or future tax period;

(ii) a taxable event; or

(iii) the obligation of a person (whether personally or on behalf of another person) to comply with a tax Act;

(b) ascertain whether a person has filed or submitted correct returns, information or documents in compliance with the provisions of a tax Act;

(c) establish the identity of a person for purposes of determining liability for tax;

(d) determine the liability of a person for tax;

(e) collect tax debts and refund tax overpaid;

It is therefore clear that the words “including on a random basis” should not be construed in isolation or on a plain reading, but should be given a purposive interpretation that aligns with the qualifying language “for the proper administration of a tax Act”. Otherwise, the word “random” would empower SARS to act capriciously and unreasonably and would therefore allow them to violate the taxpayer’s rights to privacy without justification. Such an interpretation would be anathema to our constitutional norms which disallow arbitrary derogations from taxpayer’s rights. Section 39(2) of the Constitution furthermore provides “when interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights”. Below follows an overview of relevant interpretive guidelines that will give effect to section 39(2) in the context of section 40 and section 46 of the TAA.

Administrative Justice

At its core, the TAA is a source of administrative law. In order to give effect to a constitutional interpretation of this legislation, therefore, its provisions must be construed in such a way that is harmonious with jurisprudence on this topic as well as the PAJA. PAJA has been described as "universal legislation" that applies to all citizens in its dealings with the state.[5] Where enabling legislation is silent on certain issues, then PAJA will fill in any gaps.[6] As such, s40 is subject to the requirements of procedural fairness and other components of administrative justice as contemplated in the PAJA.

In the case *CSARS v Brown*,[7] however, the Tax Court held that a request for relevant material does not constitute administrative action for the purposes of the PAJA. I will not go into a critique of this judgment but suffice to say that this decision is without doubt open to being overturned. This notwithstanding, it is still possible to review requests for information on the principle of legality- which is, happily, a simpler process than going through the labyrinthine provisions of the PAJA. This was done in the case of *Mr A v Commissioner of South African Revenue Service,*[8] where the failure to inform the taxpayer that he was selected for an audit under section 40 of the TAA resulted in the assessment being set aside.[9] Departing from section 46 and placing the focus on section 40, it is my submission that since an assessment is administrative action for the purposes

[5] *Sasol Oil (Pty) Ltd v Metcalfe NO [*2006] 2 All SA 329 (W).
[6] Hoexter Administrative Law 367-368, 409; *Zondi v MEC for Traditional and Local Government Affairs* 2005 3 SA 589 (CC).
[7] 561/2016 High Court of South Africa, Eastern Cape Division.
[8] *Ackermans Ltd v Commissioner for the South African Revenue* [1] HG 16408 2013 NG para 27.
[9] (IT13726) [2018] ZATC 8.

of the PAJA, all the preliminary steps in reaching that decision form part of the same multi-stage decision and should therefore also constitute administrative action.[10]

"Fishing Expeditions" and the Right to Privacy

The only direct authority that addresses the question of 'fishing expeditions' in the context of tax audits is in *SARS v Brown*. In this case, it was held that a request for relevant material in terms of s46 did not amount to a "fishing expedition" since the jurisdictional facts (a reasonable belief that there may have been non-disclosure, plus the fact that the taxpayer was not registered as a taxpayer nor had he submitted tax returns) were established.[11] SARS' authority to issue a questionnaire was therefore triggered. As such, it may be inferred by necessary implication that a "fishing expedition" occurs when SARS selects a taxpayer for audit and requests information in the mere *hope* of uncovering information. This much is also stated in the *SARS Short Guide to the Tax Administration Act.*[12] It is furthermore the case that, albeit in the context of warrantless search and seizure, our courts have expressed disdain for 'fishing expeditions'. In *Ferucci and Others v C:SARS and Another*,[13] the court held that 'speculative averments' do not constitute facts upon which to predicate a warrantless search and seizure, and to do so would amount to a 'fishing expedition' of the type that does violence to the taxpayer's right to privacy. It is submitted that, although the legislative context differs somewhat, audit

[10] *Oosthuizen v MEC Roads and Transport* (33736/03) [2006] ZAGPHC 79 (21 August 2006)*; Viking Pony Africa Pumps (Pty) Ltd t/a Tricom Africa v Hidro-Tech Systems (Pty) Ltd & Another* 2011 (1) SA 327 (CC).
[11] (561/2016) [2016] ZAECPEHC 17 (5 May 2016) para 42.
[12] *SARS Short Guide to the Tax Administration Act* 11.
[13] (627/2001, 6958/2001) [2002] ZAWCHC 17 (12 April 2002).

selection will be viewed in a similar way since the right to privacy is also implicated. To infringe on such a core constitutional right such as this in a manner that is arbitrary (or *random*) spits in the eye of our constitutional dispensation.

Section 40 selection for Audit

Given the delineation in the preceding paragraphs, it is apparent that the threshold in this provision is very low. However, the selection for audit must be done with the *sole* purpose of administering a tax Act, i.e. with the aim of ensuring compliance with the relevant legislation. As such, there is no room for ulterior purpose here. An example of ulterior purpose may be found in the Canadian case of *MNR v RBC Life Insurance Co.*[14] In this case, audits were performed on certain insurance policy schemes in circumstances where the revenue authority was already in possession of the relevant material, and whereby they had already internally considered these policies to be lawful. Evidence was tendered that evinced a decision to 'send a message to the industry' by taking measures to 'chill' the use of these policies, which involved an 'audit blitz'.

This is clearly an ulterior purpose and in South Africa is reviewable in terms of section 6(1)(e)(ii) of the PAJA, or alternatively in terms of the legality principle. It must be recalled that SARS remains to be a creature of statute and must perform its mandate within the four corners of the TAA and not “by its own will”.[15]

[14] [2013] FCA 50 (decided on 21 February 2013).
[15] *AM Moolla Group Ltd v Commissioner, SARS & others* [2005] JOL 15456 (T) 3.

See also the fairly recent Canadian Federal Court case *Cameco Corporation v Canada (National Revenue).*[16] Justice Noël found that section 231.1(1) of the ITA should be used with restraint. The Minister in conducting audits must be provided "all reasonable assistance" but this did not mean taxpayers must be compelled to reveal their "soft spots" (uncertain tax positions making up their tax reserves) in preparing tax returns, on a self-disclosure basis. The Minister is not vested with unlimited powers. Section 231.1(1) of the Canadian ITA reads as follows:

Inspections 231.1 (1) An authorized person may, at all reasonable times, for any purpose related to the administration or enforcement of this Act,
(a) inspect, audit or examine the books and records of a taxpayer and any document of the taxpayer or of any other person that relates or may relate to the information that is or should be in the books or records of the taxpayer or to any amount payable by the taxpayer under this Act, and
(b) examine property in an inventory of a taxpayer and any property or process of, or matter relating to, the taxpayer or any other person, an examination of which may assist the authorized person in determining the accuracy of the inventory of the taxpayer or in ascertaining the information that is or should be in the books or records of the taxpayer or any amount payable by the taxpayer under this Act, and for those purposes the authorized person may
(c) subject to subsection 231.1(2), enter into any premises or place where any business is carried on, any property is kept, anything is done in connection with any business or any books or records are or should be kept, and
(d) require the owner or manager of the property or business and any other person on the premises or place to give the authorized person all reasonable assistance and to answer all proper questions relating to the administration

[16] 2017 FC 763.

or enforcement of this Act and,
for that purpose, require the owner or manager
to attend at the premises or place with
the authorized person.

Furthermore, the selection itself must be done in accordance with SARS' internal processes lest the selection be truly arbitrary. As such, SARS may not one day wake up and conduct a 'spin the globe' exercise and select persons for audit on that basis alone. The process of audit selection must be carried out in accordance with the SARS Internal Guide, which stipulates as follows:

> *In order to carry out his tasks properly the auditor has to make professionally and technically sound decisions on the nature and scope of the audit. This requires insight into the knowledge of the business process of the taxpayer as well as those of the industry or target group of which it is part.*
> *[…]*
>
> *The risk profiling team will manually select cases to be audited by screening the tax returns in order to determine the level of risk per case, and to establish which cases warrant an audit (desk or field); selection will be done under the guidance and ambit of the Manual Risk document.*[17]

[17] *SARS Internal Audit Manual – Part 4: The Audit Process* 2.

INTERPRETIVE CANON AND DOCTRINE OF LEGITIMATE EXPECTATION

It is thus abundantly clear that the word "random" must here be read in the context of the doctrine of legitimate expectation. This doctrine has been accepted in our administrative law, and has been applied in the recent SCA case of *SANPPARKS V MTO Forestry (Pty) Ltd.*[18] The requirements for the existence of such an expectation have been set out in *Administrator v Traub*[19] and are as follows:

1. It must arise from an express promise given by the authoritative body, or
2. It must emanate from a regular practice which the claimant of a legitimate expectation can reasonably expect to continue.

Here, the legitimate expectation is that SARS will follow its own internal processes. It seems that both of the above boxes have been checked since SARS binds *itself* to the process outlined above by having created the guidelines for itself and has regularly adhered to it.

The proposition that the doctrine of legitimate expectation abides in a reasonable interpretation of this section is bolstered by the SCA in *Natal Joint Municipal Pension Fund v Endumeni Municipality.*[20] In this case, it was unequivocally stated by Wallis JA that context is to be considered from the outset when interpreting any legal document-

[18] (446/2017) [2018] ZASCA 59 (17 May 2018).
[19] 1989 (4) SA 731 (A) at page 63.
[20] 2012 4 SA 593 (SCA).

statute included. Furthermore, it was reiterated that constructions of legal documents that lead to unbusinesslike and impractical outcomes will not be used. As such, the weight of authority compels one to reject a plain grammatical reading of the word 'random'.

Furthermore, as held by Steyn J, provisions in tax acts must be interpreted in such a way that gives effect to "[...] the presumption of a fair, just and reasonable lawgiver's intention…".[21] Finally, there is the *contra fiscum* rule that states, in the event of ambiguity in a legislative fiscal provision, where such ambiguity is "*implied from the wording of the legislation and such legislation implies a burden upon the subject then that interpretation must be adopted which is in favour of the taxpayer*".[22] All of this together militates against a plain reading of the words "on a random basis". When viewing this provision against the backdrop of the Constitution and the right to just administrative action, as well as the devastating effects that truly random audits may exert on well to do business people, it becomes clear that the approach advocated for in this document is one which is lawful and gives expression to our constitutional ethos.

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[21] *ITC 1384* (1983) 46 SATC 95.
[22] *Shell's Annandale Farm (Pty) Ltd v Commissioner for South African Revenue Service* [2000] 62 SATC 97.

https://www.saica.co.za/integritax/2013/2248._Information-gathering_and_tax_audits.htm

https://www.saica.co.za/integritax/2016/2550._Contra_fiscum_rule_applied.htm

http://www.saflii.org/za/cases/ZAECPEHC/2016/17.html