

# How to save Sars

By [Patricia Williams](#)

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The performance of the South African Revenue Service (Sars) and the path it has been taking has been called into question of late, with a number of tax-related bombshells being dropped one after the other in recent months.



Patricia Williams, partner at Bowmans

The tax revenue deficit was estimated to be R50.8bn in 2017/ 18, the highest deficit since the 2009 recession, increasing to R69.3bn in 2018/ 19 and R89.4bn in 2019/ 20. No specific plans were identified in the Mid-Term Budget speech to address these severe deficits, either in relation to expenditure cuts or tax hikes. Rather, it was confirmed that these aspects have been shifted to the presidency, with announcements to be made on a mix of expenditure cuts and revenue increases in the 2018 Budget.

Then an inquiry into tax administration and governance at Sars was announced in November 2017. It appeared that Minister Gigaba did not accept that the tax revenue deficit can be explained away by economic performance. In this respect, he said, "it is critical for government to determine the cause of the tax-revenue under collection in order to enable government to take urgent remedial steps to ensure that Sars is able to meet its revenue targets".

While both the low growth rate of the economy and the massive job losses that South Africa has suffered would impact on tax collections, here are some thoughts from the perspective of a tax practitioner on the reasons for Sars' dismal performance.

## Political determinants of tax compliance

Many of the political determinants of non-compliance are present within the South African tax context. These include:

- A system perceived to be too bureaucratic, with a high tax burden, and a high number of taxes.
- An inefficient fiscal policy mirrored in squandering of public funds and low quality of public goods makes taxpayers think twice before paying the entire share of their tax liabilities.

Apart from all existing taxes, a number of new taxes are anticipated. Among them are a sugar tax, carbon tax, national gambling tax, acid mine drainage tax and a potential wealth tax.

In addition, the magnitude of the misuse and abuse of funds by government and parastatals is staggering. In the circumstances, it is predictable that there would be decreased tax compliance.

Sars would not, however, be in a position to address these political issues, except potentially by promoting broader tax compliance as discussed below, so that the high tax burden on narrow groups of taxpayers could be alleviated.

## **Lack of trust in Sars and perceived coercive power**

In a paper, *Enforced versus voluntary tax compliance: The 'slippery slope' framework* (2008), Kirchler, Hoelzl and Wahl introduced a new approach to understanding tax compliance. This framework considers two key dimensions, namely power of the tax authorities and trust in the tax authorities. Coercive power and lack of trust can easily lead to an antagonistic environment, and a slippery slope or vicious cycle of ever-decreasing tax compliance.

Over the past year or so, there have been various allegations in the public space that cast doubt on the credibility of Jonas Makwakwa, Commissioner Tom Moyane and Sars as a whole. These aspects would negatively impact trust in Sars.

In addition, the Tax Administration Act contains very severe penalty provisions that many tax practitioners consider to be excessive and unjust, and Sars has been systemically “ignoring” the “bona fide inadvertent error” exclusion that is supposed to relieve taxpayers from understatement penalties when they have acted in good faith and without intention to evade taxes. These factors would easily result in perceived coercive power.

This needs to be very carefully addressed. There are some easy first steps here:

- Sars and National Treasury should properly consider and address the submissions that the tax industry has been making in relation to the Tax Administration Act over the past few years. These are made as “Annexure C” submissions towards the end of each year, as well as other regular submissions from industry bodies such as the South African Institute of Tax Practitioners (Sait) and the South African Institute of Chartered Accountants (Saica).
- Sars should provide the interpretation note or other guidance on the meaning of “bona fide inadvertent error”, as promised in the Memorandum on the Objects of the Tax Administration Laws Amendment Bill 2013 (and not yet forthcoming). It is also submitted that this same exclusion from penalties should apply equally to the percentage-based penalties, and legislative change should be introduced as soon as possible in this respect.
- Sars and National Treasury should consult on issues of perceived inequity in the Tax Administration Act and other tax Acts. An example is the VAT law used to allow for waiver of interest in cases where there was no loss to the fiscus. Sars and National Treasury saw fit to purposefully remove this discretion, in order to levy interest on taxpayers even when the revenue service suffered no loss. Inequity also arises in relation to the lengthy periods Sars has to issue additional assessments if taxpayers have underpaid their taxes, but very short periods that taxpayers have to try to get reduced assessments if they have overpaid their taxes.

## **Loss of skilled staff**

Sars has suffered extensive loss of skills over the last while. From what has been reported in the press, it appears that various investigative divisions within the organisation which have apparently been “shut down” over the past few years. Whether this was systematic and purposeful as alleged in certain media reports, or the unfortunate consequence of other factors, Sars’ capacity to properly apply the tax legislation and conduct tax audits and investigations has been hampered.

From the point of view of the fiscus, unlawful behaviour, or simply incorrect tax positions adopted, would easily be overlooked by a “reduced capacity” Sars. If a person who deliberately evades taxes is audited and Sars does not find anything, this is sure to result in massive increases in tax evasion. It is therefore critical that, Sars has the skills necessary to identify and address the real risk areas. Also, if Sars does not make the correct legal argument when attempting to assess a taxpayer, it may easily lose the tax dispute, even if the tax position of the taxpayer is actually arguably incorrect.

From the point of view of the taxpayer, an underskilled revenue office leads to aggressiveness and lack of compliance by Sars with administrative justice provisions. Unfair competition and discrimination among taxpayers arises if certain persons can avoid customs duties, excise duties or VAT. Lack of capacity also increases the level of criminal activities within South Africa, since customs inspections and investigations are an important component of crime prevention. It is critical to re-establish skilled staff within Sars, to address these problems.

## **Focusing on “soft targets”**

Another issue, which may be related to the loss of skilled staff, is that Sars appears to be “going for soft targets”, with its auditing behaviour. This relates both to who is being selected for audit, and the types of issues that are being audited.

By this, I mean extensive and multiple audits of taxpayers who have already voluntarily registered for taxes, and who are paying taxes in the normal course, instead of going to look for the individuals and businesses that have failed to register, or who are evading taxes in spite of being tax registered.

Sars also appears to be focusing extensively on what tax practitioners would call “timing differences”, in other words issuing assessments where existing amounts of tax are simply moved between tax years, as opposed to focusing on non-declaration of income, aggressive cross-border structures that reduce the tax base, or other complex tax matters that would have a “permanent” tax effect.

This approach can have the effect of rewarding unlawful behaviour while victimising taxpayers who are essentially tax compliant through excessive audits and heavy-handed penalties. Apart from the direct impact on tax collections, in that tax is massively under collected, trust in Sars is negatively impacted, driving tax non-compliance.

Sars needs to rebuild its specialist tax teams and investigative divisions. It can take several years to investigate and assess complex tax areas, and to finalise potential disputes in court. The measurement criteria for Sars officials cannot be based primarily on factors such as “number of audits completed” (which drives multiple low-level audits of individuals), or “tax collections” within that year (which drives small assessments of timing differences where taxpayers are unlikely to dispute the matter). Complex structures, tax avoidance, transfer pricing, profit attribution to permanent establishments and other base erosion and profit-shifting aspects need to be audited by skilled Sars officials.

## **Delay in taking action and selective enforcement**

The Tax Avoidance and Reportable Arrangements Division identifies various structures or transactions that are considered potentially tax aggressive, and where it may be appropriate to introduce legislative changes to curb what could be perceived as “abuse”. However, there are frequently delays of several years after something is identified, before actual legislative change is introduced. In the interim, millions or billions of rands of potential tax are lost to the fiscus.

Taxpayers who choose not to introduce these tax avoidance structures in the interim also suffer financial prejudice relative to their competitors who do so, which promotes inequality.

Similarly, there is a lack of equal enforcement of court “wins”. When Sars wins a court case, or a tax dispute is resolved in some other manner, it does not routinely apply the findings to all potentially affected taxpayers across all relevant tax years. This results in inequality among taxpayers – if you are the “unlucky one” who was targeted, you pay more taxes, but your competitors are not necessarily treated in the same manner. At the same time, Sars collects less taxes.

## **Inadequate tax base**

A cursory review of the number of registered taxpayers for various tax types indicates that the tax base is not close to being reflective of the actual market. Sars has the power to do “inspections”, to see that businesses are tax registered, but has failed to do so to any material extent. In the circumstances, tax becomes approximately voluntary, where there can be a perception that if you register you pay tax, but if you do not register then it is highly unlikely that Sars will bother to come and “catch” you.

The inspection provisions allow Sars to arrive, unannounced, at any premises where an official has a reasonable belief that a trade or enterprise is being carried on, to check the identity of the person occupying the premises, confirm tax registration status and confirm compliance with tax record-keeping requirements. This is not an area where highly skilled officials are needed, and so there is no readily apparent excuse for Sars’ failure to take action to increase the base of registered taxpayers.

Increasing the spread of taxes, so that the tax burden is shared more evenly among income earners, has become important during challenging economic situations. The income tax system is progressive, allowing for lower income earners to pay a lower proportionate share of taxes. However, equality is a basic constitutional right, and it is unfair if certain lower income earners pay their (lower) taxes because they are tax compliant, while other lower income earners evade their taxes and Sars does nothing to promote equality.

Sars should take urgent steps to enforce the inspection provisions, and get smaller businesses tax registered. This should also involve some kind of amnesty or tax relief for certain past periods, so that tax registration is an affordable and accessible option for businesses that have not been tax registered in the past (for example because of lack of understanding of their tax responsibilities). The revenue office needs to demonstrate its commitment to enforcing the tax laws evenly and without any bias, but also with compassion and understanding of the reality of the taxpayer’s context.

## **Conclusion**

The formal inquiry into tax administration and governance at Sars is likely to take some time to complete. In the meantime, many of the issues discussed here relate to urgent turnaround actions for Sars that could be implemented without delay to mitigate the projected tax revenue deficits that South Africa cannot afford.

## **ABOUT THE AUTHOR**

Patricia Williams is a partner and tax dispute resolution expert at Bowmans

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