SARS loses out for failing to follow correct procedure

By Johan Kotze

No-one; no entity – not even the SA Revenue Service – can escape the consequences of failing to follow the correct tax procedure.

The lesson is that procedure in a statute is critical, as it aims to ensure that rights and obligations are preserved. This is especially so in tax legislation, which imposes a host of direct and indirect taxes, often even obliging third parties to collect the tax.

The recent Western Cape High Court case of *Vacation Exchanges International versus the Commissioner for the South African Revenue Service (SARS)* is an excellent example of a situation where SARS did not follow procedure.

The appellant trades under the name RCI and its business is primarily timeshare exchange. Indeed, RCI is synonymous with timeshare in South Africa, with almost every timeshare developer and marketer being affiliated to RCI in some way.

Every year, all permanent RCI employees with more than six months' service were granted 17 000 exchange points free of charge, which they could use to enjoy a holiday at an RCI-affiliated timeshare resort.

Because SARS regarded this as holiday accommodation and a taxable fringe benefit, it assessed the employer for employees' tax.

RCI argued that SARS did not follow the correct procedure; that SARS had not complied with paragraphs 3(1) and 3(2) of the Seventh Schedule of the Income Tax Act.

Paragraph 3(1) obliges the employer to determine the cash equivalent of the value of a taxable benefit in accordance with the provisions of the Seventh Schedule.

Paragraph 3(2) provides that SARS "may, if such determination appears to him to be incorrect, re-determine such cash equivalent upon the assessment of the liability for normal tax of the employee to whom such taxable benefit has been granted".

Much of the argument for RCI turned on the meaning of the word "may" in 3(2); a word, the meaning of which in a statute is rather complex. RCI argued that SARS did not have a choice when it came to taxing the employer or the employee.

It maintained that the word 'may' only meant that SARS may or may not tax the employee.

Self-evidently, SARS took exception to this limitation of its power. It prefers to tax the employer by raising one assessment, rather than having to raise hundreds of assessments on individual employees.

Judge Dennis Davis went to great lengths to explain the procedures of the Seventh Schedule of the Act and how it should be read with the rest of the Income Tax Act, and agreed that SARS did not follow the correct procedure. Accordingly, he found it unnecessary to deal with RCI's other arguments refuring SARS' employees' tax assessments.

Because SARS has not appealed against the decision, it is reasonable to conclude that they do not dispute the judge's findings. SARS, as is expected, is probably

working on a strategy to amend the Income Tax Act to counter the High Court's ruling.

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