

Business Law & Tax Review

TAX BITES

SARS' lifestyle audits dig deep to find hidden assets



Beric Croome

Checking that the taxpayer's standard of living bears a reasonable relationship with the income declared

THERE have been a number of reports in the media recently regarding lifestyle audits that may be carried out by the South African Revenue Service (SARS), which has various information-gathering powers to carry out its mandate under the South African Revenue Service Act of 1997 and various fiscal statutes.

SARS is required to ensure that taxpayers comply with their tax obligations imposed under the various tax laws.

Sections 74, 74A to 74D of the Income Tax Act, give SARS the power to gather information to ensure that taxpayers have complied with their fiscal obligations. SARS may require taxpayers to submit documentation in substantiation of the tax returns submitted, or may conduct detailed audits on a taxpayer's affairs by physically inspecting the taxpayer's premises and carrying out an audit on site.

SARS will identify taxpayers for audit using various techniques, such as risk-profiling, taking account of various criteria, and often acting on media reports regarding the vehicles, houses and other assets owned by a taxpayer. This is to ensure that the taxpayer's standard of living bears a reasonable relationship to the income declared by the taxpayer to SARS for tax purposes.

SARS may commence a lifestyle audit on the affairs of a taxpayer as a result of information printed in the press or tip-offs or other anonymous information or, alternatively, where increases in the taxpayer's assets are not supported by the levels of income

reflected in their tax returns.

SARS will seek to establish the net assets of the taxpayer at the beginning of the tax year and compare that to the net assets at the end of the tax year. Where the increase in assets is not supported by the income reflected by the taxpayer, taking account of the taxpayer's estimated living expenses, SARS will require the taxpayer to complete a lifestyle questionnaire.

That questionnaire calls for full particulars of all assets owned by the taxpayer, including details of entities to which the taxpayer is connected, and also requires the taxpayer to submit detailed living expenses, setting out how much the taxpayer spends on groceries, insurance, holiday and other travelling costs, and related personal expenditure.

SARS utilises the questionnaire in an attempt to establish the taxpayer's annual living expenses, which forms an integral part of performing a capital reconciliation on the taxpayer's affairs.

The lifestyle questionnaire utilised by SARS asks personal questions and some taxpayers take the view that SARS is not entitled to the information as it violates their right to privacy contained in section 14 of the Constitution. Taxpayers often overlook the fact that the rights contained in the Bill of Rights are capable of limitation under section 36 of the Constitution, where that limitation is reasonable and justifiable in an open and democratic society. In democracies throughout the world, the revenue authority is entitled to conduct audits on taxpayer's affairs and to investigate taxpayers where

necessary. To resist SARS' request for completion of the lifestyle questionnaire cannot, in my opinion, be justified when anomalies have arisen in the assets reflected by the taxpayer in their returns and the income reflected therein.

The difficulty that often arises in completing the lifestyle questionnaire is the taxpayer's lack of records and, particularly, trying to explain to SARS deposits reflected in bank accounts when the taxpayer has been requested to supply bank statements to SARS for numerous years.

Taxpayers are usually required to retain records for of five years from the date on which the tax return is submitted to SARS. It is important that taxpayers retain the required records, failing which it becomes difficult to satisfy SARS when questions are asked about the nature of amounts received in a bank account after many years have passed. Where the taxpayer is unable to satisfy SARS as to the nature of funds deposited in a bank account, SARS will, typically, regard those deposits as undisclosed income and will impose additional tax on the basis that the taxpayer has not disclosed income for tax purposes properly.

When SARS embarks upon a lifestyle audit it can, unfortunately, take an extended period to finalise the matter and this is exacerbated when records are not readily available to explain the increases in assets reflected by the taxpayer, or to address the nature of deposits received by the taxpayer in their bank accounts satisfactorily.

When the taxpayer's record-

keeping is poor, SARS will issue revised assessments subjecting the taxpayer to income tax on unexplained increases in assets owned. Challenging those assessments becomes difficult when the taxpayer's records are poor and explanations cannot be supplied of how the taxpayer acquired the assets.

SARS will normally resort to the lifestyle questionnaire when it has a suspicion that the taxpayer has not disclosed all income in the submitted return. If a taxpayer has failed to comply with fiscal obligations it is far better to engage with SARS sooner than later to rectify the matter. This may assist the taxpayer in seeking mitigation of additional tax of up to 200% of the tax due on undisclosed income that SARS is empowered to impose under section 76.

In addition, SARS may lodge a complaint with the National Prosecuting Authority to determine whether the taxpayer should face criminal charges.

It must be remembered that SARS cannot disclose any information pertaining to a taxpayer to any person, according to the secrecy provisions contained in section 4 of the act, and also in accordance with the taxpayer's right to privacy contained in section 14 of the Constitution. Therefore, even though the press may speculate that a particular individual is living beyond their apparent means, SARS is not authorised to disclose particulars relating to that taxpayer to the media or any other person.

■ *Dr Beric Croome is a tax executive at ENS.*