CHARTERED ACCOUNTANTS
PHYSICAL 1st FLOOR, 67 FLORIDA ROAD, DURBAN, KWAZULU NATAL, SOUTH AFRICA
POSTAL PO BOX 48619, QUALBERT 4078
TEL + 27 31 303 6130 FAX + 27 31 303 4399
EMAIL global@sjcasa.co.za WEB www.sjcasa.co.za

MoneyTalk

Capital Reconciliation: SARS' Deadly Weapon

Tax affairs are a very personal and private matter. That is even more so when people have to disclose their personal assets and liabilities to SARS. In fact, taxpayers almost find it easier to have root canal surgery done without Novocaine than disclose that information to the Receiver of Revenue. So why does SARS require this information and how can it use it against a taxpayer?

Tax practitioners worth their salt should know the well-known story of Al "Scarface" Capone, the legendary Mafia boss. Between 1920 and 1930 he was involved in smuggling and the bootlegging of liquor. The FBI had attempted, but failed, to convict him of racketeering. It was the Internal Revenue Service that successfully convicted him for income tax evasion.

How did they manage to do this? They did a capital reconciliation.

It is probably the most devastating technique applied by revenue authorities worldwide and it is something that is very difficult to defend. SARS matches any asset growth with the income declared on your return. If the asset growth does not correspond with the income declared, the alarm bell is sounded.

Legislation

In terms of section 66 of the Income Tax Act, all taxpayers are required to make a full and true disclosure in their tax returns. Failing which, SARS may impose penalties of up to 200% in terms of section 76 of the Act if there is an unexplained increase in your assets. Businesses have been liquidated as a result of these penalties being imposed.

The onus of proof lies with the taxpayer, in terms of section 82 of the Act. That means if SARS suspects that a taxpayer might not be making a full and true disclosure, the taxpayer has to prove that he is complying with the provisions of the Act.

When will SARS do a capital reconciliation?

Capital reconciliations are generally done on individuals and only under the following circumstances:

- You consistently declare a relatively low level of income from a business that appears profitable.
- You are a director of a company who consistently declares a low level of income over a few years with no apparent increase in your earnings.
- Assets are accumulated without any indication of an alternative source of income.
- You are accustomed to an expensive lifestyle.
- There is uncertainty about how your capital has grown or how your living expenses were financed.
- SARS suspects that you have not declared all your income.
- SARS suspects that private expenses were claimed in your financial statements.
- Your income decreases or losses are recurrently incurred.
- A lower estimate of living expenses is declared compared to previous years.
- There is a high growth in assets but very little income is declared.
- You have a history of undeclared income in previous years.
- Your withdrawals do not match your living expenses.
- You consistently earn low business income without a reduction in your assets.

The importance of full disclosure

Besides having to comply with tax legislation and, therefore, having to make a full declaration, full disclosure also offers your tax practitioner the opportunity to reconcile your personal assets and liabilities. He can detect any possible anomalies before submitting your personal tax return, thereby saving you from this most devastating practice and potential liquidation.

Copied from a TAXtalk article by Hennie van Deventer of BoE Private Clients

15 July 2008