

SUBMISSION TO STANDING COMMITTEE ON FINANCE BY MICHAEL KATZ

1. Introduction

- 1.1. A number of submissions are being made to the Standing Committee on Finance (“SCOF”) by various parties. I am aware of these submissions and do not propose in general terms to cover the details contained in those submissions.
- 1.2. The approach adopted by me in this submission is somewhat different. In my submission :-
 - 1.2.1. I concentrate on, and emphasize, the importance of good administration in the income tax system and particularly on tax collections;
 - 1.2.2. the relevance of the Tax Administration Bill (“TAB”) to tax administration in South Africa;
 - 1.2.3. the optimum reconciliation of the needs of the tax administrators on the one hand with the rights of tax payers on the other hand;
 - 1.2.4. the desirability of rewriting the tax laws and the relevance of the TAB to that process.

2. The Importance of Good Tax Administration

- 2.1. As a starting point it is relevant to draw attention to a number of observations contained in the First Interim Report (“Interim Report”) of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa (“Tax Commission”).
- 2.2. The Commission in the Interim Report stated as follows in paragraph 3.1.1 :-
 - “3.1.1 Tax policy and tax reform are inextricably linked to tax administration. The Commission in its deliberations has been constantly mindful of the limitations which administrative capacity inevitably place on the scope for adaptations to the tax system, and of the considerable value to the fiscus and the economy of competent and efficacious tax administration. It is apparent, for example, that :
 - (a) without good tax administration, tax law and tax policy cannot be given practical effect;
 - (b) effective tax legislation and policy making require expert inputs regarding administrative considerations;

- (c) when actual practice requires interpretation of legislative intent, tax administration impacts on tax policy;
- (d) defective tax administration can give rise to practices which are contrary to the tax policy intended by the legislature;
- (e) defective tax administration creates unintended distortions; and
- (f) constructive tax reform requires ongoing administrative reorganization."

2.3. The Commission further observed in paragraphs 3.1.6, 3.1.7 and 3.1.8 :-

"3.1.6 In addressing questions of the administration of the tax system, the Commission has distinguished between the following related but separate aspects:

- (a) the structure and operation of the tax administration, sometimes referred to as 'internal administration';
- (b) functions performed by the revenue authorities in their relationships with taxpayers, sometimes referred to as 'external administration'; and
- (c) measures taken by the revenue authorities to counter tax evasion and undesirable forms of tax avoidance;

"3.1.7 For the purposes of this Report:

- (a) 'Tax Administration', discussed in this Chapter, covers the internal administration matters referred to in paragraph 3.1.6(a);
- (b) 'Tax Collection', discussed in Chapter 4, covers the external administration issues referred to in paragraph 3.1.6(b); and
- (c) 'Tax Leakage', dealt with in Chapter 5, covers the matters referred to in paragraph 3.1.6(c)."

"3.1.8 Although these issues can be conceptually distinguished in this way and are treated separately in this Report, the Commission recognizes that these are

closely inter-related aspects of an operationally effective and efficient tax structure. The Commission has been guided in its search for appropriate reforms in tax administration, tax collection and the containment of tax leakage by both international experience and local representations. The evidence points to at least the following potential benefits of feasible reforms:

- (a) a significant recovery of additional revenue, enabling the authorities to raise the required revenue while lowering certain rates of taxation;**
- (b) greater certainty in the business community, which in turn facilitates decision taking and thereby contributes to investment and economic growth;**
- (c) an enhanced relationship between the revenue authorities and the taxpaying public;**
- (d) enhanced tax morality; and**
- (e) a reduction in disputes between the revenue authorities and taxpayers."**

2.4. The benefits of enhanced tax administration are manifold and include at least the following :-

- 2.4.1 a significant recovery of additional revenue, enabling the authorities to raise the required revenue while lowering certain rates of taxation;
- 2.4.2 greater certainty in the business community, which in turn facilitates decision taking and thereby contributes to investment and economic growth;
- 2.4.3 an enhanced relationship between the revenue authorities and the taxpaying public;
- 2.4.4 enhanced tax morality; and
- 2.4.5 a reduction in disputes between the revenue authorities and taxpayers.

2.5. In a highly competitive borderless world where countries compete to attract foreign investment there is a downward pressure on tax rates. This can only be achieved by means of :-

2.5.1 efficient tax collections;

2.5.2 broader tax base; and

2.5.3 economic growth.

2.6. Conventional wisdom is such that tax authorities worldwide seek to reduce costs of :-

2.6.1. tax administration; and

2.6.2. tax compliance.

This again requires enhanced tax administration. (See paragraph 3.1.2 of Interim Report).

2.7. Tax Collection – (See Interim Report Chapter 4).

2.8. Tax GAP and Leakages (See Interim Report Chapter 5).

2.9. The preservation of South Africa's tax base is an absolute imperative for the Revenue Authorities. It provides the finance to fund vital socio economic expenditure in South Africa. This happened with spectacular success in the post 1996 period in South Africa. All this occurred without any increase in tax rates; in fact there were substantial rate reductions in this period. This latter factor was an absolute necessity in a world where countries use their tax rates to compete for foreign investment.

2.10. The objective of tax base preservation must naturally take place in compliance with the Constitution. To ensure this objective the Revenue Authorities have consulted with, and been advised by, Constitutional law experts.

3. The Relationship Between Good Tax Administration and the TAB

3.1. Having stressed the importance of good tax administration, and the necessity to preserve the tax base, it is necessary to demonstrate how the TAB will enhance tax administration. In this regard it is respectfully submitted that the TAB :-

3.1.1. will considerably streamline and enhance tax administration;

3.1.2. will create greater certainty and productability in tax administration;

3.1.3. should reduce the number of disputes between SARS and the taxpayer;

3.1.4. should facilitate the resolution of disputes between SARS and the taxpayer;

- 3.1.5. will in many respects enhance the rights of taxpayers;
- 3.1.6. should enhance tax morality; and
- 3.1.7. endeavours to deal effectively and responsibly with the required powers of tax collectors and the rights of taxpayers.

3.2. In the balance of this presentation it is proposed to analyse the TAB by means of establishing a number of categories, namely :-

- 3.2.1. the first category being those provisions of the TAB which enhance taxpayer rights;
- 3.2.2. the second category being those provisions of the TAB which enhance SARS' powers;
- 3.2.3. the third category being those provisions of the TAB which enhance efficiencies in tax administration.

3.3. Thereafter certain aspects of the Tax Ombud are analysed.

3.4. Following thereon a brief analysis is undertaken of the endeavors that are made in the TAB to reconcile enhanced SARS powers with taxpayer rights.

3.5. Finally, brief observations are made as to the benefits that the TAB will have on the rewriting of income tax laws.

4. **Those Provisions of the TAB Which Enhance Taxpayer Rights**

- 4.1. This section is more indicative than providing an exhaustive analysis of the enhancement of taxpayer rights in the TAB.
- 4.2. The schedule attached hereto marked Annexure "A" reflects an analysis of some of the provisions in the TAB which enhance taxpayer rights. This will be tabled during the course of the submission.

5. **Those Provisions of The TAB Which Enhance SARS' Powers**

- 5.1. It is noteworthy that in a number of instances where the TAB provides enhanced powers for SARS it also imposes correlative duties on SARS.
- 5.2. The schedule attached hereto marked Annexure "A" reflects an analysis of some of the provisions in the TAB which enhance SARS' powers. This will be tabled during the course of the submission.

6. **Those Provisions of The TAB Which Enhance Efficiencies of Tax Administration**

6.1. The Explanatory Memorandum accompanying the TAB neatly expresses the objectives of the TAB to enhance tax administration. The relevant extract therefrom reads as follows :-

“The drafting of the Tax Administration Bill (the “TAB”) was announced in the 2005 Budget Review as a project to incorporate into one piece of legislation certain generic administrative provisions, which are currently duplicated in the different tax Acts. The scope of the project has since been extended so that it can now be seen as a preliminary step to the re-write of the Income Tax Act. The TAB project will assist in dividing the work of the re-write into more manageable parts, since the administrative part of the Income Tax Act comprises about 25% of the Act.

Tax legislation typically comprises two aspects: tax liability provisions or “tax charging” provisions, and tax administration provisions. The TAB only deals with tax administration. The drafting of the TAB focused on reviewing the current administrative provisions of the tax Acts administered by SARS, but excludes the Customs and Excise Act, 1964, since that Act operates in a somewhat different context and is the subject of a separate rewrite process.

The current administrative provisions in tax legislation are outdated. Although the provisions have been amended over the years, the tax Acts have become fragmented and disparate provisions arose in the different tax Acts. The current framework is outdated and needs to be aligned with modern approaches, business practices, accounting practices and constitutional rights.

In essence, therefore, the rationale for a tax administration review in South Africa is to adapt to a fast developing world, and lower the cost and burden of tax administration.

A new and modern legislative framework is accordingly required for:

(a) The modern administration of the collection of revenue.

(b) The consolidation of duplicate provisions.

(c) The alignment of disparate requirements in existing law.

To achieve the above, the TAB incorporates into one piece of legislation certain administrative provisions that are generic to all tax Acts and administrative

provisions currently duplicated in the different tax Acts, excluding the Customs and Excise Act, 1964. The TAB also seeks to remove redundant administrative provisions. It seeks to provide a simplified and single body of law that outlines common procedures, rights and remedies and to achieve a balance between the rights and obligations of both SARS and taxpayers in a transparent relationship.”

- 6.2. The schedule attached hereto marked Annexure “A” reflects an analysis of some of the provisions of the TAB which enhance efficiencies of tax administration. This will be tabled during the course of the submission.

7. **The Tax Ombud**

- 7.1. The establishment of a Tax Ombud was recommended by the Tax commission in its Third Interim Report. Paragraph 12.3 reads as follows :-

“12.3 PUBLIC PROTECTOR AND TAX OMBUDSMAN

12.3.1 In the absence of some intermediate protector, the only remedies available to the taxpayer regarding perceived infringements of basic rights or of Revenue Codes of Practice, are fruitless protest or costly litigation. Two institutions might assist in this regard.

12.3.2 The Interim Constitution makes provision for a Public Protector (sections 110 *et seq.*), who has been appointed. In terms of the Constitution the powers and function of the Public Protector, who is independent of the Executive and reports directly to Parliament, include the following :

(a) the power to investigate any alleged “abuse or unjustifiable exercise of power or unfair, capricious, discourteous or other improper conduct or undue delay by a person performing a public function” (section 112(1)(a)(ii)); or

(b) the power to investigate any alleged “act or omission by a person in the employ of government at any level, or a person performing a public function, which results in unlawful or improper prejudice to any other person” (section 112(1)(a)(v)).

12.3.3 The Public Protector is given wide powers to report to appropriate bodies, and to make recommendations for redress or other action.

12.3.4 Although the final Constitution is presently being negotiated, it seems likely that the Public Protection will remain, with powers and functions similar to

the present provisions.

12.3.5 Clearly the office of the Public Protector provides powerful assistance to any tax payer who considers that his or her basic rights have been infringed. The Commission has nonetheless examined whether any other institutional protection would be helpful. The following considerations featured in the Commission's deliberations.

- (a) The Authority of the Public Protector is a powerful weapon towards administrative fairness and justice.**
- (b) In the constitutional debate most parties agreed that "sub-Protectors" for each of the various functions of Government would not be beneficial, not only for reasons of practicality and cost, but also because these might detract from the general independence and authority of the function. It is therefore unlikely that a dedicated protector regarding tax matters will become a prescription of the Constitution.**
- (c) The Commission looked closely at the structure in the United Kingdom, where an independent Parliamentary Ombudsman has a similar role to that of our Public Protector. The UK authorities have, in addition, appointed a tax ombudsman, referred to as the Tax Adjudicator, who acts independently of the Parliamentary Ombudsman. The Adjudicator is engaged on contract, and is independent of the revenue although her staff is drawn from its ranks. In its first two years of operation, the office of the Tax Adjudicator has been remarkably successful in mediating procedural conflict between taxpayers and the authorities. The revenue authorities have quickly appreciated its contribution towards a smooth tax administration, while statistics show that taxpayers, including corporate taxpayers and their advisors, are increasingly making use of the new facility. The revenue authorities have contracted with the Office of the Tax Adjudicator that they will, except in rare circumstances, abide by the recommendations of the Adjudicator in any matter between themselves and a taxpayer. In the first two years of operation of the office, the authorities have in every instance acted on the recommendations of the Adjudicator. Where a taxpayer cannot gain satisfaction through the Adjudicator, recourse to the Parliamentary Ombudsman remains open.**
- (d) To the extent that the concept of a Statement of Taxpayer Rights has as an important objective the re-establishment and maintenance of trust**

between tax administration and taxpayer, the office of the Public Protector may be somewhat remote. Some might see it as an adversarial situation rather than one of mediation.

12.3.6 The Commission recommends that, while the role of the Public Protector as ultimate watchdog over taxpayer and other rights should be recognized and strongly encouraged, the underlying foundation of trust between taxpayers and authorities would be better served by the more direct mediatory role of a Tax Ombudsman or Adjudicator along the lines of the United Kingdom example.

12.3.7 To achieve the greatest benefit from this recommendation, the following are suggested:

- (a) the Tax Ombudsman should be appointed from outside of the revenue authorities, and should function independently;
- (b) appropriate separate funding should be provided, although the staff complement may be drawn from the revenue;
- (c) the Ombudsman should at all times be accessible to taxpayers, and have unfettered access to the revenue authorities;
- (d) the revenue authorities should in advance declare themselves to be bound by the Ombudsman's recommendations save in rare circumstances, the nature of which should be set down.

12.3.8 The Ombudsman's function would mainly be to deal with specific matters brought to its attention by the taxpaying public. It should also have the capacity to initiate suggestions to the revenue authorities regarding the Codes of Practice, or to refer general problems in the administration of tax laws to the Public Protector or other authorities, as appropriate.

12.4 RECOMMENDATIONS

12.4.1 The basic rights of taxpayers should be articulated in a clear public *Statement of Taxpayer Rights*. The principles to be encoded in this statement should include:

- (a) expeditious and timeous tax administration;
- (b) fair, impartial and consistent application of the law;

- (c) full disclosure, in simple language, of the reasoning behind adverse decisions;
- (d) respectful, courteous and helpful treatment of taxpayers; and
- (e) privacy of information. [paras.12.1.7; 12.2.1-7; 12.2.8-21]

12.4.2 In addition to recognizing the role of the Public Protector in this regard, an independent Tax Ombudsman should be appointed to protect taxpayers' rights and mediate between taxpayers and the revenue authorities. [para.12.3.6-8]

7.2. The response of the Joint Standing Committee on Finance was as follows :-

"While accepting the principle contained therein, the recommendation to appoint a separate Tax Ombud is not supported at this stage. The JSCOF expressed concern at the proliferation of such oversight bodies. Further consideration of alternatives is needed, including the possibility that the Public Protector's Office establish a specialized, skilled tax unit to achieve this purpose."

7.3. There is widespread recognition of the desirability of establishing a process for the resolution of disputes of an administrative or procedural nature. As has been observed by the Commissioner for SARS this lead to the creation of the SARS Service monitoring Office ("**SSMO**") in October 1992. At the launch of the SSMO office the then Minister of Finance announced that :-

"Once SARS' processes and procedures have improved sufficiently, the next important step that will be taken in emulating international standards will entail an important role for an Ombud."

7.4. The establishment of the Ombud in terms of the TAB is one of the checks and balances to the extension of SARS' powers in the TAB.

7.5. The next important question is what the appropriate model would be for a Tax Ombud in South Africa. In this regard it has been pointed out that the following avenues exist for resolving a procedural or administrative dispute :-

- 7.5.1. SARS' internal service issue resolution;
- 7.5.2. SARS' Service Monitoring Office;
- 7.5.3. the Public Protector; and

7.5.4. the normal Court system.

7.6. Both the Tax Commission and the provisions of the TAB consider that the best location for the Tax Ombud is between the SSMO and the Public Protector. In doing so a number of objectives must be satisfied :-

7.6.1. the Tax Ombud must not intrude on the role of the Public Protector or the Courts;

7.6.2. the Tax Ombud must be independent from SARS;

7.6.3. the Tax Ombud must be provided with adequate resources;

7.6.4. there must be appropriate reporting of the activities of the Tax Ombud.

7.7. A number of international models may be considered :-

7.7.1. the United Kingdom's Tax Adjudicator;

7.7.2. the Canadian model;

7.7.3. the United States' Taxpayer Advocate Service.

7.8. It is respectfully submitted that the provisions in the TAB relating to the establishment of the Tax Ombud take cognizance of the appropriate principles contained in similar models in other jurisdictions.

8. Reconciliation Between Enhanced Powers of SARS and The Rights of TaxPayers

8.1. In dealing with this aspect the Explanatory Memorandum states as follows :-

"Importantly, the TAB seeks to achieve a balance between the powers and duties of SARS, on the one hand, and the rights and obligations of taxpayers, on the other. This balance will contribute to the equity and fairness of tax administration. International experience has demonstrated that if taxpayers perceive and experience the tax system as fair and equitable, they will be more inclined to fully and voluntarily comply with it.

The TAB takes account of the constitutional rights of taxpayers, but does not seek to re-codify them, because all legislation, including the TAB, must be read together with the provisions of the Constitution. Particularly the right to administrative justice as well as the application of the fairness requirements are very fact and context specific.

Codifying these rights in respect of every administrative action by SARS will be an almost impossible task and may only serve to unnecessarily limit or modify them. The TAB rather seeks to effect protection of administrative fairness rights through affording taxpayers more effective and overarching remedies, such as the creation of a Tax Ombud's Office, and specific procedural rights in the clauses dealing with SARS' 174 powers, such as the right to an audit findings report after finalisation of an audit and providing reasons for assessments. In drafting the TAB, due regard was given to the following principles of international best practice in tax administration:

- (a) Equity and fairness to ensure that the tax system is fair and also perceived to be fair, which should in turn enhance compliance.**
- (b) Certainty and simplicity so that tax administration is not seen as arbitrary but transparent, clear and as simple as the complexity of the system allows.**
- (c) Efficiency, where compliance and administration costs are kept to a minimum and payment of tax is as easy as possible.**
- (d) Effectiveness, so that the right amount of tax is collected, active or passive non-compliance is kept to a minimum, and the system remains flexible and dynamic to keep pace with technological and commercial development."**

8.2. The schedule attached hereto marked Annexure "A" reflects an analysis of some of the provisions in the TAB which deals with the checks and balances relating to SARS' enhanced powers. This will be tabled during the course of the submission.

9. The Rewriting of Tax Laws

9.1. There is a widespread view that South Africa's tax laws require a total rewrite. The existing structure which dates back to 1962 has largely remained intact notwithstanding a number of important factors including :-

- 9.1.1. the reports of two Commissions of Inquiry into the tax structure in South Africa;
- 9.1.2. significant changes in the international economy as well as the South African economy;
- 9.1.3. the establishment of a democracy in South Africa;
- 9.1.4. significant changes in technology;
- 9.1.5. important judicial decisions;

- 9.1.6. new fiscal concepts;
- 9.1.7. new corporate law concepts.
- 9.2. Since 1962 a number of important changes have been introduced into the tax system including :-
 - 9.2.1. a capital gains tax;
 - 9.2.2. the taxation on a world-wide basis instead of a source based system.
- 9.3. By consolidating and harmonizing the administrative provisions of tax laws the TAB provides an important first step in rewriting South Africa's tax laws. In this regard it has been pointed out that the contents of the TAB account for approximately 25% of the total Income Tax Act.

These important changes, as well as many others, have simply been grafted onto the original structure. This has resulted in cumbersome and unwieldy tax legislation which is difficult and costly to administer and to comply with. The style is not user friendly.

10. Conclusion

- 10.1. The TAB is an important development in modernizing South Africa's tax laws.
- 10.2. One of its important objectives is to preserve the tax base by enhancing collection and enforcement mechanisms. In this regard the Explanatory Memorandum stresses that "the TAB gives recognition to the fact that the majority of taxpayers are compliant and want a more modern and responsive revenue administration but that there is a minority that seeks to evade tax or defraud the government.
- 10.3. Some of the submissions recognize this reality but express concern that the enhanced powers of SARS may be abused and that innocent taxpayers may be the victims of such abuse.
- 10.4. These concerns deserve serious attention. However in answer to these concerns the following observations are relevant :-
 - 10.4.1. clearly all tax laws must be constitutionally compliant;
 - 10.4.2. SARS has indicated on a number of occasions that it has consulted with, and been advised by, external constitutional experts. The following passage appears in the Explanatory Memorandum :-

"The TAB focuses on compliance with a number of broad constitutional principles that should apply to each administrative rule, such as equity,

fairness, and efficiency. Where fundamental rights are affected, remedial rights of taxpayers or mitigation of the impact are addressed. The TAB was reviewed by external constitutional experts, which review was provided to the Office of the Chief State Law Adviser for consideration during the pre-certification of the TAB for submission to Cabinet.”;

- 10.4.3. SARS has indicated that in the formulation and drafting of the TAB it has been guided by similar legislation in many foreign jurisdictions;
- 10.4.4. many of the enhanced powers of SARS are subject to a number of checks and balances;
- 10.4.5. if despite the foregoing any taxpayer contends that any conduct of SARS is unconstitutional the ultimate remedy is to challenge such conduct in the Courts;
- 10.4.6. one of the avowed objectives of the TAB is to promote equity and fairness to ensure that the tax system is fair and is also perceived to be fair which should in turn enhance compliance. Any abuse of its powers by SARS would undermine this objective.

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