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Dear Basil

## **SARS NON-COMPLIANCE WITH SECTIONS 42 AND 96 OF THE TAX ADMINISTRATION ACT, 2011**

### **1. INTRODUCTION**

- 1.1 Over the last few years, SARS has adopted the position that it need not issue letters of findings in all instances, and give the taxpayer an opportunity to respond, prior to an assessment being issued.
- 1.2 This situation is aggravated by the fact that the notices of assessment issued by SARS are frequently devoid of detail, leaving taxpayers uncertain of the basis of, or reasons for, the assessment.
- 1.3 We believe that, in these circumstances, SARS is contravening *inter alia* section 42 of the Tax Administration Act, 28 of 2011 (the TAA), section 96 of the TAA, and section 3 of the Promotion of Administrative Justice Act (PAJA).
- 1.4 Another matter, although not the subject of this submission, is that even though the taxpayer has the option to request reasons for the assessment (if the intention is to dispute the assessment), often, after requesting reasons by the relevant deadline, the time period within which SARS must respond expires with no reasons or inadequate reasons provided. In some instances, this results in SARS invalidating objections lodged on the basis that these are 'late' according to the timeline on the system which does not acknowledge the request for reasons that has not been responded to at all or has been responded to late, by SARS.



## **2. EXECUTIVE SUMMARY**

- 2.1 The overriding constitutional and administrative justice framework and principles of interpretation are set out in 3 below.
- 2.2 The key tax provisions are section 42 of the TAA (in 4 below) and section 96 of the TAA (in 5 below). The key administrative justice provision is section 3 of PAJA (in 6 below).
- 2.3 The tax case law regarding unenforceability or invalidity of assessments where SARS does not comply with section 42 and/or section 96 of the TAA is set out in 7 below.
- 2.4 The problem of no letter of findings, as it arises in practice, is discussed in 8 below.
- 2.5 The problem of inadequate notices of assessment, as it arises in practice, is discussed in 9 below.
- 2.6 The SAICA recommendations are set out in 10 below.

## **3. CONSTITUTIONAL FRAMEWORK AND RELEVANT PRINCIPLES OF INTERPRETATION**

- 3.1 The Constitution is the supreme law of South Africa, and a law or conduct inconsistent with it is invalid, and the obligations imposed by it must be fulfilled.<sup>1</sup>
- 3.2 SARS is an administrative body within the public administration.<sup>2</sup> SARS' powers must accordingly be exercised within the framework of administrative justice, including that everyone has the right to administrative action that is lawful, reasonable and procedurally fair<sup>3</sup>. PAJA was enacted to give effect to the right to administrative action that is lawful, reasonable and procedurally fair.<sup>4</sup>
- 3.3 The right to procedurally fair administrative action, as set out in section 33 of the Constitution, incorporates the right to be heard (*audi alteram partem*).
- 3.4 The Constitutional Court has explained this right as follows:

*“Observance of the rules of procedural fairness ensures that an administrative functionary has an open-mind and a complete picture of the facts and circumstances within which the administrative action is to be taken. In that*

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<sup>1</sup> Section 2 of the Constitution

<sup>2</sup> Section 2 of the South African Revenue Service Act

<sup>3</sup> Section 33(1) of the Constitution

<sup>4</sup> In terms of section 33(3) of the Constitution



*way the functionary is more likely to apply his or her mind to the matter in a fair and regular manner.”<sup>5</sup>*

3.5 As well as:

*“Everyone has the right to state his or her own case, not because his or her version is right, and must be accepted, but because in evaluating the cogency of any argument, the arbiter, still a fallible human being, must be informed about the points of view of both parties in order to stand any real chance of coming up with an objectively justifiable conclusion that is anything more than chance.”<sup>6</sup>*

3.6 In terms of section 4(2) of the South African Revenue Service Act, “SARS must perform its functions in the most cost-efficient and effective manner and in accordance with the values and principles mentioned in section 195 of the Constitution” (emphasis added). These values and principles include a high standard of professional ethics<sup>7</sup>, the obligation to promote the efficient, economic and effective use of resources (i.e. own and taxpayer resources)<sup>8</sup>, that people’s needs must be responded to<sup>9</sup>, accountability<sup>10</sup> and transparency<sup>11</sup>.

3.7 In *CIR v Nemojim (Pty) Ltd*, Corbett JA stated<sup>12</sup>:

*“It has been said that ‘there is no equity about a tax’. While this may in many instances be a relevant guiding principle in the interpretation of fiscal legislation, there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus. And it may be fairly inferred that such a result is in conformity with the intention of the Legislature.”*

3.8 The relevant principles of contextual interpretation to be applied in interpreting legislation were stated by Wallis JA in *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>13</sup> as follows:

*“[18] .... The present state of the law can be expressed as follows. Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or*

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<sup>5</sup> *Janse van Rensburg NO & Another v Minister of Trade and Industry & Another NNO* 2001 (1) SA 29 (CC), 2000 (11) BCLR 1235 (CC) at para 24

<sup>6</sup> *De Lange v Smuts NO & Others* 1998 (3) SA 785 (CC), 1998 (7) BCLR 779 (CC) at para 131

<sup>7</sup> Section 195(1)(a) of the Constitution

<sup>8</sup> Section 195(1)(b) of the Constitution

<sup>9</sup> Section 195(1)(e) of the Constitution

<sup>10</sup> Section 195(1)(f) of the Constitution

<sup>11</sup> Section 195(1)(g) of the Constitution

<sup>12</sup> (1983 (4) SA 935 (A) at 958)

<sup>13</sup> 2012 (4) SA 593 (SCA).



*provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document ...”*

3.9 Finally, another important principle of interpretation of fiscal statutes is the *contra fiscum* rule. In terms of the *contra fiscum* rule, where a provision of a taxing legislation is open to more than one meaning, the court must follow the interpretation which favours the taxpayer (and goes against the fiscus).<sup>14</sup>

#### **4. SECTION 42 OF TAA**

4.1 Section 42 of the TAA is titled “Keeping taxpayer informed”.

4.2 SARS is obliged, “upon conclusion of the audit or criminal investigation” to “provide the taxpayer with a document containing the outcome of the audit, including the grounds for the proposed assessment or decision”.<sup>15</sup> This is the so-called “letter of findings”. The taxpayer is then afforded 21 business days to “*respond in writing to the facts and conclusions set out in the document*”.<sup>16</sup>

4.3 There is a variation of these requirements “if a senior SARS official has a reasonable belief that compliance with those subsections would impede or prejudice the purpose, progress or outcome of the audit”.<sup>17</sup> In these circumstances, “*the grounds of the assessment or decision must be provided to the taxpayer within 21 business days of the assessment or the decision*”.<sup>18</sup>

#### **5. SECTION 96 OF TAA**

5.1 Section 96 of the TAA is titled “Notice of assessment”.

5.2 Section 96 requires that SARS issues a notice of assessment to a taxpayer and sets out the various requirements for this notice of assessment.

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<sup>14</sup> Silke on South African Income Tax, De Koker & Williams, LexisNexis electronic edition, March 2019 version, at paragraph 25.1A

<sup>15</sup> Section 42(2)(b) of the TAA

<sup>16</sup> Section 42(3) of the TAA

<sup>17</sup> Section 42(5) of the TAA

<sup>18</sup> Section 42(6) of the TAA



5.3 One of these requirements is that, in the case of an estimated assessment or “*an assessment that is not fully based on a return submitted by the taxpayer*”, SARS must give the taxpayer “*a statement of the grounds for the assessment*”.<sup>19</sup>

## 6. SECTION 3 OF PAJA

6.1 Section 3 of PAJA is titled “Procedurally fair administrative action affecting any person”.

6.2 The requirements of section 3 of PAJA apply to “*[a]dministrative action which materially and adversely affects the rights or legitimate expectations of any person*”. An additional assessment would result in financial prejudice to a taxpayer, and accordingly this is a material and adverse effect.

6.3 In terms of section 3 of PAJA, SARS must give the taxpayer “*adequate notice of the nature and purpose of the proposed administrative action*”<sup>20</sup>, “*a clear statement of the administrative action*”<sup>21</sup> and “*a reasonable opportunity to make representations*”<sup>22</sup>.

## 7. RELEVANT TAX CASE LAW

### 7.1 *Unenforceability of assessments*

7.1.1 In 2017, there were two cases where the court held that assessments issued without proper procedural compliance by SARS were unenforceable.

7.1.2 In *Nondabula v CSARS*<sup>23</sup>, it was held that upon issuing its additional assessment under section 92, SARS was required to comply with section 96 of the TAA, which requires that the notice of assessment must give the taxpayer a statement of the grounds for the assessment.

7.1.3 In the *Nondabula* case, section 96 was not complied with, and the court subsequently stated at paragraph 25 to 26:

*“There is no doubt that the first respondent [SARS] dealt with the applicant in an arbitrary manner contrary not only to the Act but most importantly the values enshrined in the Constitution were not observed by the first respondent...”*

*The least that is expected of the first respondent [SARS] is to comply with its own legislation and most importantly promote the values of our Constitution in the exercise of its public power. This, the first respondent failed to do. In failing to*

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<sup>19</sup> Section 96(2)(a) of the TAA

<sup>20</sup> Section 3(2)(b)(i) of PAJA

<sup>21</sup> Section 3(2)(b)(iii) of PAJA

<sup>22</sup> Section 3(2)(b)(ii) of PAJA

<sup>23</sup> *Nondabula v Commissioner for SARS and Another*, 79 SATC 333



*provide the applicant with all the information prescribed in terms of s 96 which the first respondent was obliged to provide the applicant, it acted unlawfully and unconstitutionally.”*

7.1.4 Since the assessment raised by SARS did not meet the formal requirements of section 96 of the TAA, SARS was not entitled to enforce payment based on the assessment.

7.1.5 In *A Way To Explore v CSARS*<sup>24</sup>, SARS issued an assessment as part of a verification process, without having complied with section 42 of the TAA. SARS then purported to apply set-off in order to satisfy the VAT owing by the taxpayer in terms of this assessment.

7.1.6 The court stated, at paragraph 29:

*“Section 42 imposed a duty on the Respondent [SARS] to keep the taxpayer informed during an audit and to provide a timeline on the periods the audit could take to complete. Its promulgation was brought about by a need to improve on the taxpayer’s rights and curb the injustices that may result from an audit that may take place without the knowledge of the taxpayer or affording it [the taxpayer] an opportunity to make submissions with regard thereto.”* (emphasis added)

7.1.7 The court prevented SARS from effecting set-off in order to collect the debt, as *“the Applicant was not alerted or afforded an opportunity to make submissions”*<sup>25</sup>.

7.1.8 The assessment issued by SARS was unenforceable, as a result of procedural non-compliance.

7.1.9 It should be noted that this case was an unopposed application. In the circumstances, it may well be that the court was conservative with its judgment (choosing the less severe outcome of “unenforceability” rather than “invalidity”), owing to the fact that SARS did not put forward any arguments, and the court was denied the opportunity to hear the matter fully argued before it.

## 7.2 **Invalidity of assessment**

7.2.1 In 2018, the court went further, to find that an assessment issued without complying with section 42 of the TAA was invalid and must be set aside. In *Income Tax Case 1921*<sup>26</sup>, the court had to decide whether the audit conducted prior to the issuing of the additional assessment was valid and whether the assessment itself was therefore valid. The additional assessment was found to not comply with the

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<sup>24</sup> 80 SATC 211

<sup>25</sup> At paragraph 40

<sup>26</sup> 81 SATC 373



peremptory prescripts of the applicable legislation, and to be constitutionally unsound. The assessment was found to be invalid and was set aside in its entirety.

7.2.2 In this respect, the court stated:<sup>27</sup>

*“The respondent’s breach of the legality principle is further compounded by its failure to comply with s 42(1) of the TAA which requires the SARS official responsible for the audit to provide the taxpayer with a report indicating the stage of completion of the audit. The appellant was not kept informed regarding the status of the audit. In addition the papers do not reveal any written conclusions or findings as would be required at the end of an audit...”*

*The outcome of the audit was not conveyed to the appellant either. In this regard s 42(2)(b) of the TAA was flouted by the respondent. Accordingly the appellant was deprived of the opportunity to respond to any of the issues raised...”*

7.2.3 And:<sup>28</sup>

*“The respondent’s non-compliance with ss 40 and 42 of the TAA clearly offends both the Constitution and the principle of legality. Accordingly, the respondent’s decision to conduct an additional assessment without notice, must be set aside as it does not comply with the peremptory prescripts of the applicable legislation and it is also constitutionally unsound. In the circumstances, the assessment is found to be invalid.”*

### 7.3 **Additional assessment to be based on proper grounds**

7.3.1 In the *Pretoria East Motors (Pty) Ltd*<sup>29</sup> judgment, the court stated<sup>30</sup> that:

*“As best as can be discerned, Ms Victor’s approach was that if she did not understand something she was free to raise an additional assessment and leave it to the taxpayer to prove in due course at the hearing before the Tax Court that she was wrong. Her approach was fallacious. The raising of an additional assessment must be based on proper grounds for believing that, in the case of VAT, there has been an under declaration of supplies and hence of output tax, or an unjustified deduction of input tax. In the case of income tax it must be based on proper grounds for believing that there is undeclared income or a claim for a deduction or allowance that is unjustified. It is only in this way that SARS can engage the taxpayer in an administratively fair manner, as it is obliged to do. It is also the only basis upon which it can, as it must, provide grounds for raising the*

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<sup>27</sup> At paragraph 22 to 23

<sup>28</sup> At paragraph 30

<sup>29</sup> SARS v Pretoria East Motors (Pty) Ltd (291/12) [20140 ZASCA 91 (12 June 2014)

<sup>30</sup> At paragraph 11



*assessment to which the taxpayer must then respond by demonstrating that the assessment is wrong."*

7.3.2 In this case, the court therefore placed significant emphasis on the fact that, to ensure fairness and proper court procedure, SARS must clearly state the grounds on which it bases its assessments and make it clear to the taxpayer what is in dispute, in order to enable the taxpayer to determine what is required from it to discharge the onus of proof.

## 8. PROBLEM IN PRACTICE – NO LETTER OF FINDINGS

8.1 Section 42 of the TAA intends to keep a taxpayer informed when under audit, including providing the taxpayer with a “letter of findings” and an opportunity to respond before issuing an assessment.

8.2 The problem that has arisen in practice is that SARS has adopted the view that these provisions only apply to a “formal audit”, and not to a “verification”, an adjustment that SARS wishes to make as a result of a request for relevant material.

8.3 There are a few key reasons why SARS’ approach is problematic, including:

8.3.1 **Conflicts with literal meaning of the word “audit”:** A dictionary definition of “audit” is “a formal examination of an organization's or individual's accounts or financial situation” or “a methodical examination and review”.<sup>31</sup> The ordinary meaning of the term “audit” accordingly encompasses any of SARS’ actions that would lead to the issuing of an additional assessment.

This seems to be supported in the judgment in the 2017 Cart Blanche Marketing CC case where it is stated at paragraph 36<sup>32</sup>:

*“[36] **The word “audit”** is not defined in the Tax Administration Act. It can therefore mean a wide range of things. More importantly, an audit can be **something very unobtrusive and simple as the verification** of very basic information, such as medical expenses or travelling expenses. On the other hand, it could be an extremely invasive process seriously affecting a business’s commercial confidentiality and an individual’s privacy.” (our emphasis)*

8.3.2 **Principles of interpretation are breached:** This approach by SARS undermines the intent of section 42 of the TAA (intention of the legislature / intention of the legislation), since SARS would then be able to avoid its obligations to keep a taxpayer informed, merely by changing the “label” of the relevant interaction with the

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<sup>31</sup> <https://www.merriam-webster.com/dictionary/audit>

<sup>32</sup> Carte Blanche Marketing CC and Others v CSARS (26244/2015) [2017] ZAGPPHC 253 (26 May 2017)



taxpayer. This is furthermore an insensible or un-businesslike interpretation, and conflicts with the *contra fiscum* rule.

- 8.3.3 **Breaches constitutional and administrative justice law requirements to be heard:** The constitutional right to be heard (*audi alteram partem*) is breached where SARS fails to give a taxpayer an opportunity to make submissions before an assessment is raised. In addition, SARS breaches section 3 of PAJA, because SARS does not give the taxpayer adequate notice of, *inter alia*, the nature and purpose of the proposed administrative action (the issue of the additional assessment) and a reasonable opportunity to make representations.
- 8.3.4 **Conflicts with constitutional principles of public administration:** There is no transparency or accountability, where the proposed administrative action, its purpose and its reasons are not conveyed to the taxpayer. SARS is not responding to taxpayers' needs to understand actions that affect them. Time and money is wasted, in trying to understand and potentially unnecessarily disputing assessments, which does not promote the efficient, effective and economic use of taxpayer and SARS resources.
- 8.3.5 **Assessments are invalid, or at the least unenforceable:** In terms of existing tax case law, the assessments issued by SARS without complying with section 42 are invalid, or at a minimum unenforceable. (This then raises issues of unfairness and unlawfulness if SARS attempts to act upon the relevant assessments.)

## 9. PROBLEM IN PRACTICE – INADEQUATE GROUNDS OF ASSESSMENT

- 9.1 In practice, the notices of assessment issued by SARS do not always comply with the requirements of section 96 of the TAA. As set out above, SARS must give the taxpayer "a statement of the grounds for the assessment".<sup>33</sup> This is frequently missing, or incomplete, so that the taxpayer is left "grasping inferentially" for the basis of SARS' assessment.
- 9.2 The standard principles to be applied in terms of what would be considered 'adequate reasons', was established in the *Phambili Fisheries* case<sup>34</sup>, namely:
- 9.2.1 Reasons must be specific, written in clear language and be of a length and detail appropriate to the circumstances (i.e. the reasons must be of sufficient quality); and
- 9.2.2 Reasons must comprise more than mere conclusions and should refer not only to the relevant facts and law but must also refer to the reasoning process leading to those conclusions (i.e. set out the rationale applied in coming to the conclusions reached).

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<sup>33</sup> Section 96(2)(a) of the TAA

<sup>34</sup> Minister of Environmental Affairs & Tourism v Phambili Fisheries (Pty) Ltd [2003] (6) SA 407 (SCA)



9.3 While taxpayers are entitled to ask SARS for reasons for the assessment, in practice SARS frequently responds with no further explanation, even where the taxpayer has set out in the request for reasons the specific issues that the taxpayer would like clarified.

9.4 There are [two] key areas where this happens in practice:

***Coding system applied***

9.4.1 Rather than a formal assessment letter, explaining the grounds for the assessment, it appears that SARS is using some form of “coding system”, in conjunction with the notice of assessment.

9.4.2 For example, there may be a number reflected on the notice of assessment, and then a key indicating what the number means, such as “burden of proof not discharged”.

9.4.3 The problem with this approach, is that the taxpayer may not know what specifically is being alleged. If the taxpayer has submitted certain documents, and SARS states “burden of proof not discharged”, the taxpayer does not know which documents were considered inadequate, and why the relevant document/s were considered inadequate. The taxpayer is then denied the opportunity to properly address SARS’ issues during the objection stage and may not know how to formulate its objection.

***Understatement penalties***

9.4.4 SARS bears the burden of proving the facts upon which SARS based the imposition of an understatement penalty.<sup>35</sup>

9.4.5 However, notices of assessment issued by SARS inevitably do not set out these facts, to enable the taxpayer to understand, and consider whether or not to object against, the imposition of the understatement penalty.

9.4.6 This issue frequently persists throughout the entire dispute process. This can be seen from *ITC 1926*<sup>36</sup>, where the taxpayer successfully took an exception to the Rule 31 statement of the grounds of assessment, on the basis that it lacked the averments necessary to sustain a finding of gross negligence and the corresponding understatement penalty imposed by SARS. The court stated:<sup>37</sup>

*“Absent the essential facts that SARS relies upon as to why there is gross negligence, the pleadings will simply be a bare denial of gross negligence, and that will not be helpful for the purposes of explaining the true dispute that must be resolved on appeal.”*

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<sup>35</sup> Section 102(2) of the TAA

<sup>36</sup> 82 SATC 161

<sup>37</sup> At paragraph 26



9.4.7 While this specific matter involved allegations of gross negligence, the quotation above is equally applicable in other matters. Absent the essential facts that SARS relies upon, all the taxpayer is able to do is give a blanket denial, and the parties are denied the opportunity to successfully resolve the dispute during the objection and appeal (including ADR) process.

## 10. SUBMISSION

### 10.1 *Letters of finding*

10.1.1 We recommend that SARS issues a formal statement acknowledging the obligation to issue letters of findings in all cases where SARS has determined that an additional assessment is necessary (other than jeopardy assessments), and that SARS communicates this to all of its employees.

10.1.2 This change would not prejudice the fiscus, but would promote compliance with administrative justice laws, as well as improving the relationship between SARS and taxpayers.

### 10.2 *Notice of assessment*

10.2.1 While SARS may have template notices of assessment, making it difficult to add in the detailed grounds of assessment, we recommend that SARS adopts one of the following approaches:

- Send a separate letter of assessment, being a manual letter sent by email, setting out the detailed grounds of assessment; or
- Attach an annexe to the standardised notice of assessment, setting out the detailed grounds of assessment.

10.2.2 SARS auditors should be trained on the fact that the taxpayer must be provided with the grounds of assessment, in sufficient detail that the taxpayer could understand exactly what is at issue. Taxpayers should not be obliged to engage in extra steps, such as having to send requests for reasons, or pay tax practitioners to “explain what SARS might mean”. This results in unnecessary extra costs for the taxpayer (and as a result, SARS is not promoting the efficient, effective and economic use of resources), and conflicts with the principle of good public administration of transparency.

10.2.3 If, in contrast, SARS is transparent and explains the issues clearly to the taxpayer, there are various positive potential outcomes including:

- Improved relationship with taxpayers (which encourages a culture of voluntary compliance);
- A streamlined dispute process, focusing on the actual issues only; and



- Fewer unnecessary disputes.

We appreciate the opportunity to engage SARS on these issues with a view to working together towards resolving these. Should you wish to discuss any aspects of this submission, please contact us.

Yours sincerely

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