Combating impermissible tax avoidance through efficient administrative approaches: what SARS can learn from its Canadian counterpart

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Abstract

Impermissible tax avoidance transactions cross the dividing line between legal tax avoidance and illegal tax evasion. In response, governments across the globe have adopted legislative, judicial and administrative measures to combat this type of tax avoidance. This article reviews the use of the administrative techniques employed by the Canada Revenue Agency (CRA). These include awareness resources, monitoring tools, audits and administrative penalties. Through the evaluation of Canada's regime, the article seeks to make recommendations in an attempt to improve the South African administrative approach. It is proposed that the South African Revenue Service (SARS) continues to develop a cogent compliance programme in order to improve tax compliance.

INTRODUCTION

Although often separated by a rather thin line, an important distinction must be drawn between tax evasion and tax avoidance. Tax avoidance is characterised by open and full disclosure, where a taxpayer has arranged his affairs in a perfectly legal manner so that he has either reduced his income or has no income on which tax is payable. Tax evasion, on the other hand, is usually characterised by fraud and deceit. It refers to all those activities deliberately undertaken by a taxpayer to free himself from the tax that the law charges upon his income. Examples include the falsification of returns and the conclusion of sham transactions.[1]

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1 De Koker *Silke on South African income tax* (LexisNexis Butterworths Intranet Resources (2011)) at 19.1.

Tax authorities, however, typically frown upon tax avoidance where it strays into what the South African Revenue Service (SARS) refers to as 'impermissible tax avoidance'.[2] This, in general, refers to artificial or contrived arrangements, with little or no actual economic impact upon the taxpayer, that are usually designed to manipulate or exploit perceived 'loopholes' in the tax laws in order to achieve results that conflict with or defeat the intention of parliament.[3]

In response, governments across the globe have adopted various measures to combat this phenomenon. These measures may be classified into three distinct techniques, namely legislative, judicial and administrative approaches.[4] This article reviews the use of the administrative techniques used in Canada.[5] Through the evaluation of Canada's regime, the article seeks to make recommendations in an attempt to improve the South African administrative approach.

ANTI-AVOIDANCE MEASURES

A detailed exposition of the legislative and judicial measures is beyond the scope of this article. Briefly, the first technique, namely the legislative approach, entails that legislation is used to counteract tax avoidance. This anti-avoidance legislation may fall into one of two groups: first, legislation that changes the way the tax system deals with a particular transaction or arrangement (*ie* a general anti-avoidance rule), and secondly, legislation that

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2 *Per* Oguttu 'Curbing tax avoidance – investments in offshore "protected cell companies and cell trusts": the American and British approach – what is South Africa's view?' (2011) 23 *SA Merc LJ* at 17, the term refers to certain 'tax avoidance' practices that extend beyond what is legally acceptable and thus cross the dividing line between tax evasion and tax avoidance.

3 SARS 'Discussion paper on tax avoidance and section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)' (November 2005) at 4.

4 As categorised by, among others, Finance Quebec 'Aggressive Tax Planning' (January 2009) available at: www.finances.gouv.qc.ca/documents/.../AUTEN_DocCons_PFA.pdf (last accessed 14 December 2011) and the UK Tax Law Review Committee 'Countering tax avoidance in the UK: which way forward?' available at: www.ifs.org.uk/comms/dp7.pdf (last accessed 16 December 2011).

5 The Organisation for Economic Cooperation and Development (OECD) 'Peer Review Report of Canada' (2011) at 7 acknowledges that Canada has an extensive history of exchanging information for tax purposes, during which time it has established a strong framework to ensure the elements for effective availability and access to relevant information are in place. As such, Canada was selected as this country has historically been at the forefront of devising techniques to counter tax avoidance.

introduces specific anti-avoidance rules which are affixed to existing legislation or are included in new legislation.[6]

As regards the South African legislative position, the general anti-avoidance rule (GAAR) was enacted in section 103(1) of the Income Tax Act 58 of 1962, as amended (the Act). This section was repealed by section 36(1)(*a*) of the Revenue Laws Amendment Act 20 of 2006 and replaced by a new general anti-avoidance rule enacted in Part IIA of the Act. Part IIA contains sections 80A to 80L, which target impermissible tax avoidance arrangements. These provisions apply to any arrangement (or any steps therein or parts thereof) entered into on or after 2 November 2006. Part IIA defines an 'impermissible avoidance arrangement' as any avoidance arrangement described in section 80A.[7]

A reporting system was also required to uncover innovative corporate tax products that effectively cost the tax system hundreds of millions of Rand annually.[8] This reporting system (in the form of the first reportable arrangements provisions) was designed to counter tax evasion and was introduced to the Act by section 76A, which came into effect on 1 March 2005.

Section 76A was repealed on 1 April 2008 and replaced by a new Part IIB, inserted into the Act by section 6(1) of the Revenue Laws Second Amendment Act 21 of 2006. Part IIB contains sections 80M to 80T and applies to any arrangement entered into with effect from 1 April 2008. A reportable arrangement (RA) is defined in section 80T of the Act as any arrangement contemplated in section 80M. Such an arrangement must be reported to the Commissioner of SARS within sixty days in terms of the

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6 The UK Tax Law Review Committee n 4 above at 23 explains that a specific rule seeks to withdraw the tax benefits stemming from a specific planning scheme. On the other hand, the GAAR applies if the tax avoidance scheme leads to the abuse of one of the provisions, or of the law read as a whole.

7 Section 80A has four requirements to determine whether an arrangement is an impermissible tax avoidance arrangement. Van Schalkwyk & Geldenhuys 'Section 80A(c)(ii) of the Income Tax Act and the interpretation of tax statutes in South Africa' (2009) 17/2 *Meditari Accountancy Research* at 167–168 summarise the four requirements as follows: (1) An avoidance arrangement (as defined) is entered into or carried out. (2) It results in a tax benefit (as defined). (3) Any one of the following 'tainted elements' is present: abnormality regarding means, manner, rights or obligations; a lack of commercial substance (as defined) in whole or in part; and misuse or abuse of the provisions of this Act (including Part IIA). (4) The sole or main purpose is to obtain a tax benefit.

8 SARS *Explanatory Memorandum on the Revenue Laws Amendment Bill* (2003) available at: http://www.sars.gov.za/home.asp?pid=2631 (last accessed 22 January 2011).

disclosure obligation in section 80O. Failure to disclose such arrangements may result in a R1million penalty under terms of section 80S. This penalty will increase significantly when the Tax Administration Act (TAA) comes into force.[9]

As is the case in many other countries, South Africa has legislation to curb offshore tax abuse. This includes: Controlled Foreign Company (CFC) legislation, transfer pricing, thin capitalisation provisions, and anti-avoidance legislation dealing with offshore trusts.[10] South Africa also has exchange control regulations that are instrumental in ensuring the timeous repatriation into the South African banking system of foreign currency acquired by residents of South Africa.[11]

The second technique, namely the judicial approach, requires that the courts settle disputes between taxpayers and the tax administration concerning the interpretation of the law and the application of the law to an aggressive tax planning scheme. South Africa has two accepted common law principles in this regard, established by decisions of the courts. The first is the 'substance over form' doctrine, in terms of which courts will have regard to the substance and not the form of a transaction.[12] The second is the 'sham transactions' doctrine which applies when the substance or reality of the agreement is in *fraudem legis* and is intended to differ from its nominal form.[13] These two doctrines are closely related and tend to overlap.[14]

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9 The Tax Administration Bill was promulgated into law as Act 28 of 2011 in *Government Gazette* 35491 of 4 July 2012. In terms of s 272 of the TAA, the Act will come into operation on a date to be determined by the President by proclamation in the *Gazette*. The TAA contains a revised penalty clause in s 212, which reads as follows: '(1) A participant who fails to disclose the information in respect of a reportable arrangement as required by section 37 is liable to a penalty, for each month that the failure continues (up to 12 months), in the amount of (*a*) R50 000, in the case of a participant other than the promoter; or (*b*) R100 000, in the case of the promoter. (2) The amount of penalty determined under subsection (1) is doubled if the amount of anticipated tax benefit for the participant by reason of the arrangement (within the meaning of section 35) exceeds R5 000 000, and is tripled if the benefit exceeds R10 000 000.'

10 As identified by Oguttu 'Exposing and curtailing secret offshore tax shelters: the tools and the enablers. A call for vigilance in South Africa' (2011) 44/1 *CILSA* at 49.

11 *Ibid*. Exchange controls also prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa.

12 Clegg & Stretch *Income tax in South Africa* (LexisNexis Butterworths Intranet Resources (2011)) at 26.7.5 observe that in certain cases the economic substance of an arrangement may also be of assistance in interpreting or arriving at the legal substance where the documentation or facts are unclear. This could be useful, for example, in determining whether a particular expense is of a revenue or a capital nature.

13 In the recent case of *C*: *SARS v NWK Ltd* 2011 73 SATC 55 (SCA) at 67 Lewis JA affirmed that, although there is nothing wrong with arrangements that are tax-effective, there '… is something wrong with dressing up or disguising a transaction to make it

Depending on the scope of the courts' rulings, taxpayers, tax professionals and the tax administration may want to apply them to other contentious aggressive tax planning schemes. The court rulings thus have significant repercussions on the management by stakeholders of the risks inherent in aggressive tax planning schemes.[15]

The remainder of the article is devoted to a discussion of the third technique, namely the administrative approaches adopted by Canada and South Africa.

ADMINISTRATIVE APPROACH OF CANADA

The Canada Revenue Agency (CRA) delineates tax avoidance and tax planning as follows:[16]

> Tax avoidance and tax planning both involve tax reduction arrangements that may meet the specific wording of the relevant legislation. Effective tax planning occurs when the results of these arrangements are consistent with the intent of the law. When tax planning reduces taxes in a way that is inconsistent with the overall spirit of the law, the arrangements are referred to as tax avoidance.

Various factors in Canada's tax system contribute to a more pronounced tendency towards avoidance and evasion:[17]

- The tax system itself, which is based on self-assessment – although self-assessment reduces the costs involved in managing the system, taxpayers who provide incorrect or incomplete information may never be audited.

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appear to be something that it is not'.

14 Clegg & Stretch n 12 above at 26.7.4 segregate these doctrines as follows: 'while the legal substance of an agreement will generally be looked to in situations of genuine uncertainty or disagreement as to the nature of a transaction, the sham transaction test is more usually applied in situations where the parties have purposefully disguised the true nature of the transaction between them through the adoption of a form which is at variance with their actual intentions.'

15 *Per* the Université de Sherbrooke's Research Chair in Taxation and Public Finance *Aggressive tax planning and inherent risks: would Canada benefit by adopting tools developed by some of its trading partners? The Canadian context* at 34 available at: http://www.usherbrooke.ca/chaire-fiscalite/fileadmin/sites/chaire-fiscalite/documents/Tax_avoidance/Avoidance_Canadian_Context.pdf (last accessed 10 December 2011).

16 *Per* the CRA available at: http://www.cra-arc.gc.ca/gncy/lrt/vvw-eng.html (last accessed 23 November 2011).

17 As identified by the Canadian Library of Parliament '41st Parliament: current and emerging issues' (June 2011) at 39 available at: http://parl.gc.ca/Content/LOP/ResearchPublications/CurrentEmergingIssues-e.pdf#page=40 (last accessed 25 November 2011).

- The complexity of tax legislation – in response to escalating aggressive tax planning and tax avoidance schemes, the Canadian Income Tax Act (ITA) has become increasingly intricate.[18] This complexity has facilitated tax avoidance and evasion in some cases and has led to confusion in others.
- Incomplete harmonisation of federal and provincial tax legislation – taxpayers can make different tax decisions at federal and provincial levels, which sometimes result in lower taxes.
- The regulatory measures invoked by the CRA are premised on the concept of a 'regulatory pyramid'. The pyramid comprises a range of regulatory responses, escalating from the least intrusive for the majority of complying taxpayers at the bottom of the pyramid, to the most intrusive for a minority of consistent non-compliers at the top of the pyramid.[19] The CRA's administrative approach comprises awareness resources, monitoring tools, audits, and administrative penalties, each of which will be addressed below.

Awareness resources

In November 2005 the CRA launched the 'Tax Alert!' initiative to strengthen measures aimed at combating aggressive tax planning.[20] This initiative provides taxpayers with access to centralised information and notification services on various topics, including tax shelters, tax havens and tax avoidance schemes.

The rationale for the introduction of this awareness resource is that certain taxpayers and advisers could decide that it is too risky to implement tax planning schemes similar to those identified by the CRA in a public news release or on its website.[21] It is, however, conceded that this initiative will not

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18 The ITA (RSC, 1985, c 1 (5th Supp)) is available at: http://laws-lois.justice.gc.ca/eng/acts/I-3.3/index.html (last accessed 5 January 2012).

19 According to Duff *Tax Avoidance in the 21st century* at 496 available at: http://ssrn.com/abstract=1457453 (last accessed 29 November 2011), these measures reflect the more flexible and innovative regulatory strategies associated with theories of responsive regulation.

20 According to the CRA press release 'Revenue Minister John McCallum launches the Taxpayer Alert initiative' (14 November 2005) available at: http://news.gc.ca/web/article-eng.do;jsessionid=ac1b105330d8c0d2421c96e343199835c583901b80e9.e38RbhaLb3qNe38TaxuMa3uQa40?crtr.sj1D=&mthd=advSrch&crtr.mnthndVl=&nid=183049&crtr.dpt1D=&crtr.tp1D=&crtr.lc1D=&crtr.yrStrtVl=&crtr.kw=tax%2B&crtr.dyStrtVl=&crtr.aud1D=&crtr.mnthStrtVl=&crtr.yrndVl=&crtr.dyndVl= (last accessed 2 December 2011), this strategy targets taxpayers who feel compelled to participate in aggressive tax planning schemes.

21 *Per* the Université de Sherbrooke n 15 above at 39.

prevent taxpayers and advisers from pursuing other aggressive tax planning schemes, since the CRA is not necessarily able to identify all of them.[22]

Monitoring tools

Tax shelters

Section 237.1 of the ITA contains a definition for 'tax shelter' and was originally enacted in 1989 as an administrative provision.[23] Generally speaking, persons who promote the sale of a tax shelter and those who act as advisers in respect of such a sale must obtain a registration number from the tax administration before offering the investment for sale to potential investors.[24] The promoters must also maintain a list of purchasers, who, in

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22 *Id* at 40.

23 The section 237.1(1) definition of 'tax shelter' is as follows: '(a) a gifting arrangement described by paragraph (b) of the definition "gifting arrangement"; and (b) a gifting arrangement described by paragraph (a) of the definition "gifting arrangement", or a property (including any right to income) other than a flow-through share or a prescribed property, in respect of which it can reasonably be considered, having regard to statements or representations made or proposed to be made in connection with the gifting arrangement or the property, that, if a person were to enter into the gifting arrangement or acquire an interest in the property, at the end of a particular taxation year that ends within four years after the day on which the gifting arrangement is entered into or the interest is acquired, (i) the total of all amounts each of which is (A) an amount, or a loss in the case of a partnership interest, represented to be deductible in computing the person's income for the particular year or any preceding taxation year in respect of the gifting arrangement or the interest in the property (including, if the property is a right to income, an amount or loss in respect of that right that is stated or represented to be so deductible), or (B) any other amount stated or represented to be deemed under this Act to be paid on account of the person's tax payable, or to be deductible in computing the person's income, taxable income or tax payable under this Act, for the particular year or any preceding taxation year in respect of the gifting arrangement or the interest in the property, other than an amount so stated or represented that is included in computing a loss described in clause (A), would equal or exceed (ii) the amount, if any, by which (A) the cost to the person of the property acquired under the gifting arrangement, or of the interest in the property at the end of the particular year, determined without reference to section 143.2 would exceed (B) the total of all amounts each of which is the amount of any prescribed benefit that is expected to be received or enjoyed, directly or indirectly, in respect of the property acquired under the gifting arrangement, or of the interest in the property, by the person or another person with whom the person does not deal at arm's length.'

24 According to Wertschek & Wilson 'Shelter from the storm: the current state of the tax shelter rules in section 237.1' (2008) 56 *Canadian Tax Journal* at 286, the registration scheme was introduced in order to facilitate the effective audit of tax shelters by the CRA. The CRA was concerned that interests in tax shelters were being acquired by individual investors who were claiming significant tax deductions and were not normally subject to tax audits. In light of this, section 237.1 was enacted to facilitate the auditing of individual taxpayers who acquired an interest in a tax shelter, by requiring the promoter of the tax shelter, before selling or issuing any interests in the property, to 'pre-register' it and obtain an identification number.

order to claim the tax benefits, must file an information return along with their income tax returns, indicating the registration number of the investment.

Obtaining a registration number is merely an administrative formality, one that does not confirm the tax benefits.[25] However, promoters who do not obtain a registration number prior to the sale of the tax shelters are liable to a penalty of up to twenty-five per cent of the compensation that they may receive from the purchasers.[26] They are also liable to a fine of up to Canadian Dollars (CAD) 25 000 if they fail to file the prescribed form containing information on the purchasers.[27] Moreover, failure by the promoters to register a tax shelter may mean that the purchasers are unable to claim the tax benefits.[28]

In recent years the registration of tax shelters has enabled the tax administration to take steps to curb tax shelters. It should nonetheless be emphasised that, according to a report of the auditor general, the CRA does not automatically match the information provided by the promoters in the returns that they file with purchasers' income tax returns. The CRA is assessing the possibility of enhancing reliance on information returns in this respect to better manage risks related to tax shelters.[29]

Exchange of information

Tax information exchange agreements, as negotiated by Finance Canada, are used to reduce the ability of taxpayers to hide income and assets in overseas banks. Taxpayers must file information returns concerning their offshore

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25 Briefly, a 'tax benefit' is defined in section 245(1) of the ITA as 'a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act'. According to Cassidy 'To GAAR or not to GAAR – that is the question: Canadian and Australian attempts to combat tax avoidance' in (2004–2005) 36 *Ottawa Law Review* at 280, the notion of 'tax benefit' seems to be comprehensively defined to reflect any mode through which a benefit may be obtained through the Canadian tax regime, whether that be from the non-assessability of income, claiming deductions, rebates or credits that would otherwise be available, the avoidance of interest or penalties or the deferral of liabilities.

26 Subsection 237.1(7.4) of the ITA.

27 Subsection 238(1) of the ITA. Technically, the promoters could also be liable for a maximum prison sentence of twelve months.

28 Subsection 237.1(6.1) of the ITA.

29 Canada 'Chapter 3, "Canada Revenue Agency—verifying Income Tax returns of individuals and trusts"' *The 2005 November report of the Auditor General of Canada* (2005) at 3.34 available at: http://www.oag-bvg.gc.ca/internet/English/parl_oag_200511_03_e_14941.html (last accessed 2 January 2011).

transactions with the tax administration.[30] The Canadian parliament is seeking, among other things, to obtain additional information to better evaluate provisions in the ITA governing such transactions. Moreover, these information returns could deter taxpayers from implementing aggressive tax planning schemes.[31]

Although international information returns can prove useful in responding to concerns arising from the inappropriate transfer of income to tax havens, the quality of information contained in these reports may not always be of a sufficient level to properly assess the overall risks stemming from international transactions. In an attempt to enhance the quality of information and better control the integrity of data from these information forms, the auditor general of Canada recommended that the CRA implement the following steps:

- develop a risk assessment model to plan the audit of international issues of large corporations,
- evaluate the international tax risk in all large files that will be audited in a given year before developing the workload of the international auditors,
- use tools to screen for international issues to select small and medium companies for audit, and
- implement better controls over the integrity of data in the foreign reporting database.

The Organisation for Economic Cooperation and Development (OECD) Global Forum on Transparency and Exchange of Information for Tax Purposes has as its main output the peer review of its member and non-member jurisdictions.[32] The Global Forum notes that exchange of

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30 The Université de Sherbrooke n 15 above at 41–42 notes that information filings enable the tax administration to better target its audits. The following main information returns are identified: T106, Information return of non-arm's length transactions with non-residents; T1135, Foreign income verification statement; T1134-A, Information return relating to foreign affiliates that are not controlled foreign affiliates; T1134-B, Information return relating to controlled foreign affiliates; T1141, Information return in respect of transfers or loans to a non-resident trust; and T1142, Information return in respect of distributions from and indebtedness to a non-resident trust.

31 Canada 'Chapter 4, "Canada Customs and Revenue Agency—taxing international transactions of Canadian residents"' *The 2002 December report of the Auditor General of Canada* (2002) at 4.43 available at: http://www.oag-bvg.gc.ca/internet/English/parl_oag_200212_04_e_12398.html (last accessed 29 December 2011).

32 The original Global Forum was initially established in 2001 by OECD member countries and certain participating partners and has been a driving force behind the development of the international standard of transparency and exchange of information for tax purposes. The Global Forum now includes 105 member jurisdictions and the European

information requires the existence of an appropriate legal and regulatory framework.[33] Canada was found to have at least three elements in place, and was only required to improve certain aspects of the legal implementation of one of the elements (which was already in place).[34]

The efficacy of these measures also depends on the consequences for taxpayers who do not provide all of the information requested in the information returns. The penalties levied on taxpayers when they provide false information or omit to provide information can enhance the efficacy of these tools.[35]

The Voluntary Disclosures Program (VDP) allows taxpayers to come forward and correct inaccurate or incomplete information or disclose information they have not previously reported to the CRA. Taxpayers using the programme have to pay the taxes owing, plus interest, but may avoid penalties and prosecution relating to the amounts disclosed.[36] The programme saw growth in intake and an increase in the number of disclosures processed during the 2010/2011 tax year totalling CAD 600 million in additional tax revenue.[37]

Union.

33 In this regard, the peer reviews assess: the availability of information, in particular accounting, banking and ownership information; the access to information and powers to obtain it by the competent authorities, in particular without a domestic tax interest requirement, and without hurdles which would unduly delay information exchange; and whether exchange of information mechanisms (which generally are bilateral agreements, either Double Tax Conventions or Tax Information Exchange Agreements, multilateral conventions or, more rarely, unilateral domestic legislation) provide for effective exchange of information. See the OECD 'Report on Progress' (November 2011) at 30 available at: http://www.oecd.org/dataoecd/52/35/48981620.pdf (last accessed 4 January 2012).

34 *Id* at 35. The element highlighted in the report refers to ownership information.

35 Subsection 163(2.4) of the ITA. Briefly, these penalties correspond to the greater of CAD 24 000 and an amount equivalent to five per cent of the cost or value of the asset covered by the respective returns.

36 The CRA notes in its *Department Performance Report* (31 March 2011) at 31 available at: http://www.tbs-sct.gc.ca/dpr-rmr/2010-2011/inst/nar/nar00-eng.asp (last accessed 2 January 2012) that during 2010 to 2011, the programme was promoted through speaking engagements and other outreach initiatives, as well as increased references to VDP in their correspondence with taxpayers and in tax alerts. In addition, clarification of VDP policies was provided through presentations to various associations and responses to media enquiries.

37 *Ibid*. Although arguably a laudable effort by the CRA, it should be borne in mind that this programme is driven by taxpayers coming forward and therefore it is not possible to control either the number of taxpayers disclosing, or the associated unreported income.

Centres of expertise

In August 2005, the CRA set up eleven Centres of Expertise to strengthen and enhance its audit and collection programmes. These centres were established to pinpoint and better understand international tax avoidance and abusive international tax planning. They are located in Regional Tax Services Offices across Canada and bring together international tax administration auditors and tax avoidance officers.[38]

According to the CRA, a preventive monitoring strategy will enable it quickly to bolster its risk management and clearly and promptly indicate its position in respect of such risks, compared with monitoring operations conducted solely in conjunction with audits.[39] The CRA also participates in a number of groups that work to combat offshore abusive tax schemes, including the OECD, the Pacific Association of Tax Administrators (PATA),[40] the Joint International Tax Shelter Information Centre (JITSIC),[41] and the Seven Country Tax Haven Working Group.[42]

The CRA has a number of ongoing initiatives that focus on combating aspects of the abusive use of tax havens.[43] For example, they:

- identify promoters of aggressive tax planning schemes from information provided by treaty partners;
- identify Canadian beneficial owners of investment accounts that have been created under the names of entities located in tax havens;

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38 The CRA 'Aggressive international tax planning centres of expertise' (August 2005) available at: http://www.cra-arc.gc.ca/nwsrm/fctshts/2005/m08/050823-eng.html (last accessed 30 November 2011).

39 *Ibid*.

40 PATA is an inter-governmental organisation whose members include Australia, Canada, Japan and the USA. It seeks to provide guidance with respect to mutual agreement procedures and bilateral advance pricing arrangements. PATA information is available at: http://www.irs.gov/newsroom/article/0,,id=108024,00.html (last accessed 6 January 2012).

41 JITSIC is an example of international cooperation between national tax authorities (outside the OECD) in countering international cross-border tax arbitrage activities on a real time basis. JITSIC was established in May 2004 between the tax authorities of Australia, Canada, the UK and the USA, with the objective of supplementing 'the ongoing work of tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements and schemes'. JITSIC information is available at: http://www.irs.gov/businesses/international/article/0,,id=223291,00.html (last accessed 6 January 2012).

42 This group consists of Canada, the USA, Japan, Australia, Great Britain, France and Germany and primarily serves as a forum for these administrations to share best practices with regard to tax haven issues. Information is available at: http://www.cra-arc.gc.ca/E/pub/tg/rc4507/rc4507-09e.pdf (last accessed 6 January 2012).

43 CRA 'Using tax havens to avoid paying taxes worth the risk?' available at: http://www.cra-arc.gc.ca/E/pub/tg/rc4507/rc4507-09e.pdf (last accessed 6 January 2012).

- identify non-filers and non-compliant taxpayers who may be actively moving assets offshore to tax havens;
- access third-party information as it relates to offshore credit cards held by taxpayers;
- review investors who have previously participated in tax-shelter schemes; and
- are developing a systematic risk-assessment model to identify unregistered tax shelters.

Information requests during audit

Generally speaking, auditors in each tax office must detect the risks of tax avoidance in the files that they process. The auditors are divided into four main groups of taxpayers, *ie* big businesses, small and medium-sized enterprises, individuals, and charitable organisations.

The CRA tends to focus most of its audits on high-risk sectors, including aggressive tax planning schemes.[44] In this respect, the tax administration can develop tools to enhance the tracking of aggressive tax planning schemes during audits of a taxpayer's affairs.[45] This tracking will allow it more accurately to ascertain the additional information that it should obtain in order to apply the anti-avoidance rules. In addition to verifying the taxpayers' books, registers and information returns, the tax administration may demand that taxpayers and, as the case may be, advisers submit information to it on demand during an audit, subject to the application of the solicitor-client privilege concerning the information requested.[46]

More specifically, the Tax Avoidance Program, which encompasses the GAAR Committee, assists the auditors in identifying aggressive tax planning schemes during audits.[47] The auditors must submit their files involving aggressive tax planning schemes to the GAAR Committee, which then

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44 CRA *Annual Report to Parliament 2003-2004* at 31 and 34 available at: http://www.cra-arc.gc.ca/gncy/nnnl/2003-2004/prfrmnc-e/menu-eng.html (last accessed 18 December 2011).

45 The CRA has already put the following measures into place to bolster its capacity and ability to identify and combat abusive schemes that utilise offshore jurisdictions: an increased number of field auditors has been assigned to do both regular international audit work and targeted projects involving offshore jurisdictions; new legislation has been introduced to aid in addressing potentially abusive situations concerning non-resident trusts and foreign investment entities; and there has been an increase in staff training regarding the detection and identification of abusive schemes.

46 Subsection 232(1) of the ITA stipulates that this privilege applies to lawyers and notaries in Québec and to barristers and solicitors elsewhere in Canada.

47 *Per* Université de Sherbrooke n 15 above at 44.

formulates its recommendations to ensure uniform application of the GAAR.[48] These tools enable the tax administration to increase its chances of detecting aggressive tax planning schemes during audits and also allow it to make practical use of information derived from the preventive monitoring tools mentioned earlier, such as the Centres of Expertise and the JITSIC.

Audit requirements

The CRA is empowered to demand from taxpayers, or any other person, information that may prove relevant to the application of the law. Those who fail to comply with a requirement are liable to legal consequences ranging from monetary penalties to imprisonment.[49] The courts are called upon to ascertain the validity of a tax administration's request for information from the taxpayer or any other person.[50]

The courts are of the opinion that the auditors may ask taxpayers to file information located abroad concerning their aggressive tax planning scheme. They may also request information from any other person when this information is located in Canada, insofar as the information may be relevant in determining whether the planning scheme amounts to an abuse of the law.

When the tax administration audits a taxpayer's affairs, it may, in particular, demand that another person, such as another taxpayer or an adviser, provide information on the purposes that the person is pursuing in an aggressive tax planning scheme.[51] If the tax administration wishes to audit taxpayers who are not personally identified, but who are identifiable, it must obtain the court's authorisation to request that another person file information on aggressive tax planning schemes that concern the person.[52]

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48 A section of this programme is devoted to identification, detection and coordination in order to communicate the necessary legislative amendments to the Department of Finance. See Canada 'Chapter 11, "Revenue Canada – Combating Tax Avoidance"' *Report of the Auditor General of Canada* (May 1996) at 11.12 to 11.19 available at: www.oag-bvg.gc.ca/internet/.../parl_oag_199605_11_e_5042.html (last accessed 5 January 2011).

49 Parliament also established that a taxpayer residing in Canada may not submit in evidence before the courts information located abroad that he has not submitted on request to the tax administration. See also section 231.6(8) of the ITA.

50 Université de Sherbrooke n 15 above at 45 remarks that the tax administration may demand a person to provide any information that may prove relevant for the application and execution of the law, including the collection of an amount payable by a taxpayer. The tax administration must, however, be authorised by the courts to obtain from a person information concerning other persons that the tax administration cannot precisely identify, but who are nonetheless identifiable.

51 *Fraser Milner Casgrain LLP v Minister of National Revenue* 2002 DTC 7310 (FC).

52 *Redemeer Foundation v Minister of National Revenue* 2005 DTC 5617 (FC).

Following recommendations by the auditor general in 2002 that the CRA resort more extensively to requirements to file information located abroad, the auditors have focused more closely on the filing of information by taxpayers and advisers, whether such information is located in Canada or abroad.[53]

Pursuant to section 231.6 of the ITA, a taxpayer may not submit as evidence before the courts information located abroad that he has not submitted on request to the tax administration. However, the courts may nonetheless allow the taxpayers to submit the documents if the tax administration's request was unreasonable.[54]

Non-compliant persons will usually be subject to the monetary penalties stipulated by law. The taxpayers could, nonetheless, submit as evidence the information that was not filed with the tax administration in an attempt to overturn the application of the anti-avoidance rules, except if the information is located abroad.[55] In the latter instance, circumstances the courts would under exceptional circumstances allow the information to be submitted as evidence, in particular if this prohibition creates an injustice in respect of the taxpayer.[56] This may occur if the tax administration exercises its power in an abusive manner, in particular, if it demands the filing of a substantial volume of documents that are not reasonably identifiable.[57] It should be noted that in the case of *Glaxo SmithKline Inc v The* Queen[58] the court pointed out that the prohibition on submitting unfiled documents as evidence could, depending on the circumstances, undermine the taxpayers' right to a fair, impartial hearing in accordance with the principles of fundamental justice. Moreover, the tax administration may not obtain information that is protected by the solicitor-client privilege.

Audit programmes implemented by the CRA

Once a return has been filed, the CRA auditors conduct various reviews and verification and risk assessment activities to identify areas where reporting by individuals, trusts, registered plans and businesses are not consistent with

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53 See Canada n 29 above at 4.38 to 4.43. The CRA indicated that it was seeking to establish a process to facilitate recourse to this measure.

54 See *Saipem Luxembourg SV v Canada Customs and Revenue Agency* 2005 DTC 5348 (FCA).

55 *Per* Université de Sherbrooke n 15 above at 46.

56 *Glaxo SmithKline Inc v The Queen* 2003 DTC 5318 (TCC).

57 Université de Sherbrooke n 15 above at 47 succinctly remarks that the courts can hardly determine whether each of thousands of documents is subject to an information request.

58 *Glaxo SmithKline* case n 56 above.

taxpayers' obligations to report complete and accurate information. Once identified, they proceed to address the highest-risk accounts. Table 1 provides a summary of the audit programmes implemented by the CRA.[59]

TABLE 1: Audit programme implemented by the CRA

Programme	Population	Description	Success rate
Core Audit Program	Self-employed individual	Self-employed individuals are selected for a random sample audit. Businesses under-reporting CAD 5 000 or more in federal taxes are likely non-compliant to a significant degree.	Non-compliance rate • 2010/2011: 12.2 per cent. Previous reviews: • 2001/2002: 8.6 per cent • 2006/2007: 12.7 per cent
Research Audit Program	Small and Medium Enterprises (SME)#	Replaces the Core Audit Program. Conduct random audits that establish statistically valid levels of non-compliance for sectors of the Canadian economy	Implemented in 2011/2012. No results available yet
Large Business Program	Large Business	Risk levels are assessed using sector intelligence, CRA-based expertise and information from Canada' tax treaty partners. This is combined with information related to the nature of the business and its current and past behaviour (including aggressive tax planning).	Rate of changes made to assessments for 2010/2011: ninety-four per cent.
Special Enforcement Program	All	Focuses on taxpayers engaged in more serious acts of non-compliance. Conduct audits and undertake other civil enforcement actions against individuals and businesses known to be or suspected of deriving income from illegal activities.	See 'Criminal Investigations Program' below

59 Table 1 is based on information contained in the CRA Department Performance Report n 36 above at 33–35.

Criminal Investigations Program	All	Deals with suspected significant cases of fraudulent non-compliance. Investigates and refers cases for prosecution to the Public Prosecution Service of Canada.	In 2010/2011, 204 taxpayers were convicted of tax evasion or fraud
Full Time Equivalent (FTE)	CRA Employees	New performance measure aimed at measuring the effectiveness of the CRA's actions in obtaining fiscal impact per employee. This will highlight the value of the CRA's auditing function. Each audit FTE is responsible for addressing an average of: • Large business: CAD 2.9 million • SME and others: CAD 400 000	Implemented in 2011/2012. No results available yet .

#The CRA defines small business audits to include owner-operated businesses, small corporations and partnerships that have revenues of less than CAD 1 million. Medium-sized business audits typically include individuals with annual revenues over CAD 1 million and corporations with annual revenues between CAD 1 million and CAD 20 million for income tax.

Mutual administrative assistance

CRA auditors may resort to the information exchange mechanisms stipulated in tax treaties in order to collect information on international tax planning schemes. It should be noted that the signing by Canada in April 2004 of the *Convention on Mutual Administrative Assistance in Tax Matters* affords auditors an additional tool to obtain relevant information on aggressive tax planning schemes when they audit a taxpayer's affairs, mainly in the case of multinationals.[60]

The aforementioned Convention was developed jointly by the Council of Europe and the OECD in 1988 and facilitates international cooperation for enhanced operation of national tax laws, while respecting the fundamental

60 CRA press release 'Canada signs international tax Convention' (29 April 2004) available at: http://www.cra-arc.gc.ca/nwsrm/rlss/2004/m04/0429ttw-eng.html (last accessed 3 January 2012). Under the Convention, participating countries benefit from three forms of administrative assistance: the exchange of information, assistance in the collection of taxes and delivery of documents.

rights of taxpayers. It thus makes provision for all possible forms of administrative cooperation between states in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. This cooperation ranges from exchange of information, including automatic exchanges, to the recovery of foreign tax claims.[61]

Tax information exchange agreements, negotiated by Finance Canada, are also often used to reduce the ability of taxpayers to hide income and assets in overseas banks. Over the years, Canada has worked hard to update and establish tax agreements and treaties with various countries.[62]

Solicitor-client privilege

The Canadian parliament recognises the existence of solicitor-client privilege in respect of communications between clients and lawyers.[63] Taxpayers and their legal advisers may invoke the application of professional privilege when faced with requests from the tax administration to file information. The courts must judge whether the information requested by the tax administration concerning aggressive tax planning schemes is protected by solicitor-client privilege. As is presently the case, taxpayers do not have to submit the information to the tax administration.[64]

Although solicitor-client privilege can be considered a basic legal right in all legal fields, it appears to be something of a misnomer in Canada.

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61 *Per* the OECD Centre for Tax Policy and Administration 'Convention on mutual administrative assistance in tax matters' (November 2011) available at: http://www.oecd.org/document/14/0,3746,en_2649_33767_2489998_1_1_1_1,00.html (last accessed 5 January 2012). The Convention was subsequently amended by a Protocol to bring it in line with the international standard on exchange of information for tax purposes and to open it up to all countries (previously, it was only open to members of the OECD and the Council of Europe). During the G20 Summit in France in November 2011, all G20 countries signed the Convention. The Convention had already been signed by twenty-one countries: Belgium, Denmark, Finland, France, Georgia, Iceland, Ireland, Italy, Korea, Mexico, Moldova, the Netherlands, Norway, Poland, Portugal, Slovenia, Spain, Sweden, Ukraine, the UK and the USA.

62 The Canadian Department of Finance regularly posts the latest developments regarding the status of international tax treaty negotiations. Canada currently has eighty-nine tax treaties in force, notably protocols signed with Switzerland, South Africa, the United Kingdom, France and Australia. The complete list of tax treaties (those in force, those signed but not in force and those under negotiation) is available at: http://www.fin.gc.ca/treaties-conventions/treatystatus_-eng.asp (last accessed 5 January 2012).

63 See section 232 of the ITA. Université de Sherbrooke n 15 above at 48 explains that pursuant to this privilege, a person could refuse to disclose an oral or written communication on the grounds that it is a confidential communication between the person and his lawyer.

64 *Ibid*.

Conceptually, a privilege is distinct from a right and is triggered only when information covered by it is sought in litigation.[65] If there is no litigation, there is no privilege to invoke, and one is left with other common law remedies to prevent or compensate for disclosure.[66]

Although it began in Canada as a privilege, solicitor-client privilege has developed into a right which can be asserted even in the absence of legal proceedings.[67] It seeks, among other things, to enable individuals to exercise their rights, especially in complex fields such as taxation, and facilitate the administration of justice.

This privilege will only be lifted if it is necessary to do so to hand down a fair ruling and the benefits stemming from it are greater than the permanent injury that the person entitled to it would sustain.[68] It will only give way to other basic social values or an urgent public interest, *eg* in criminal or public security matters. In tax matters, the courts have lifted the privilege in the case of tax fraud and criminal or illegal acts.[69] However, aggressive tax planning schemes cannot necessarily be likened to illegal or fraudulent activities. There is therefore a possibility that this privilege applies to communications focusing on aggressive tax planning schemes.[70]

Moreover, the courts have recognised that professional privilege may be lifted in circumstances other than criminal ones, *eg* in the case of abuse or misuse of process in civil matters to achieve an improper purpose.[71] The question that remains is whether the courts may apply such reasoning in the realm of aggressive tax planning schemes.

It should be noted that in the case of tax matters, the courts have refused to extend the solicitor-client privilege to advisers other than lawyers, in

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65 According to AM Dodek 'Reconceiving solicitor-client privilege' (2010) 35 *Queen's LJ* at 497. As an evidentiary concept, a privilege allows a litigant to resist the introduction of otherwise admissible evidence in court proceedings. He further explains that, while a privilege may be asserted outside the courtroom, for example in the course of discovery, the touchstone of a privilege is the connection between litigation and the 'privileged' information. Information that is protected by a privilege is protected from disclosure in the course of legal proceedings.

66 *Id* at 498. These common law remedies include actions for breach of confidence or breach of fiduciary duty.

67 *Ibid*.

68 See *R v McClure* [2001] 1 SCR 445.

69 Université de Sherbrooke n 15 above at 48.

70 *Ibid*.

71 *Id* at 49.

particular to accountants. These advisers may have to file with the tax administration information in their possession concerning aggressive tax planning schemes. Consequently, taxpayers and other advisers may be inclined to solicit the participation of legal advisers from the outset in the elaboration of aggressive tax planning schemes. This privilege gives lawyers a competitive advantage over other professionals providing similar services who do not have the marketing advantage of the privilege.[72]

Administrative penalties

Canadian taxpayers are liable to a penalty when they voluntarily, or under circumstances equivalent to gross negligence, make a false declaration or an omission in their income tax return.[73] Briefly, this penalty equals fifty per cent of the tax under-stated because of the false declaration or the omission. The tax administration must justify the imposition of the penalty before the courts when the taxpayers challenge it.

The question arises as to whether the tax administration may contemplate applying this penalty to taxpayers participating in aggressive tax planning schemes. One could also question whether taxpayers could defend themselves by alleging the complexity of the law or by relying on the opinion of an adviser.[74]

Third parties may also be subject to penalties if they transmit misleading information in tax matters. The CRA states that the objective of third-party civil penalties is to deter third parties from making false statements or omissions in relation to income tax or goods and services tax/harmonised sales tax (GST/HST) matters.[75] Prior to the implementation in 2000 of third-party civil penalties, no provision was made for an administrative penalty in respect of individuals who advised other individuals to file their income tax

[72] Dodek n 65 above at 519 provides two examples where lawyers may use the privilege as a competitive advantage: one is in the area of tax, where they compete with accountants, and the second is when they generally compete with paralegals.

[73] Section 163 of the ITA.

[74] In this respect, it is noteworthy that the courts have already taken into consideration a taxpayer's lack of expertise in tax matters to lift a penalty (see *Harris v The Queen* 2005 DTC 1179 (TCC.)). The courts have also already given the benefit of the doubt to taxpayers when they have acted in good faith according to the advice or recommendations of tax advisers (see *Julian v The Queen* (May 11, 2005), No 2003-2947(IT) I (TCC); *Pilon v The Queen* 2005 DTC 504 (TCC)).

[75] Per the CRA's 'Third-party civil penalties' *Information Circular IC 01–1* (18 September 2001) at par 3 available at: http://www.cra-arc.gc.ca/E/pub/tp/ic01-1/README.html (last accessed 28 December 2011). These penalties are directed at ensuring tax compliance by deterring behaviour that results in non-compliance.

returns using false or misleading data or who turned a blind eye to false data provided by their clients for tax purposes. The penalty is CAD 1 000 or, as the case may be, the amounts that the adviser may collect in respect of the planning scheme.[76]

The provisions pertaining to these penalties do not stipulate precise parameters by which to determine whether a tax opinion concluding that the anti-avoidance rules may not apply can be considered a false declaration or reckless disregard in respect of the law. The advisers may then provide a minimally reasonable position to support an aggressive tax planning scheme, based on the terms of the law, and thus minimise the risks to which they and their clients expose themselves by implementing a planning scheme.

It should be noted that the CRA does not make provision for the application of penalties to advisers who participate in planning schemes covered by the general anti-avoidance rule, unless they have submitted false declarations or their opinion contradicts the established jurisprudence.[77] In the absence of the application of the penalty, its deterrent effect from the standpoint of aggressive tax planning schemes is mitigated.[78]

The next part of the article will evaluate South Africa's administrative approach against the measures adopted by Canada.

ADMINISTRATIVE APPROACH OF SOUTH AFRICA

The problem of impermissible tax avoidance in South Africa has been exacerbated by the impact of global forces, such as globalisation, increasing deregulation, particularly in the financial markets, and rapid advances in computer and telecommunications technology, as well as a number of local factors. These include the major changes that have been made to the South African income tax system over the past few years, including the shift from source- to residency-based taxation, the concomitant enactment of new CFC rules, the introduction of a new tax on capital gains, and the adoption of new company restructuring rules.[79]

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76 *Id* at par 8 and par 10.

77 *Id* at par 77. The reason for this is that the GAAR applies only if an arrangement is otherwise technically effective. This means that the particular filing position is based on true statements rather than false statements. Thus, the penalties cannot apply.

78 *Per* Université de Sherbrooke n 15 above at 29.

79 *Per* SARS *Discussion paper* n 3 at 8. At worst, the very complexity of some of these new provisions can interfere with legitimate business transactions, while in some cases actually creating new opportunities for misconduct.

Simultaneously, advances in computer and telecommunication technology have radically transformed the way in which multinational firms, particularly multinational accounting firms, can share and exchange information. As a result, new tax avoidance schemes that are developed in the United Kingdom or the United States of America can now migrate to South Africa almost immediately, for all practical purposes, rather than taking months, if not years to do so, as may have been the case in the past.[80]

SARS believes that non-compliance is most meaningfully dealt with by addressing its root causes and strengthening the factors that promote compliance.[81] Non-compliance may be due to ignorance, inability or intent. Each of these non-compliance elements may have legal, economic, regulatory, system or behavioural drivers.[82] Because of this complexity, it is necessary to determine the root causes of the non-compliance with precision in order to determine the most effective action to address the non-compliance. SARS acknowledges that inappropriate responses may exacerbate non-compliance rather than reduce it.

SARS' compliance model is premised on three necessary components to encourage desired taxpayer and trader behaviour:[83]
- Taxpayers must know what is expected of them and how to comply (Education);
- SARS must make it as easy and as cost effective as possible for taxpayers to be compliant (Service); and
- SARS must ensure that there is a credible and visible ability to detect and punish non-compliance (Enforcement).

Non-compliance is addressed through a range of educational, service, deterrence or fool-proofing measures. One key element of deterrence is

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80 *Ibid*. This, according to SARS, effectively puts them (SARS) on the front line with the most advanced tax administrations in the world in combating these schemes.

81 SARS *Strategic Plan 2011/12 – 2013/14* at 23 available at: http://www.sars.gov.za/home.asp?pid=286 (last accessed 5 January 2012). SARS envisages a necessary and essential role for taxpayer education, enhancements to taxpayer services and enforcement interventions in mitigating causes of non-compliance and encouraging taxpayer compliance.

82 *Ibid*.

83 SARS *Annual Report 2010/2011* at 20 available at: http://www.sars.gov.za/home.asp?pid=286 (last accessed 4 January 2012). Tax compliance is measured across all steps of the SARS value chain, from registration to filing declaration and payment. Through the successful application and implementation of SARS' compliance initiatives, the overall SARS tax and trader register reflects an average positive growth of forty-eight per cent.

effective detection of non-compliance. In order to be cost effective in bringing about greater compliance, SARS focuses on high risk areas with minimal intervention in low risk areas. In order to bring about precision in this focus, emphasis is placed on being data-rich and on being able to model compliance effectively.[84]

- SARS has effected the following changes in order to increase compliance:[85] Building a reality of *fiscal citizenship* whereby all South African employees and businesses operating in South Africa are included in the scope of SARS' view, even if at any particular point in time they are not eligible to pay tax or submit returns. This also includes building a relationship with all South Africans to educate them on the importance of their tax contribution.
- Shifting from an ineffectual gate-keeping approach to a *focused risk management approach* to compliance. This involves focusing enforcement activity on areas of highest risk, while automating areas of lower risk by increasing access to third party data and by increasing third party validation of declarations.
- Becoming *data and information rich*. This will assist in identifying trends and specifics of non-compliance. Through the pre-population of declarations from third party data, it is possible to reduce the opportunity for false or inaccurate declarations.
- Moving from a transactional to an *economic view* of the taxpayer/trader. SARS will be able to detect inaccuracies in declarations as well as identify those who have attempted to remain outside the tax net, but at the same time provide a more appropriate service.
- Focusing *enforcement activity* more effectively on cases of highest risk and proportionalising the level of enforcement activity to the scale of the risk.

Awareness resources

SARS' Legal and Policy Division aims to develop and maintain a sound tax knowledge-base by issuing tax guides and brochures for relevant stakeholders. This promotes the transfer of tax and customs information and

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84 SARS *Strategic Plan* n 81 above at 24. SARS elaborates on their strategic plan by explaining that deterrent and enforcement action requires a combination of coverage (the need to ensure sufficient likelihood of detection of non-compliance), depth (sufficient thoroughness where necessary to detect the full extent of non-compliance) and leverage (utilisation of the detection of non-compliance to encourage other non-compliers to become compliant).

85 *Id* at 24–25.

relevant skills to various stakeholders.[86] SARS conducted a review of the previous GAAR provision of section 103(1) of the Act. It was found that it had not kept pace with the times and that improvements were possible based on both domestic and international experience. Accordingly, SARS released a discussion paper on tax avoidance and section 103(1) of the Act in November 2005. The release of the discussion paper prompted a 'healthy and constructive' debate, with a wide variety of views on the issues raised by the discussion paper.[87]

Thereafter, when the GAAR provisions of section 103(1) were repealed and replaced by sections 80A to 80L during 2006, SARS subsequently issued a '*Draft Comprehensive Guide to the General Anti-Avoidance Rule*' on 13 December 2010 after which public comments were invited. As a corollary, when the reportable arrangements provisions were amended, a revised '*Draft Guide to Reportable Arrangements*' was released for public comment on 31 March 2010.

Neither of the two draft guides has been issued in its final format and no response documents to the latest rounds of public commentary have yet been released by SARS. Therefore, more than a year after the release of the draft GAAR guide, and nearly two years after the release of the draft RA guide, there are still no finalised, updated guides available to address the 'new' anti-avoidance legislation.

Monitoring tools

SARS acknowledges that the use of tax havens has become an integral part of the tax abuse strategy employed by many individual taxpayers, as well as multinational companies. The use of tax havens has become wide-spread and today tax havens serve all the major financial and commercial hubs.[88]

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86 SARS *Annual Report 2005/2006* at 73 available at: http://www.sars.gov.za/home.asp?pid=286 (last accessed 4 January 2012).

87 *Id* at 60.

88 A remark made by the Commissioner of SARS in 'Drawing distinctions between tax havens and genuine attempts to offer tax incentives or attracting foreign investment to stimulate national economic development' at the African Tax Administration Forum (ATAF) 1st General Assembly in Mauritius (25 July 2011) at 2 available at: http://www.sars.gov.za/home.asp?pid=4&cx=009878640050894574201%3Aku-btv50zym&cof=FORID%3A10%3BNB%3A1&ie=UTF-8&q=ataf&sa= (last accessed 5 January 2012). He further observed that there is 'little political appetite … to regulate tax havens, coupled with a lack of monetary and fiscal policy and acerbated by complete administrative stonewalling which is intentional in its design and purpose to promote and ensure that advantages are retained despite changing international regulation and attitudes.'

SARS' tax shelters sub-division actively monitors tax avoidance schemes through its relationships with other SARS business units and the reportable arrangements legislation. These schemes are analysed, research is conducted into their effect, and assistance is provided in countering them.[89]

Arguably one of the most effective weapons in SARS' arsenal against offshore tax shelters was the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003.[90] Violators were given the opportunity to regularise their affairs in respect of their foreign assets for the 2003 year of assessment. As a result of this tax amnesty, South Africa's tax base appears to have been extended.[91]

As part of a global push to clamp down on tax havens, SARS has signed a watershed agreement with Guernsey, Cayman Islands, Bermuda, Jersey, the Bahamas and San Marino which will oblige these countries to hand over any information SARS requires.[92] The *Exchange of Information Relating to Tax Matters* agreement also rules out the possibility of the required information being refused because the conduct being investigated is not a crime in the so-called tax haven.[93]

SARS and the South African Reserve Bank (SARB) operated a Voluntary Disclosure Programme (VDP) from 1 November 2010 to 31 October 2011.[94] As regards the tax VDP, successful applicants were granted relief in terms of reduced interest and penalties, while the exchange control VDP offered

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89 SARS *Annual Report 2005/2006* n 86 at 72.

90 *Per* Oguttu n 10 above at 52.

91 Treasury collected about R2.3 billion in taxes from these amnesty applications. See Treasury, available at: http://www.treasury.gov.za/documents/mtbps/2003/Chapter%204.pdf (last accessed 6 January 2012).

92 Lund 'SARS blocks tax havens' (4 August 2010) available at: http://www.fin24.com/Economy/Sars-unlocks-tax-havens-20100804 (last accessed 6 January 2012) states that SARS merely has to ask and, according to the agreements, information 'shall' be provided for relevant determinations, investigations and enforcement.

93 For an updated list of 'tax information exchange agreements and mutual administrative assistance agreements', see SARS, available at: http://www.sars.gov.za/home.asp?pid=53079 (last accessed 6 January 2012).

94 The tax VDP was implemented in terms of the Voluntary Disclosure Programme and Taxation Laws Second Amendment Act 8 of 2010. The Exchange Control VDP was implemented in terms of the regulations issued under section 9 of the Currency and Exchanges Act 9 of 1933, as amended, and applied by the Financial Surveillance Department (or VDP Division) of the SARB.

successful applicants administrative relief.[95]

The Financial Intelligence Centre has also been involved as it administers the Financial Intelligence Centre Act (FICA),[96] which regulates the reporting obligations of advisers who act as intermediaries for applicants applying for the tax VDP and/or exchange control VDP.

The VDP is an internationally accepted mechanism to broaden compliance with tax and exchange control requirements. It flows from efforts around the globe to end bank secrecy and recognises the greater access to information enjoyed by SARS both domestically and internationally. In both domestic and international cases, successful applicants may also avoid possible criminal prosecution.[97] The OECD avers that a successful VDP programme will:[98]

- be clear about its aims and its terms;
- have a demonstrable and cost-effective increase in short term revenues;
- be consistent with the generally applicable compliance and enforcement regime;
- be required to specifically improve levels of compliance among the population eligible for the programme; and
- place the short-term boost to revenues in the context of improving compliance across the taxpayer population as a whole by complementing it with measures that improve compliance in the medium term.

It is not yet clear how successful the South African VDP has been in light of the abovementioned OECD characteristics.[99] There also appears to be some

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95 The exchange control VDP offered an opportunity to South African residents (including former South African residents) to regularise their exchange control affairs by making a voluntary disclosure to the SARB of contraventions of the provisions of the regulations, including the direct and/or indirect ownership of any unauthorised foreign asset(s) and/or structure(s) of whatever nature, excluding bearer instruments.

96 Act 38 of 2001.

97 SARS and the SARB 'Guide to the tax and exchange control voluntary disclosure programme 2010' (27 October 2010) available at: http://www.sars.gov.za/home.asp?pid=63327 (last accessed 7 January 2012).

98 The OECD draws upon the experience of countries who have implemented a voluntary disclosure programme (including, amongst others, Canada, the UK and South Africa). It identifies principles for reconciling those tensions in designing a successful offshore voluntary compliance programme as part of a wider tax compliance strategy in its guide 'Offshore voluntary disclosure: comparative analysis, guidance and policy advice' (September 2010) available at: http://www.oecd.org/dataoecd/60/31/46244704.pdf at 11-14 (last accessed 22 December 2011).

99 By 21 October 2011, SARS had received nearly 6 000 applications from businesses and individuals who applied for relief from penalties and interest on their outstanding tax. See 'Few days left for tax defaulters to come clean: SARS' available at:

confusion as to whether the VDP contemplated in sections 225 to 233 of the TAA is the same as the previous VDP. It would appear that the relief offered under the permanent VDP contemplated in the TAA is not as favourable and does not cover all taxes, as customs and excise duties are excluded. However, taxpayers will be entitled to disclose all defaults and will not be limited to defaults before a prescribed date. Under the TAA VDP, SARS will not pursue criminal prosecution against the taxpayer and certain penalties imposed under the TAA, excluding penalties imposed for the late submission of a return or for the late payment of tax, may be waived by SARS.[100]

Due to the current global economic context, the G20 has placed specific emphasis on the importance of enhanced international cooperation amongst revenue authorities, as cross border tax avoidance and evasion have become easier with the liberalisation of financial markets. To this end, SARS signed the Convention on Mutual Administrative Assistance in Tax Matters at the G20 Summit in France in November 2011.[101]

Audits

In 2005 SARS established a sound working relationship in accordance with chapters 71 and 73 of the Prevention of Organised Crime Act with the Asset Forfeiture Unit and the Financial Intelligence Centre.[102]

The enforcement function of SARS comprises a variety of activities, ranging from targeted campaigns and proactive enforcement checks, to investigations, sanctions and, ultimately, prosecution. Enforcement is divided into four functional sections: audit, debt management (collection of money owed and management of the debt book), collection of outstanding returns,

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http://www.sabc.co.za/news/a/86ef650048c51f9bbceafe55598b330f/Few-days-left-for-tax-defaulters-to-come-clean:-SARS-20111021 (last accessed 8 January 2012).

100 *Per* Cliffe Dekker Hofmeyr 'Final date for VDP applications drawing near' (3 October 2011) available at: http://www.polity.org.za/article/final-date-for-vdp-applications-drawing-near-2011-10-03 (last accessed 8 January 2012). The taxpayer will, however, still be liable for the outstanding interest amount, which may be significant if the taxes involved have been outstanding for a number of years.

101 SARS Media Statement 'Signing of the Convention on mutual administrative assistance at the G20 Summit' (4 November 2011) available at: http://www.sars.gov.za/home.asp?PID=65442&ToolID=2&ItemID=73089 (last accessed 5 January 2012). See also G20 n 61 above.

102 *SARS Annual Report 2005/2006* n 86 above at 75. The premise of this relationship is that if an individual or company is being investigated, there are invariably non-compliance, tax evasion or tax avoidance implications.

and criminal investigations.[103]

The total audit cases completed for the 2010/2011 tax year amounted to 79 631, which is two per cent above the annual target of 78 000. Investigative audits also increased from 5 629 cases in 2009/2010 to 6 472 cases in 2010/2011. The hit rate on investigative audits for 2010/11 was eighty-three per cent against the annual target of seventy-five per cent.[104] The audit approach used was one of an equitable coverage model in respect of segments, tax types, sectors, types of non-compliance and geographical areas. This allowed a risk-based approach to audit case selection.[105] Audit yield is measured through cash collected on assessments raised plus reduced refunds (or savings). The 2010/2011 achievement of R3.9 billion – thirty-two per cent above target – was largely due to a major emphasis on Value-added Tax (VAT) refunds due to an increase in fraudulent transactions detected.[106]

South African tax practitioners have been largely unregulated for years. However, since the introduction of section 76A into the Act in 2005, every natural person is required to register as a tax practitioner if he or she has provided tax advice, completed tax forms, or provided assistance therewith.[107] Thereafter, the South African Institute of Tax Practitioners (SAIT) was established as a professional association of tax practitioners. A draft Tax Practitioners Bill was released in 2007 for public comment. The draft bill was subsequently revised and reissued as the Regulation of Tax Practitioners Bill during July 2008. SARS' endeavours to tighten the regulatory control of tax practitioners is indeed one way of achieving increased revenue collections and increasing the tax base.

It should be cautioned that where an accountant provides tax advice (including advice on the structuring of arrangements that may fall within the ambit of the reportable arrangements provisions), such advice is not

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103 *Id* at 46. According to SARS, the grouping together of these functions in enforcement centres across the country has enabled a more integrated view of taxpayers and resulted in sharpened enforcement skills and cross-functional synergy in administering revenue laws.

104 According to *SARS Annual Report 2010/2011* n 83 above at 22, these achievements are attributed to improved case selection, use of audit tools (including computer assisted audit techniques) and hiring of top-end auditors for improved governance.

105 *Ibid*.

106 *Id* at 23.

107 Section 75 of the Act was subsequently amended, thereby making it an offence for a person who is required to register, to fail to register as a tax practitioner with SARS. On conviction, that person may be subject to a fine or imprisonment.

protected in South Africa by legal professional privilege.[108] It should further be noted that the TAA currently does not contain a provision extending legal professional privilege to accountants who act as tax advisors.[109] It was suggested that the TAA should extend legal professional privilege to all tax practitioners, including non-lawyer tax practitioners, such as accountants.[110] However, SARS' view on the issue is that, as is the case in Germany, the USA and (if a limited privilege is extended in that country) Australia, a prerequisite for considering the extension of privilege in tax matters to non-lawyers is that the tax practitioners are regulated, not by self-constituted professional bodies, but by law.[111] Accordingly, SARS recommended that the matter rather be dealt with when the Regulation of Tax Practitioners Bill is enacted.

Administrative penalties

In addition to these compliance strategies and in order to ensure consistency in compliance behaviour, SARS is increasingly using administrative penalties to deter administrative non-compliance. The administrative penalty regime was revamped to introduce the concept of proportionality, *ie* the penalty amount levied on non-compliant taxpayers and traders would be in proportion to the degree of the transgression.[112]

Administrative penalties for non-compliance came into effect from 1 January 2009 in terms of section 75B of the Act, whereby taxpayers are charged a fixed or percentage-based penalty for not complying with their tax obligations. Chapter 15 of the TAA distinguishes between administrative penalties which are imposed for particular forms of non-compliance which

[108] Edward Nathan Sonnenbergs 'Seeking to extend legal professional privilege' (10 October 2011) available at: http://www.ens.co.za/images/news/10_10_11%2001%2001lr1010LAW_AL_11.pdf (last accessed 29 November 2011) contends that, if called on by SARS, such advice would (on the face of it) be required to be supplied to SARS. This could place attorneys and advocates in a preferential position in advising clients on tax matters.

[109] Although the TAA deals with privilege in section 64, it only refers to privilege as it currently stands. Accordingly, unless the TAA is amended, the *status quo* will remain.

[110] Cliffe Dekker Hofmeyr 'Tax Alert' (30 September 2011) at 3 available at: http://www.cliffedekkerhofmeyr.com/news/files/CDH-Tax-Alert-30-September-2011.pdf (last accessed 8 January 2012).

[111] Standing Committee on Finance 'Report-back hearings on Tax Administration Bill' *Response Document* (21 September 2011) at 6 available at: http://www.sars.gov.za/home.asp?pid=2635 (last accessed 8 January 2012).

[112] *Per* SARS *Annual Report 2010/2011* n 83 above at 41. Under this new penalty regime, penalties range between R250 to R16 000, and the penalty amount would escalate based on the time period taken for the taxpayer or trader to move from being non-compliant to being fully compliant.

have not been criminalised, and penalties by way of a fine or imprisonment for criminal offences which are dealt with in chapter 17. Criminal offences relating to tax evasion are separately provided for in section 235.[113]

In addition, the system whereby penalties are levied on non-compliant taxpayers and traders was also automated. The South African public was regularly informed of the impending changes to the penalty regime, through various media releases and statements released by SARS. During the 2010/2011 financial year, a total of 80 886 taxpayers against whom SARS levied administrative penalties, subsequently submitted their outstanding returns. This also amounted to financial gain of approximately R191,7 million in penalties.[114]

RECOMMENDATIONS

The International Monetary Fund (IMF) notes that improving tax compliance requires long-term reform efforts, beginning with strengthening the organisation and management of the revenue agency, implementing robust collection systems, and building capacity in core tax administration functions.[115]

A taxpayer *compliance programme* is a high level plan which brings together in a single document a description of the most significant compliance risks identified in the tax system and sets out the broad detail of how the revenue agency intends to respond to those risks. These programmes are, briefly:[116] *Taxpayer education and assistance* programmes – help taxpayers and their advisors to understand their obligations and entitlements (taxpayers cannot comply if they do not understand the tax laws and procedures). *Simple laws and procedures* – make it easier and less expensive for taxpayers to comply

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113 PWC 'Additional tax, administrative penalties and criminal penalties' *Synopsis Tax Today* (September 2011) at 5 available at: http://www.pwc.co.za/en/assets/pdf/Synopsis-September-2011.pdf (last accessed 8 January 2012).

114 *Per* SARS *Annual Report 2010/2011* n 83 above at 21. In addition to this, 46 939 taxpayers had submitted returns, but had not paid the penalties at this time. In the case of taxpayers who did not advise SARS of their change of address and who fall into the pool of taxpayers who have outstanding returns for 2007, 2008 and 2009, an additional administrative penalty was levied for the non-compliance.

115 Russel 'Revenue administration: developing a taxpayer compliance program' *IMF technical notes and manuals* (November 2010) at 1 available at: http://www.imf.org/external/pubs/ft/tnm/2010/tnm1017.pdf (last accessed 7 January 2012).

116 *Id* at 2. The purpose of a taxpayer compliance programme is therefore to identify and respond to the most significant risks in the tax system through a range of measures aimed at the underlying causes of the noncompliant behaviour. The objective is to achieve the widest possible impact on voluntary compliance across the taxpayer population.

with their obligations and access their entitlements (taxpayers may not voluntarily comply if the tax system itself makes it too difficult or too expensive for them to meet their obligations).
Risk-based verification programmes – create a downside to poor compliance behaviour by detecting and deterring non-compliance through the use of risk management approaches (taxpayers are more likely to comply if they perceive a strong chance of detection and see blatant non-compliers being brought to account).

A comparison of the CRA's and SARS' administrative approaches reveals that, despite creditable efforts by SARS to combat tax avoidance, a number of issues have to be resolved by SARS in order to augment its compliance programme.

As regards the first administrative tool, that of awareness resources, SARS appears to fall somewhat short in its efforts to educate and provide guidance on the application of its anti-avoidance provisions. It is incumbent upon SARS to issue accurate guides which are finalised and properly updated. As a corollary, SARS should take into consideration public commentary received on these guides by timeously issuing response documents which adequately address queries and concerns raised by industry role-players.

In the case of monitoring tools, it is not yet possible to evaluate the success of the South African VDP in light of the OECD's recommendations. However, despite the fact that the VDP success rate has not yet been established, the 2011 tax statistics indicates that the number of individuals registered for income tax has increased significantly from 5,9 million in 2009/2010 to over 10,3 million in 2010/2011.[117] SARS should be commended for this increase in the tax base as well as its commitment towards the exchange of information by signing the Convention of Mutual Administrative Assistance in Tax Matters.[118]

The 2011 tax statistics suggests that SARS' audit efforts are on par with those of Canada's. The R674,2 billion tax revenue collected was R2 billion higher than the revised estimate set in the February 2011 budget. The cost of revenue collection, which is an important indicator of the efficiency of a

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117 *Per* National Treasury *2011 Tax Statistics* (23 February 2012) at 2 available at: http://www.treasury.gov.za/publications/tax%20statistics/2011/ (last accessed 22 March 2012). The latest available tax statistics, in the form of a joint publication by National Treasury and SARS, covers the tax periods from 2006/2007 to 2010/2011.

118 See SARS n 101 above.

revenue administration, has also improved by decreasing from 1,2 per cent to 1,1 per cent.[119] The finalisation of the TAA is eagerly awaited and is expected to further increase regulatory control of tax practitioners and consequently to improve tax compliance. It is also recommended that SARS appropriately addresses the concerns surrounding legal professional privilege and non-lawyer tax practitioners.

SARS' revamp of its administrative penalties, the last of the tools to be evaluated, has seemingly reaped rewards. The 2011 tax statistics report a rather dramatic increase of compliance in filing from fifty-eight per cent in 2008/2009 to eighty-one per cent in 2010/2011.[120] However, SARS' compliance rate is slightly lower than the CRA's reported eighty-eight per cent.[121] Along with the promulgation of the TAA, the penalty regime could prove as effective as that of Canada's.

CONCLUSION

In addition to the domestic initiatives discussed above (*viz* awareness resources, monitoring tools, audits and administrative penalties) revenue authorities have also embarked on international joint initiatives, cooperating with other revenue authorities to address tax avoidance arrangements involving more than one jurisdiction.

Whether these measures are fully adequate to address the problem of tax avoidance in the 21st century, however, remains uncertain. In the meantime, SARS would do well to continue with the development of a cogent compliance program, bearing in mind the OECD and IMF suggestions for improving tax compliance. Ultimately, SARS could benefit from remaining abreast of propitious anti-avoidance measures undertaken by efficient tax administrations, such as Canada, in combating impermissible tax avoidance.

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119 National Treasury n 117 above at 1.
120 *Id* at 26.
121 The Core Audit Program's success rate is reported in Table 1 above.