Regulations: Write off or Compromise of Tax Debts

13 February 2007

SARS South African Revenue Service

Background

- Before its repeal the Exchequer Act, 1975, enabled the then Commissioner for Inland Revenue, as part of the then Department of Finance, to write off the whole or any portion of a tax claim
- The Exchequer Act was repealed upon commencement of the Public Finance Management Act, 1999 (“PFMA”)

Background

- Section 76(1) of the PFMA and its regulations provide for *inter alia* the write off of State money and the waiver of claims by the State
- Section 76(1) and its regulations do not apply to SARS
  - Regulations only relate to departments
  - SARS is defined in the PFMA as "public entity" listed in Schedule 3A of the PFMA

Background

- An appropriate legislative framework in terms of which undisputed tax debts should be written off or compromised was required
- International benchmarking – Several jurisdictions, such as Australia, Canada and New Zealand, provide the revenue authority with the power to write off or compromise undisputed tax debts

Legislative framework

- Enabling legislation in the form of section 91A was incorporated into the Income Tax Act, 1962, during 2005
- Section 91A(1) provides that the Minister may by regulations prescribe the circumstances under which the Commissioner may write off or compromise a tax debt

Legislative framework

- Section 91A(2) provides that the regulations must prescribe
  - the procedures to be followed by the Commissioner in writing off or compromising an amount
  - the requirements for reporting by the Commissioner of any amounts which have been written off or compromised
- Section 91A(3) provides that prior to publication of the draft regulations, the regulations must
  - be published for external comment and
  - be submitted to Parliament for parliamentary scrutiny at least 30 days before their promulgation

Legislative framework

- The draft regulations were published for external comment on the 31 July 2006 (*Gazette* No 29092)
- Closing date for comment 25 August 2006
- The various comments received were considered and the final regulations were formulated and formally submitted to Parliament on the 5 February 2007

Discussion of regulations (paragraph 2)

- Commissioner's duty to collect tax debts
  - Basic principle: Duty of Commissioner to pursue recovery of all debts and not to forego any such debts
  - Circumstances may require that strictness and rigidity of basic principle be tempered where it would be to the best advantage of the State
  - Regulations aim to prescribe the circumstances under which the Commissioner may exercise this power

Discussion of regulations (paragraph 4)

- **Decision to write off (or reverse) such a tax debt may be of a temporary or permanent nature**
- **Temporary write off**:
  - Commissioner is satisfied that tax debt is uneconomical to pursue (paragraph 5)
  - Does not absolve the debtor permanently from the liability of that tax debt
  - If financial position of debtor improves the debt may be re-raised and action to collect the debt may recommence
  - On reinstatement of the tax debt interest will be calculated for the period from the date that the debt was written off to the date of payment

Discussion of regulations (paragraph 5)

- A tax debt will be uneconomical to pursue if the Commissioner is satisfied that it is probable that the total costs of recovery of the tax debt will exceed the amount of the tax debt recovered
- Question whether amount is uneconomical to pursue must be decided on a case by case basis taking into account various factors, for example:
  - Amount of the tax debt
  - Length of time that the tax debt has been outstanding
  - Steps taken to date to recover the tax debts and the costs involved in those steps, including tracing fees
  - Likely costs of continuing action to recover the tax debt and the anticipated return from that action
  - Financial position of debtor (including assets and liabilities, cash flow and possible future income streams)

Discussion of regulations (paragraph 6)

- Permanent write off if Commissioner:
  - is satisfied that tax debt is irrecoverable at law (paragraph 7)
  - has compromised a tax debt in terms of the regulations (paragraphs 9 -14)
- Taxpayer is permanently absolved from liability of tax
- Notification to taxpayer in writing

Discussion of regulations (paragraph 7)

- Irrecoverable at law only if:
  - Tax debt cannot be recovered by action and judgment of a court
  - Tax debt is owed by a debtor that has been liquidated or sequestrated
  - Court sanctioned offer of compromise or scheme of arrangement
- If debtor is a company or trust Commissioner must first explore action against or recovery from the personal assets of any director, shareholder, trustee or persons acting in the management of that debtor

Discussion of regulations (paragraph 8)

- Procedure for writing off a tax debt on a temporary or permanent basis
  - Consolidation and reconciliation of all amounts owed by and to the debtor, including penalties, interest and costs
  - Breakdown of tax debt and periods to which the outstanding amounts relate
  - Document history of recovery process and reasons for deciding to write off the tax debt
  - Offers of compromise in terms of section 311 of Companies Act, 1973: Commissioner must in addition also consider information relevant for purposes of a compromise in terms of these regulations

Discussion of regulations (paragraph 9)

- Compromise of a tax debt
  - Purpose of compromise must be to secure the highest net return from the recovery of that tax debt taking into account considerations of good management of the tax system and administrative efficiency

Discussion of regulations (paragraph 10)

- Request for compromise
  - Debtor must submit a written request setting out reasons for seeking a compromise of tax debt
  - Request must be accompanied by evidence supporting the debtor's claims for not being able to make payment of the full amount of the tax debt
  - The assessment of the request will be based on a detailed knowledge of the financial affairs of the debtor, past, present and future
  - Full and frank disclosure by the debtor is therefore fundamental to the success of the debtor's request

Discussion of regulations (paragraph 11)

- Assessment of request – factors to be considered
  - savings in the cost of collection
  - collection at an earlier date than would otherwise be the case without the compromise
  - collection of a greater sum than would otherwise have been recovered
  - Abandonment by debtor of any claims arising under any Act administered by the Commissioner

Discussion of regulations (paragraph 12)

- Circumstances where Commissioner may not compromise a tax debt, includes for example:
  - If the amount payable in terms of compromise is less than market value of total net assets which can be taken into account to reduce the tax debt
  - If compromise will prejudice other creditors
  - If liquidation or sequestration proceedings have been initiated
  - If the only reason to support the request to compromise is the debtor's claim of hardship in paying the tax debt
  - If the taxpayer's tax affairs are not in order
  - It may adversely affect broader taxpayer compliance

Discussion on regulations (paragraph 13)

- Agreement to compromise
  - Must set out amount payable in full satisfaction of the debt
  - Must contain an undertaking by the Commissioner not to pursue the recovery of the balance of the debt
  - May contain any other condition as the Commissioner may determine, including a requirement that debtor must comply with other Acts administered by the Commissioner

Discussion of regulations (paragraph 14)

- Commissioner not bound by compromise in certain circumstances for example:
  - Where the debtor failed to make full disclosure of material facts or made incorrect disclosure of material facts
  - Debtor fails to comply with any provision or condition contained in the agreement
  - Debtor is liquidated or his estate is sequestrated before the debtor has fully complied with all conditions in agreement
- Agreement to compromise will be invalid and Commissioner may reinstitute recovery proceedings for the full tax debt

Discussion of regulations (paragraph 15)

- Records of tax debts written off or compromised
  - Commissioner must maintain register with following detail
    - Details of debtor, including name, address and tax reference numbers;
    - Amount of tax debt written off or compromised;
    - Reasons for writing off or compromising the tax debt.

Discussion of regulations (paragraph 16)

- Reporting by Commissioner
  - Amount of tax debts written off or compromised during any financial year must be reflected in annual financial statement of SARS
  - Commissioner must provide an annual summary of all tax debts which were written off or compromised to the Auditor-General and to the Minister of Finance

Discussion of regulations

- Power to write off or compromise debt may be delegated by the Commissioner
- No relationship between debtor and person writing off or compromising debt is permitted