

# LESSONS LEARNT FROM HISTORY: TAX EVASION

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## ABSTRACT

Tax evasion is not a new discovery. The concept of cheating the taxman has been around since the time of the Egyptian Pharaohs. Tax evasion and punishment methods in ancient times, specifically in Egypt, Greece and Rome, are discussed and compared to the history of the native poll tax and the evasion thereof in South African during the 18<sup>th</sup> century. The tax evasion court case of Al Capone in 1931 laid the foundation for methods such as collaboration between tax authorities and law enforcement agents to investigate charges and convict tax evaders in modern day society. The curbing of tax evasion is a hurdle which governments and policy makers struggle to overcome. This study focuses on establishing whether the rules, legislation and policies implemented by the revenue authorities, for this study, South African Revenue Service, are adequate to prevent tax evasion. Evidence from recent court cases in South Africa and interviews with economic crime offenders serving prison sentences indicated that rules, legislation and policies implemented by the South African Revenue Service, detect and combat tax evasion but do not aim to prevent tax evasion. The reason for this is that rules, legislation and policies do not address the motive for economic crimes. Therefore, it is suggested that the South African Revenue Service adopts a holistic approach towards policy design in order to prevent tax evasion.

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## CHAPTER 1: INTRODUCTION

### 1.1. BACKGROUND

*Let me tell you how it will be.*

*There's one for you, and nineteen for me.*

*'Cause I'm the taxman, yeah, I'm the taxman.*

*Should five per cent appear too small*

*Be thankful I don't take it all*

*'Cause I'm the taxman, yeah I'm the taxman*

(Taxman lyrics from the Beatles, 2016)

Famous artists wrote songs about taxes. In 1966 George Harrison wrote a song, “Tax man,” as the opening song in the Beatles album “Revolver” in protest against the aggressive tax rates under the government of Harold Wilson. Paying taxes at a rate of 95%, Harrison said: “'Taxman' was written when I first realised that even though we had started earning money, we were actually giving most of it away in taxes” (Taxman by The Beatles, 2016). Johnny Cash released his song “After taxes” in 1978 to express his feelings when he saw what was left of his pay check after tax (VH1, 2015).

Taxation has played a vital part in people’s lives and in all economies around the globe. Since ancient times, rulers devised ways to increase wealth in their dominions –.from the pharaohs, who delegated the collection of taxes to “scribes”, to the Mediterranean civilisations, where the Greeks taxed almost every right to use or purchase something, giving rise to the term “indirect taxes” (Adams, 2001). The Greeks imposed taxes on harvested crops and severe penalties were applied to tax evaders. Foreigners living in Athens paid a poll tax and tested every possibility to evade this burden (Poll Tax, 2014). Taxpayers have sought methods to minimise their tax liability since early times, and will probably be doing so for many years to come.

Throughout the past century, newspapers carried stories of rich and famous people who evaded tax and how they were convicted. Crime boss Al Capone was convicted of tax evasion in 1931, after being number one on Chicago’s list of public enemies

(Clark, 2008). This was surely one of the most talked-about sagas of that time. It is ironic that although this mafia boss, known to his friends as “Scarface”, was hunted by the police and the FBI for multiple murders, he ended up behind bars for tax evasion (Salinger, 2013).

Many theories, studies and experiments exist on how tax evasion and avoidance influence economies, taxpayers and government’s pockets. Examples of such theories include:

- Allingham and Sandmo's (1972) theoretical analysis of tax evasion
- The Expected Utility theory ("Yitzhaki puzzle")
- The Prospect Theory and Tax Evasion: A Reconsideration of the Yitzhaki Puzzle, by Amedeo Piolatto (Barcelona Institute of Economics (IEB) and Matthew D. Rablen (Brunel University), 20 August 2013.

Governments around the world have taken actions to combat tax evasion by implementing strict policies. High penalties have also been levied for non-compliance. In South Africa, a new law called the Tax Administration Act (no. 28 of 2011) was promulgated. From its opening sentence: “*To provide for the effective and efficient collection of tax*” (SARS, 2012a), one can only assume that Government was in need of more effective ways to ensure that all taxpayers pay their dues.

Although, according to The Justice Network, South Africa does not form part of the top 10 countries with the largest tax evasion (Berr, 2011), the question remains whether SARS considers tax evasion to be a problem in South Africa. If it does, is it they doing enough to combat tax evasion? Is South African legislation supporting SARS to ensure that taxpayers do not evade tax?

*If you drive a car I'll tax the street*

*If you try to sit I'll tax your seat*

*If you get too cold I'll tax the heat*

*If you take a walk I'll tax your feet*

(Taxman lyrics from the Beatles, 2016)



## **1.2. PROBLEM STATEMENT**

Ample research exists on tax evasion, but some controversies still remain about why people evade tax. Some arguments suggest that the more aggressively a government enforces policies, the higher the risk of getting caught for tax evasion, and therefore fewer people will evade tax (Alm, 2012). Another reason for tax evasion is that people cannot afford to pay taxes and maintain a life of luxury at the same time. They may even be willing to give up their citizenship in order to escape high taxes – preferring a higher lifestyle elsewhere, with more disposable income after tax, to being patriotic (Lenzner, 1994).

In the past century there are have been many cases where taxpayers were caught out and punished for tax evasion, but people around the globe will still try to evade tax. Tax evasion is a problem in most countries. It seems as if tax evasion policies implemented over the years do not deter taxpayers from evading tax. Therefore it is can be asked whether governments are taking previous tax evasion events, cases and studies into account when implementing policies.

## **1.3. RESEARCH OBJECTIVES**

The research objectives guiding this is study are:

- To critically evaluate historic tax evasion policies in ancient Egypt, during the Golden Age in Greece and in the Roman Empire.
- To discuss court cases in the past century where people (specifically Al Capone) were caught and punished for tax evasion. This discussion could provide evidence of methods governments used to convict tax evaders.
- To critically evaluate the methods and strategies used by SARS and the South African government in recent court cases to establish whether SARS is taking into account previous tax evasion events when conducting an investigation.
- To identify and evaluate tax evasion policies and deterrents implemented by SARS and the South African government to detect tax evasion schemes and punish tax evaders.

## **1.4. RESEARCH QUESTION**

The research question guiding this study is:

Are rules, legislation and policies implemented by the SARS aimed at preventing tax evasion?

## **1.5. IMPORTANCE AND BENEFITS OF THE STUDY**

Tax evasion has occurred and is still occurring despite many attempts by government to counter it. Governments may benefit from this study by understanding possible shortcomings in its legislation. Taxpayers may also benefit by gaining knowledge of previous tax evasion cases, which may influence their decision to attempt or not to attempt to evade tax.

## **1.6. LIMITATIONS AND ASSUMPTIONS**

### **1.6.1 Limitations**

A limitation of this study is that decision making has an emotional and psychological side, which limits the control over how a person will react towards a situation or a decision. For example, if the chances of a taxpayer being audited by the tax authority and being caught for tax evasion are high, a person will be less likely to evade tax (Sandmo & Alingham, 2005). Another example is that if the tax saving a person can achieve is higher than the penalties charged if caught for tax evasion, a person will be more likely to evade tax (Dhami & al-Nowaihi, 2006).

Another limitation is that each government will each respond differently to tax evasion. The punishment for tax evasion differs from one country to another. A person may be charged with a jail sentence in one country, while another country will only sentence a tax evader to community service or impose a fine.

### **1.6.2 Assumptions**

This study will assume that each individual person makes decisions that benefit only himself or herself and governments will make decisions to benefit their own economies and its citizens. It is also assumed that most taxpayers have a negative attitude to paying their taxes, although not all of them will try to evade tax.

## 1.7. RESEARCH METHODOLOGY

The present research is qualitative in nature with an informative orientation. The research can be divided into four phases:

- Historical documents – The search for information on the history of tax evasion consisted of internet searches for historical documents and articles written on tax evasion in ancient times. It also included searching for books recently written on historical times with regard to taxes. Three different nations were compared in terms of the types of taxes which existed at the time, policies to combat tax evasion and punishment imposed if caught for tax evasion.
- A search was conducted to find articles, letters, press releases and web pages providing information on a famous person convicted for tax evasion during the past century. The case of Al Capone (1931) was identified and summarised. Evidence was found suggesting that this famous tax evasion case affected the way law enforcement agencies go about convicting a tax evader.
- The research was then narrowed down to South Africa. Case law, legislation and policies over the past 5 years were analysed to establish whether SARS had changed its policies and legislation in order to increase tax compliance.

The research concludes with an overview of the current legislation, rules and regulations implemented to combat tax evasion in South Africa.

## 1.8. THEORIES, STUDIES AND EXPERIMENTS WITH TAX EVASION

Different theories exist on tax evasion of how to calculate the probability of a taxpayer under-declaring or not declaring his or her income. Experiments and studies have also been performed to establish the potential offender's reasoning and emotions when the decision is made to evade tax.

### 1.8.1. Tax evasion: A theoretical analysis, Allingham and Sandmo (1972)

Tax evasion has been studied and analysed for many years. An early analysis of tax evasion was performed by Allingham and Sandmo in 1972. Their paper analysed the decision of an individual taxpayer to under-declare his/her income for tax purposes.

The paper concluded that the greater the chances are that the taxpayer will be investigated by the tax authority, the less likely he/she will be to evade tax. This theory suggests that an increase in tax rates reduces the taxpayer's wealth. This taxpayer will then decide to evade tax if the cost of detection (penalties and interest) is less than the tax saving in case they get away with evasion (Sandmo & Allingham, 1972).

### **1.8.2. The Expected Utility Model Theory (Yitzhaki Puzzle)**

Like the theory of Allingham and Sandmo, this theory also suggests that a decrease in absolute risk aversion and an increase in tax rates cause an increase in tax evasion. The Expected Utility Theory is based on variables such as the amount of income to be underdeclared, the amount of penalties if caught for evasion and the tax rate itself. A person will be less likely to evade tax if it is uncertain whether he/she will be caught and exposed to high penalties on top of a high tax rate on evaded taxes (Dhami & al-Nowaihi, 2006).

### **1.8.3. Prospect Theory and Tax Evasion: A Reconsideration of the Yitzhaki Puzzle**

In contrast with the Expected Utility theory, this model disagrees with the suggestion that tax evasion decreases with the tax rate. The Prospect theory suggests that tax evasion in some cases increases as the tax rate increases. This theory does not take loss aversion or probability weighting into account. Only the reference income (amount of income not declared) plays the vital role in determining the relationship between tax evasion and the tax rate itself (Piolatto & Rablen, 2014).

### **1.8.4. A study by John Witte 1985**

Alm (2012) analysed a study on tax expenditure performed by John Witte in 1985. Alm declared that taxpayers' stances are influenced by many factors, including their disposition towards public institutions, the perceived fairness of the taxes, prevailing social norms and the chances of non-compliance being detected and punished. The behaviour of taxpayers and the decision to evade or not to evade tax is seen as the result of a careful assessment of the costs and benefits of evasion (Franzoni, 1999).

### **1.8.5. An experiment with tax evasion: emotions and rationality**

Economic approaches and theories usually ignore the emotional dimension of tax evasion and whether it is a cost or benefit to the taxpayer. In an experiment it was found that there was a positive correlation between the emotions of a taxpayer and the decision to cheat on his/her tax return. The emotional intensity increases when the decision to cheat is made and also increases as the evaded tax amount increases. Therefore the monetary factor will influence the emotions of a taxpayer which will cause him/her to evade or not to evade tax (Coricelli, Joffily, Montmarquette & Villeval, 2010). Apart from the personal emotional dimension, it is suggested that a person is less likely to evade tax when he/she is at risk of being publicly exposed (Coricelli et al, 2010).

In conclusion, this experiment provides evidence that a taxpayer may be deterred from evading tax when the taxpayer has negative emotions towards the amount of fines and penalties imposed by a tax authority or if a person is at risk of being caught and exposed. Therefore, this rationale may increase tax compliance (Coricelli et al, 2010).

### **1.8.6 Conclusion**

Although many theories, studies and experiments have been performed on human behaviour with regard to tax evasion, the decision to evade or not to evade seems to remain an unsolved puzzle (Piolatto & Rablen, 2014).

Why are the dynamics behind tax evasion so relevant then? Basically, legislators need to obtain a clear understanding of how a taxpayer will behave when completing a tax return. The type of experiments and methods used for data collection are very important, because it can be difficult to obtain valid data on tax evasion. People do not often provide honest answers when asked about tax evasion. “The key is to design experimental situations that engage the same psychological processes as their real-world counterparts” (Webley, 1991:1). Knowledge of the behaviour of a person who is considering cheating on a tax return can be a valuable resource in a tax policy design process (Webley, 1991).

## 1.9. DEFINITION OF KEY TERMS

Table 1 below defines key terms relating to this study.

**Table 1: Key terms and definitions**

<u>Key term</u>	<u>Definition</u>
Tax evasion	<p>The illegal non-payment of taxes by individuals, corporations and trusts. Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions.</p> <p>Tax evasion is an activity commonly associated with the informal economy. One measure of the extent of tax evasion (the "tax gap") is the amount of unreported income, which is the difference between the amounts of income that should be reported to the tax authorities and the actual amount reported (Wikipedia, 2016b).</p> <p>Tax evasion may take on various forms, such as</p> <ul style="list-style-type: none"> <li>• Withholding information from the tax authority</li> <li>• Submitting false or inaccurate information to a tax authority during an audit process</li> <li>• Manipulating supporting documents in any way to reduce or eliminate a tax liability (Arnaldo, 2014).</li> </ul>
Tax avoidance	<p>The legal usage of the tax regime in a single territory to one's own advantage to reduce the amount of tax that is payable by means that are within the law. Tax sheltering is very similar, although unlike tax avoidance tax sheltering is not necessarily legal. Tax havens are jurisdictions which facilitate reduced taxes (Dyrenge, 2008).</p> <p>While forms of tax avoidance which use tax laws in ways not intended by governments may be considered legal, it is almost never considered moral in the court of public opinion. Many corporations and businesses which take part in the practice</p>

	<p>experience a backlash, either from their active customers or online. (Conversely, using tax laws in ways which were intended by governments is sometimes referred to as "tax planning") (Foster Back, 2013).</p> <p>Court cases have also distinguished between tax avoidance and tax evasion (IRC v. Duke of Westminster, 1936).</p>
Tax authority	<p>A revenue service, revenue agency or taxation authority is a government agency responsible for the intake of government revenue, including taxes and sometimes non-tax revenue. Depending on the jurisdiction, revenue services may be charged with tax collection, investigation of tax evasion, or carrying out audits.</p> <p>The chief executive of the revenue agency is usually styled as Commissioner, Minister, Secretary or Director (Wikipedia, 2016).</p>

## 1.10. SUMMARY OF CHAPTERS

**The summary of chapters was compiled from the information provided in the chapters and all references to sources are made within the chapters.**

**1.10.1. Chapter 1**

This chapter presents a short discussion of what this study is about. Information on the history of tax and tax evasion is given together with the problem statement, research objectives, research question and methodology. References are made to the benefits of this study as well as the limitations and assumptions.

### **1.10.2. Chapter 2**

A brief history of tax collection and tax evasion in ancient Egypt, Greece and Rome (3000 –30 B.C.) is presented. These nations are compared with regard to tax types imposed, collection methods, evasion methods, anti-avoidance policies implemented and punishment for tax evasion. A snapshot of South African tax history between 1869 and 1924 is provided. The reasoning behind the implementation of the Native Hut and Poll Taxes is discussed as well as the strong resistance to these taxes, which went hand in hand with tax evasion. It is also shown how the tax collection process over

many centuries mostly involved strict enforcement and was in many cases accompanied by violence.

### **1.10.3 Chapter 3**

Al Capone is considered a world-wide legend because of his high-profile involvement in gang operations in the Chicago's underworld during the years 1919 to 1931. Capone's tax evasion case left clear and traceable footprints in the history of tax evasion convictions, prompting law enforcement agencies and tax authorities to work closely together in order to combat tax evasion as well as other crimes. Lastly, the chapter mentions of recent tax evasion cases from South Africa to identify similarities between these cases and the Al Capone case with regard the strategy used, such as collaboration with law enforcement and prosecuting authorities in order to make arrests and secure convictions.

### **1.10.4 Chapter 4**

This chapter focuses on South Africa. The impact of tax evasion on the development of legislation and policies is illustrated through an evaluation of the success of anti-avoidance and anti-evasion legislation, rules and policies implemented by SARS. Taking into account offenders' viewpoint of law enforcement with regard to tax evasion and the reasons behind the decision to evade tax, it is suggested that a more holistic approach to curbing tax evasion should be adopted.

The chapter concludes with statistics from SARS on successful tax evasion prosecutions over the past years and the stance of SARS in dealing with tax evaders.

### **1.10.5 Chapter 5**

The research objectives are attained by stating how the findings from the study relates to the research objectives. The chapter explains how the study addresses the research question. Final comments and recommendations for further research are made.



## CHAPTER 2: A SNAPSHOT OF HISTORY

### 2.1 INTRODUCTION

In primitive economies, most people grew crops to harvest and through the produce took care of their families. Many people used their harvests to pay for living necessities, including their taxes (Dues and Duties, 2010).

In the times of the pharaohs, taxes on harvests were collected by force and therefore tax collectors were feared. The Greeks implemented an indirect tax system in a way to motivate the wealthy to contribute more tax. The Romans, on the other hand, taxed their people at extremely high tax rates in order to save their empire from foreign invasion. People fled from the tax collectors. If a person was caught, extreme prison sentences were imposed or, in many cases, the death penalty (Adams, 2001).

Although South Africa has a very young economy, many different tax policies have been implemented over the past centuries. The Native Poll tax applicable to black African people is just one example of how even the tax system became part of the oppressive regime. Tax evasion and the negative attitude to the native poll tax played a vital role in the transformation from oppression to freedom (Roth, 2016).

### 2.2. THE WISE AND POWERFUL PHARAOHS

Historians believe that there are many secrets and answers to mysteries yet to be discovered, but buried deep within the pyramids of Egypt. While much has been learned, our knowledge of daily life in ancient Egypt remains incomplete.

In a barter economy, the simplest way to extract taxes was by seizing part of the produce, merchandise or property. The agricultural sector of such an economy was easiest to tax; a farmer could not hide a piece of land he owned, and the produce from the land was in bulk and too large to be hidden from tax collectors. The harvests were easy to measure and assess for tax purposes. Therefore tax on produce was the highest and produce was most consistently taxed (Dues and Duties, 2010).

The pharaohs were regarded as gods. They would make regular appearances before the cheering crowds. The people of Egypt adored them. It is no wonder that they employed “scribes” to collect taxes on their behalf; they simply could not afford the risk of losing their countrymen's affection. A “scribe” was authorised by the pharaoh and sent to the fields to collect taxes, especially tax on the crop production (harvest tax). These scribes were empowered to such a level that they had their own tax courts, but a person charged with tax evasion could not even get an opportunity to dispute the case (Rostovtzeff, 1953).

Tax evasion was seen as a serious crime and was punished by 100 strokes with a cane, as well as five bleeding cuts in more severe situations (Anonomous, 2015).

The pharaoh, on the other hand, was not as harsh as the scribes. He was willing to let a farmer off the hook if a harvest was poor (Ehrenberg, 1960). This is not exactly a sentence any modern tax authority would easily include in legislation. With human nature, desire being what it is, there was always an opportunity for the scribes to overtax people to enrich themselves. Special agents were summoned to inspect and almost spy on the scribes to ensure fair collection processes. The agents were also responsible for handling taxpayer complaints (Adams, 2001).

Very soon these special agents learnt from the scribes and began sharing the tax moneys with the scribes – even though a corrupt agent could be punished by having his nose cut off (Adams, 2001).



*A man and a woman offering produce to a surveying scribe Tomb of Menna,  
(New Kingdom Excerpt, Bodsworth)*

With every new pharaoh came new laws and policies. When Akhenaten became Pharaoh, he reigned over Egypt for 17 years. Around 1353 BC he reformed the empire to adopt only one god and brought changes to the administration of revenue collection. Under the new laws, all temples became tax immune, and this became a great opportunity for tax evasion: one could simply run into a temple to escape a tax collector (Adams, 2001).



*A Statue of Pharaoh Akhenaten in the museum in Cairo. The meaning of the name Akhenaten is "living spirit of Aten". Aten was the only God that Akhenaten acknowledged as the true god (Crystalinks, 2016).*

It seems that Akhenaten was so occupied with transforming the country to fit his religious rage that he failed to realise that scribes were becoming reluctant to collect taxes, and with the tax immunity of the temples and other religious buildings there were not many places to collect tax from. This resulted in a shortage in the revenue bureau (Adams, 2001).

The ways the pharaohs structured and implemented policies to suit their individual beliefs and needs make one wonders how strict tax collection policies should be to find the perfect balance between fair tax collection for sufficient revenue and punishment for tax evasion.

### **2.3. THE CREATIVE GREEKS**

The Greeks structured their tax system with indirect taxes such as tax on the use of roads and public facilities. In the Greek city of Athens, the "tax the rich" system, called liturgy (Wikipedia, 2016) was used to collect monies for special government projects. The wealthy people of the city were approached by the government to fund projects

such as building infrastructure for the city. Although the collection of taxes was harsh, it seems that the rich contributed as if they were donating monies to improve their city. Such donations were mostly seen as a status symbol, because it would prove that a person was wealthy (Frank, 2012). Imagine a world where people voluntarily paid taxes because of social responsibility. In such a world, tax evasion simply would not exist.

For the non-Athenians it was a different situation altogether. Just like the Egyptians, the Greeks used agents to collect taxes. These agents were sent to the fields to collect the harvest tax, which was a direct tax, and evasion of a direct tax carried heavy punishment, such as confiscation of property and even imprisonment (Adams, 2001). Evasion of harvest tax was not difficult to accomplish due to a lack of agents in the fields at harvest times. To compensate for lost harvest taxes, foreign merchants called *metics* (Stieber, 2010) were taxed through a poll tax, a *metoikion* (Roberts, 2002). Only a true Athenian, with both parents born in Athens, could be exempted from this tax. Therefore many birth certificates were forged to evade poll tax. The punishment for evading a *metoikion* was confiscation of the land and high tax payments (Adams, 2001).

#### **2.4. A FIGHT FOR THE GLORY OF ROME**

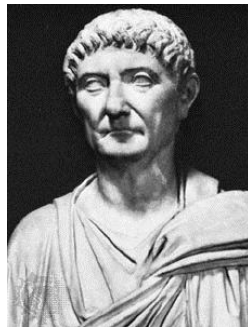
*Rome, at the height of her empire. The greatest civilization the world has ever seen, which stretches from Spain to Jerusalem. It is a time of art and beauty, of conquerors and slaves. The borders of her empire hungrily expand outward, forcing all to submit to its dominion or die* (Clickhole, 2015).

In 476 A.D. the barbarian king Odovacar invaded Rome. This brought a change in the political system and is believed to be one of the main reasons for the collapse of the Roman Empire (Adams, 2001). Some historians believe that the fall of Rome can be attributed to tax evasion. Had the empire had enough state revenue to maintain its military force, the invasion by Odovacar could have been prevented (Cousin, 2015).

But why this excessive tax evasion?

Diocletian, a Roman Emperor at that time, built Rome into a mighty empire that would have defended itself very easily against any foreign invasions (Cousin, 2015). To accomplish this he needed high state revenues, which required high tax rates. Tax collectors were summoned to go out to the fields and collect harvest taxes. They even interrogated the children of farmers to give evidence of actual harvest quantities so that the parents could be captured and tortured. Because of these harsh tax collections, small farmers could not survive economically and therefore sold their farms to large farm owners. The large farm estates were not prepared to pay Caesar his dues either, so they simply evaded tax by bribing the tax collectors (Adams, 2001). Because tax collectors were contract workers for the government, they would try and collect as much tax as possible or make up for it through bribes. Taxes collected over and above the contracted amount would be profit in the tax collector's own pockets (Pope, 2010).

While farmers struggled to put food on the table, rich men bought themselves seats in the senate and enjoyed tax immunity and luxury villas. Those who could not make the cut into the senate joined the legions. Others fled and became peasant farmers. Anything to get away from tax collectors (Adams, 2001).



*Diocletian, detail of the bust in the Capitoline Museum, Rome.*

When Julian became emperor of Rome in 361 AD, he attempted to save Rome by reducing tax rates and retrenching government employees; but soon after his death in 363 A.D. all his reforms fell to pieces and taxes were doubled to fund the Roman army. In order to avoid paying tax on workers, farmers sold their useless slaves to fight in battles on the country's borders. No wonder Rome lost the battle against the barbarians (Adams, 2001).

## 2.5. SOUTH AFRICA: BLOOD TAX

*“In order to increase the Negro's wants or to teach him the value of labour, a poll-tax and a hut-tax have been imposed on him. If these imposts were not levied, this race of agriculturists living on their farms would not enter mines hundreds of feet deep in order to extract gold or diamonds, and if their labour were not available for the mines, gold as well as diamonds, would remain in the bowels of the earth. Likewise, the Europeans would find it difficult to get any servants, if no such tax was imposed.”•*

(Gandhi, 1968)

When deep-level mining began in South Africa around 1894 more mineworkers were needed to meet the growing demand for gold. The Government had to find a way to force farm workers to become gold diggers. They imposed taxes upon black farm workers, namely the poll tax and the hut tax. Some called it “blood-stained tax” (Redding, 2000). These taxes were only applicable to black South African farmers (the poorer section of the community) and were levied at a flat rate, i.e., regardless of the amount of income earned by a black farmer, the same amount of tax would apply. This left much room for defaulting and tax evasion. Taxes were payable in physical money (coins) and not by way of harvests or cattle like before. The farmers had no money to pay taxes. To avoid paying tax, they gave up their farms to work in the gold mines (Callinicos, 1981).

Some black farmers refused to submit to government by not paying their taxes. They evaded tax by simply not paying it (South African History Online, 2011). This caused “harshly-managed raids” (Historical papers, 2013:9) by the police to enforce this tax policy. Criminal charges were laid and tax evaders were liable for a prison sentence (Jabavu, 1932).



Migrant labourers in South Africa (Callinicos, 1981)

The native poll tax and hut tax policies, together with the negative attitude to paying them, are believed to have been the motive behind the Bambatha Rebellion in 1906. It was a fight for the abolition of native poll tax and the hut tax that turned into a bloodbath (Redding, 2000).



Bhambatha (on the right) with an attendant. He was one of the chiefs who resisted the introduction and collection of the new tax (Stuart, 1906)

## 2.6. CONCLUSION

Table 2 sets out a summary of the different nations discussed in this chapter with examples of the types of taxes they implemented in each era. It also lists countermeasures used to discourage tax evasion and punishment if a person were convicted of tax evasion.

### Table 2: Summary of examples of tax types and evasion countermeasures



<u>Country/ Nation</u>	<u>Period</u>	<u>Tax Type</u>	<u>Method of evasion</u>	<u>Preventative measures and policies</u>	<u>Punishment for tax evasion</u>
<b>Ancient Egypt</b>	3000- 2800 B.C.	Harvest tax (especially on grain produce)	Taxpayers paid bribes to the “scribes” for low assessments	Two scribes to count the harvest to ensure accurate figures	If unexplained differences were found, both scribes were punished by death
	1353 B.C.	Harvest tax	People fled from the lands to seek shelter at the temples, which were tax immune	No additional policies, as tax immunity was granted by the pharaoh himself	
		Harvest tax	The scribes over- assessed the farmers and divided the excess amongst them	Government agents were appointed to monitor and inspect the work of the scribes	Ancient drawings show images of punishment by way of beatings
<b>The Greeks</b>	776 – 30 B.C.	Indirect taxes on use of public facilities. Liturgy was used to fund special projects.	Wealthy people contributed monies to fund special projects to improve the cities	Government approached the wealthy people of the city to collect tax for the special projects.	The collection of liturgy was seen as status symbol. Therefore these taxes were not evaded.
		Direct tax (harvest tax)	Farmers hid grain from the tax collectors	Tax collectors were sent to the fields to count harvests	Punishment by confiscation of the farmer’s property and imprisonment
		Poll tax on foreigners	Foreigners forged birth certificates in order to pose as Greek citizens and avoid poll tax	Tax agents to collect poll taxes	Punishment by confiscation of property and severe penalties
<b>The Romans: Caesar Diocletian</b>	476 A.D.	Harvest tax	Farmers hid their crops from the tax collectors in the field to avoid paying high tax	Tax collectors used children of farmers to testify against their parents in order to collect tax on hidden crops	Punishment by torture (beatings)
			Owners of larger farm estates would bribe the	This evasion was difficult to combat	No punishment because



			tax collectors for lower tax assessments	because tax collectors were still paying the contracted amount over to government. The surplus (over and above the contracted amount) was profit for the tax collector	government received the taxes it expected
The Colonial State (South Africa)	1894-1924	Native hut tax and poll tax	Black farmers gave up their land and worked in the mines to avoid paying tax  Some farmers simply refused to pay their taxes	Police officers randomly requested proof of tax payments in the form of a "pass" from the farmers	Criminal charges were laid against tax evaders and they were given prison sentences

Sources: Adams, 2001; James. *Pharaohs Volk*; Kraft, Demand media; Pope, 2010; Callinicos, 1981; Jabavu, 1932.

History shows that tax evasion had a destructive effect on empires and countries since ancient times, when only a few taxes existed. Tax evasion crippled economies and caused foreign takeovers and wars, as seen in the Roman Empire. Many centuries later, heavy tax burdens laid upon farmers in South Africa caused violent outrages.

The importance of sufficient revenue is emphasised by the Greeks with their system of collecting funds from the wealthy to build infrastructure. It is no wonder that since these early times tax evaders, if caught, were punished severely.

## CHAPTER 3: FAMOUS TAX EVADERS



(Al Capone, 1931)

### 3.1 INTRODUCTION

Al Capone was the head of the most profitable crime syndicate in Chicago, USA during the years 1920 to 1933. He was also believed to be the mastermind behind the Valentine's Day Massacre (Clark, 2008). Many assumed him to be responsible for most of the illegal activities that gave Chicago the name "The lawless city" (Chicago History Society, 1999).

Al Capone was suspected of numerous murders and extortion, but the only thing the US government and FBI could convict him of was tax evasion (Clark, 2008). His conviction in 1931 and 11 year prison sentence contributed to the convictions of many other tax evaders globally.

### 3.2 THE TAX EVASION CASE OF AL CAPONE

Alphonse Gabriel Capone (Al to his friends), born on 17 January 1899 in Brooklyn, New York, was one of nine children. During a very rough childhood he was always part of a neighbourhood gang until he eventually became one of the biggest crime bosses in history. "Al" married Mary Coughlin in 1918 and they had a son named Albert "Sonny" (Chicago History Society, 1999).

In 1919, at the age of 22 years, he went to Chicago to help a gang leader, Johnny Torrio, with his bootlegging operation. In 1925 he took over Torrio's operation. At the

age of 26, Al Capone controlled the criminal underworld, including gambling and prostitution (Linder, 2011).

### **3.2.1 The FBI's list of most wanted criminals**

Capone was charged for the murder of Bill McSwiggin, an assistant state's attorney, who was killed in 1925. In 1928 Capone killed three men who plotted to assassinate him. The most famous killings were on 14 February 1929. Capone's men killed seven of George Moran's gang members. This made Al Capone one of the most wanted criminals in the USA (Linder, 2011).

### **3.2.2 How he evaded taxes and was caught**

Al Capone never submitted income tax returns. By the end of 1929 his assets were worth approximately 30 million dollars. An FBI agent, Wilson, and his team started investigating Al Capone. It was very difficult to trace transactions, as Al Capone had no bank account in his name nor did he ever sign any cheques himself. Accounting records with Al Capone's name on were found by the FBI in 1930. After consultation with his tax attorney, Al Capone submitted that he would pay all outstanding taxes – which ranged from \$26 000 to \$100 000 (Clark, 2008).

In March 1931 Al Capone pleaded guilty on the charges of tax evasion and requested a plea bargain. His trial began on 5 October 1931, when he was charged with 23 cases of tax evasion. On 17 October 1931 the jury pointed out that Al Capone was guilty of evading federal income taxes since 1924. Refusing the option of a plea bargain, Federal Judge James H. Wilkenson said in his verdict: "The parties to a criminal case may not stipulate as to the judgment to be entered. [...] It is time for somebody to impress upon the defendant that it is utterly impossible to bargain with the Federal Court" (Linder, 2011;5). Al Capone was sentenced to 11 years in prison (Clark, 2008).



Al Capone (with an unidentified associate) en route to prison after being sentenced to 11 years for tax evasion (Clark, 2008).



*Al Capone's mug shot, 1931, CHS DN-91508 (Chicago History Society, 1999)*

### **3.3. THE SIGNIFICANCE OF AL CAPONE'S CONVICTION ON TAX EVASION**

Since the conviction of Al Capone and his prison sentence in 1931, many more arrests for tax evasion have been made by law enforcement agencies across the globe. Tax authorities started to work closely with the law enforcement agencies.

Tax crime became an easy method to convict organised criminals when evidence of their other crimes was not available. In his speech on how the ATO works together with law enforcement, sharing useful information about taxpayers suspected of organised crime including tax crimes, Australian Commissioner of Taxation D'Ascenzo said: "Taxation is a logical weapon to use against organised crime. While those at the top of the criminal hierarchy can distance themselves from the crime, as long as they are committing these crimes for a profit, they cannot distance themselves from the money" (D'Ascenzo, 2011).

The Organised Crime Strategic Framework (OCSF) was established in 2009 by the Australian Government. One of the main drives behind this framework is to obtain and

share information with regard to suspicious activities, not only between local authorities, but with the rest of the world. Currently there are officers located in 30 countries to build partnerships with the various authorities and to provide support in information sharing (Australian Government, 2009).

In France the Anti-tax Evasion and Major Economic and Financial Crime Bill was adopted in 2013. The Bill includes plans to strengthen and streamline the cooperation between the tax administration and judicial authorities in tax evasion cases (Lomas, 2013).

### **3.4 CRIME AND TAX EVASION IN SOUTH AFRICA**

At the Crime Stoppers international Conference in 2014, SARS commissioner Moyane said that one of the policies SARS implemented is that a senior SARS official is appointed to work together with other legal experts when information is requested by law enforcement agencies. This arrangement is necessary in order to ensure that proper confidentiality provisions are complied with when an exchange of taxpayer's information takes place. Otherwise the cases may be challenged in court and jeopardised, allowing criminals to walk free (SARS, 2014).

Attention was drawn to the limitations of SARS's authority when suspicious activities are found. Only penalties and interest may be levied on a taxpayer's account when non-compliance (tax evasion) is discovered. The case will have to be submitted to the prosecuting authorities in order to make a criminal case, but a first-time offender will likely walk away with a penalty and some interest without any prison sentence. Specific reference is made to the legitimacy of deals, which includes the tobacco and cigarette trade. SARS has collaborated with many countries and accomplished easy exchange of information in order to combat tax crime (SARS, 2014a).

Another area where collaboration is promoted is between SARS and the public. SARS encourages owners of small businesses not to purchase products such as tobacco from illegal suppliers. This may reduce the importation of these products and increase tax collection on products from legitimate importers. SARS also encourages anonymous tip-offs from the public (SARS, 2014a).

### 3.5 CONCLUSION

Historic tax evasion cases have had a significant influence on modern day society. Co-operation with other authorities in the same country is an important strategy, and involving civilians could lead to a better conviction rate for tax evasion.

Table 3 lists examples of cases where tax authorities worked together with law enforcement agencies and other parties in order to make arrests and bring tax evaders to justice.

**Table 3: Cases of cooperation between tax authorities, law enforcement agencies and the general public**

<u>Country</u>	<u>Case details</u>	<u>How tax authority, law enforcement and public work together</u>	<u>Details of the convictions</u>
Australia	The ATO identified suspicious tax refund patterns of a certain taxpayer	The ATO contacted the local law enforcement agency and obtained information how an individual linked to the taxpayer was involved in money laundering operations.  Evidence could be obtained about how the tax practitioner was involved.	Working together by exchanging information and linking evidence resulted in convictions of 20 individuals on multiple offences, including tax offences. Prison sentences for the tax offences amounted to 9 years.  The ATO informed the Tax Practitioners Board and the tax practitioner was deregistered and barred from practising.
South Africa	SARS received an anonymous tip-off from a member of the public with regard to illegal cigarettes being transported.	A member from the South African public supplied SARS with information and as a result SARS contacted the local customs officers, who intercepted the illegal cigarettes.	The driver of the truck was arrested. The local police confiscated illegal cigarettes worth R560 587.
South Africa	The chairperson of the South African Premier Soccer League Team, Dr Irvin Khoza, was arrested in 2001 for possession of an unlicensed firearm and	Khoza complained about SARS submitting information to the police on grounds of a provision in the Income Tax Act which prevented SARS from disclosing a person's tax affairs even to the police. SARS and	Khoza was charged with tax evasion. An under declaration of R66 million income earned. In 2002 Khoza agreed to settle his tax debt of R 10,3 million after additional penalties and



	<p>smuggling gold and diamonds. The prosecuting authorities were only approached by SARS after they found the firearm and smuggling documents while conducting a tax audit. Khoza walk free on bail. Khoza had been investigated since the late 1970s for financial fraud and drug dealing. He was also a murder suspect in 1996. He was never convicted of these crimes.</p>	<p>the South African Police Service (SAPS) came to an arrangement to exchange information legally. The SAPS was able to complete its investigation.</p>	<p>interest of R 7,2 million had been imposed.</p>
South Africa	<p>In 2016 a South African accountant, Ivan van der Linde, evaded tax by claiming fraudulent VAT refunds from SARS.</p>	<p>SARS logged an investigation into his accounting firm. In an audit, various documents were found that led to further criminal charges against van der Linde. The prosecuting authorities charged Van der Linde with tax evasion, forgery, uttering and money laundering. Evidence from the SARS computer system was also put before the court which strengthened the State's position. The conviction could not have been successful if SARS had not reported its findings and collaborated with the authorities.</p>	<p>Van der Linde was found guilty on 255 counts of fraud (including tax evasion), 1 count of forgery and 1 count of uttering. Judge Nicholls sentenced Van der Linde to an effective 15 years' imprisonment.</p>
South Africa	<p>Mhlwatika Lusindiso, a tax practitioner, was arrested in 2010 for submitting income tax returns with fraudulent claims on behalf of individuals. He charged a fee based on the amount successfully claimed from SARS.</p>	<p>SARS worked together with the SAPS, and Lusindiso could be arrested. SARS provided evidence of tax returns containing various expenses fraudulently claimed as tax deductions and submitted to SARS.</p>	<p>Lusindiso was charged with 290 counts of fraud and 145 counts of fraudulent tax assessments for evasion. The total monetary loss to the state was R1,5 million.</p>

Sources: Australian Taxation Office, 2012; SARS,2016; Meintjies et al, 2001; Brummer, 2001; De Wet, 2002; The State v van der Linde, 2016; Molosankwe, 2016; SARS, 2013.

The Al Capone case indicated that law enforcement agencies took the view that if they could not find sufficient evidence to charge a person with murder or any other crime, chances were that the same person was involved in tax evasion, which was easier to prove (Clark, 2008). This same stance was used in more recent cases, specifically in South Africa. Soccer boss Khoza's lawyer (see Table 3) even compared Khoza to Al Capone (Meintjies, Goagoses and Phahlane, 2001).

In the past, criminals were apprehended and punished through the tax system, even if the criminal activity was initially not a tax issue. Illegal activities were brought to light during investigations of tax evasion conducted by revenue authorities such as SARS.. Tax evasion is not an activity that is limited to individuals with a criminal intent, as can be seen from the Van der Linde and Lisindiso cases.

Due to the complicated nature of tax evasion and the driving force behind such conduct, one needs to seek guidance from the past to interpret the presence and to improve the policies for the future.



## CHAPTER 4: LESSONS LEARNT: A SOUTH AFRICAN PERSPECTIVE

### 4.1 INTRODUCTION

Studies, experiments and historical cases show that empires, countries and societies have always been battling with tax evasion. A remarkable observation is that lessons learnt from tax history and prosecuting methods were adopted by modern-day tax authorities and law enforcement agencies (De Wet, 2002). In 2014, an estimated tax gap of R14,5 billion was predicted in South Africa. One of the reasons for this gap was believed to be the result of tax evasion. Without affective revenue collection, South Africa cannot maintain the economy and repay government debts (Sizwe Ntsaluba Gobodo, 2014).

Taxation history and historical court cases indicate that knowledge of taxation history and policing of the legislation, amongst others, are needed in order to combat tax evasion effectively. The impact of a taxpayer's psychological decision making process (Dhami & al-Nowaihi, 2006) as well as the perception that tax evasion is a criminal offence (Swanepoel & Coetzee, 2014) should be taken into account when anti-avoidance and anti-evasion policies are designed.

The question remains: Do rules, legislation and policies implemented by SARS aim to prevent tax evasion?

### 4.2 CRIME OFFENDERS' PERCEPTIONS OF CRIME AND TAX EVASION

#### 4.2.1 Background

In 2014 a study was published consisting of interviews held with 82 economic offenders which included tax evaders convicted and serving a prison sentence in Gauteng. The purpose of this study was to establish whether economic offenders considered tax consequences when they decided to commit financial fraud (Swanepoel & Coetzee, 2014).

Despite the fact that 76,83% of the convicted economic offenders interviewed admitted that their actions had been unlawful, they still decided to commit the crimes. This

suggests that the “motivation to commit” (Swanepoel & Coetzee, 2014:1) such crimes should be suppressed in order to prevent crimes such as tax evasion. According to the answers provided by the offenders, the three main reasons or motivations for committing economic crime were the need for money, to ease cash flow problems, and greed (Swanepoel & Coetzee, 2014).

In response to questions with regard to the adequacy of law enforcement, prosecution and sentencing, the majority of the offenders felt that laws and regulations were adequate, but should be applied and managed more effectively (Swanepoel & Coetzee, 2014:11).

During the interviews, the convicted offenders were requested to respond to a questionnaire. Table 4 below lists the questions and the responses.

**Table 4: Summary of the economic offenders' responses**

<u>Questionnaire section (Dimension)</u>	<u>Likert scale options</u>		
	<u>Agree</u>	<u>Uncertain</u>	<u>Disagree</u>
A. Law enforcement, prosecution and sentencing practices are not adequate.	72,82%	6,54%	20,64%
B. Prevention or management will minimize or reduce the possible negative impact of fraud, corruption and related taxation consequences.	82,68%	5,62%	11,70%
C. Current laws and regulations are adequate to address fraud, corruption and tax conduct in general.	58,21%	11,21%	30,58%
D. Fraud or corruption is perpetrated without taking into account any possible taxation consequences that might occur as a result thereof.	55,34%	11,72%	32,94%
E. The perpetrator of fraud or corruption is aware of any possible taxation consequences or tax liabilities that might occur as a result of his fraudulent actions.	67,30%	17,32%	15,38%
F. The perpetration of fraud or corruption has an impact on taxation in South Africa.	60,57%	8,13%	31,30%

G. The type of fraud or corruption being perpetrated is a function of the opportunities available to the potential offender.	66,88%	14,25%	18,87%
H. Morality and sound principles would impact positively on the occurrence of fraud, corruption and possible related taxation consequences.	69,50%	9,80%	20,70%
I. The perpetration of fraud, corruption and tax evasion may be influenced by the cost to comply with all the taxation administration requirements in South Africa.	67,10%	7,30%	25,60%
J. The prospective fraudster has no concern for his fraud or corruption being detected and eventually being prosecuted for the perpetration of the fraudulent action.	63,83%	4,47%	31,70%
<b>Average</b>	<b>66,42%</b>	<b>9,64%</b>	<b>23,94%</b>

Source: Swanepoel & Coetzee, 2014

#### **4.2.2. Additional disclosures made by economic offenders**

Interesting information was produced by the answers of the questionnaires. Of the 82 offenders interviewed, 63 were males and 19 were females. 85,37% were between 20 and 49 years of age. This indicates that most economic offenders are people forming part of the general working population. In other words, young people and older people do not generally commit economic crimes (Swanepoel & Coetzee, 2014).

From the offenders interviewed, 62,2% had an academic qualification of up to Grade 12 and the value of the economic crimes averaged R208 833. For the rest of the offenders, who had higher education levels, the crimes amounted to R19 541 997 (Swanepoel & Coetzee, 2014). It is therefore accepted that the higher the level of education, the higher the monetary appetite of the person committing the crime.

This research also revealed that 74,39% of the convicted offenders were more concerned about the instant financial benefit obtained through economic crime than the possibility of getting caught. Therefore, an economic crime offender is willing to take the risk of getting caught and being prosecuted in exchange for the financial reward from an economic crime (Swanepoel & Coetzee, 2014). This type of behaviour

is in contrast with the study done by John Witte in 1985, where the risk of getting caught is weighed up against the monetary benefit of evading tax.

#### **4.2.3. Motives behind economic crimes**

Table 5 indicates the ranking of the reasons for committing economic crime as provided by economic offenders during the 82 interviews.

**Table 5: Ranking of reasons for perpetrating fraud, corruption or tax evasion (economic crimes)**

<b><u>Reasons</u></b>	<b><u>Ranking order</u></b>
Needs/wants	1
Facilitation of payments/cash-flow problems	2
Greed	3
Bribes paid to get things done/sorted out	4
Excursions/entertainment offered to foster informal relations with potential clients	5
Marketing targeted at specific individuals in the form of expensive gifts	6
Criminal behaviour	7
Getting even with SARS/the government	8
Tax savings	9
Political pressure reasons	10

Source: Swanepoel & Coetzee, 2014

#### **4.2.4. Conclusion on findings**

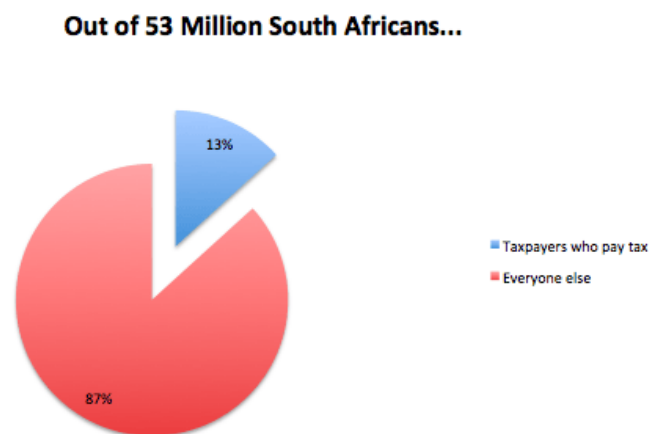
From the above outcomes it is submitted that the number 1 motive behind economic crime is greed, which can be defined as a desire to acquire more than what one needs regarding material wealth (Collins dictionary, 1819). Greed is regarded as a social human behaviour (Taflinger, 1996), and therefore it is suggested that a holistic approach should be considered when legislation and policies dealing with finances and tax are designed.

A prison sentence is a temporary measure in the fight against tax evasion. If a person does not take into account the consequences when choosing to evade tax, but only thinks of the financial reward it holds, such a person will be likely to evade tax again when released from prison (Swanepoel & Coetzee).

#### 4.3 MEASURING TAX EVASION

Measuring the extent of tax evasion in any economy is a difficult task due to the very limited data and information available (Franzoni, 1999). The existence of a large informal economy and criminal activity sector in South Africa makes the collection of data almost impossible. No official statistics could be obtained that offered data on lost taxes from business profits generated within the informal sector. Income from illegal trade or activities is usually not declared to SARS, and therefore tax evasion in the course of these activities is unpreventable.

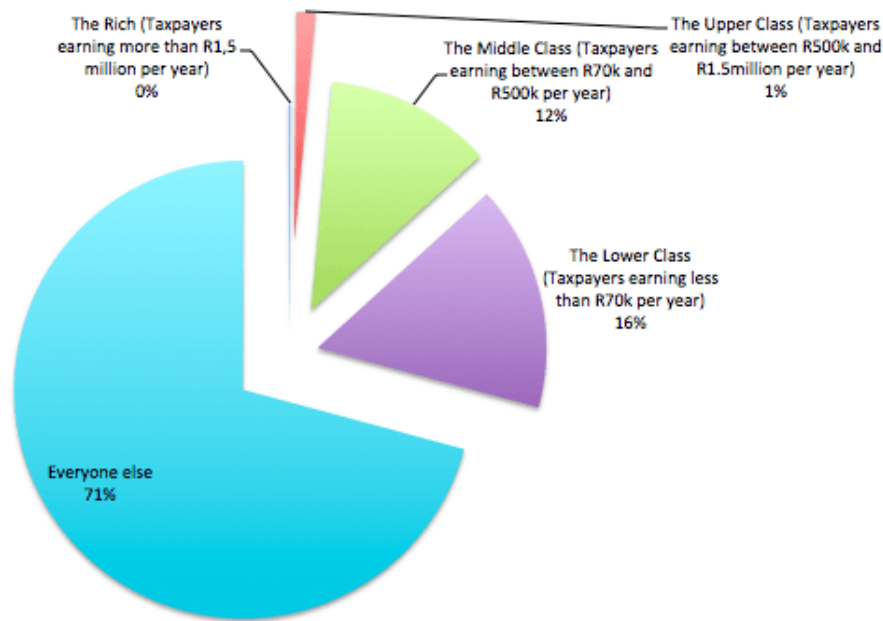
Figure 1 shows that the South African population consists of 53 million people, of which only 13% pay income tax.



(Rolling Alpha, 2015)

**Figure 1: The South African population**

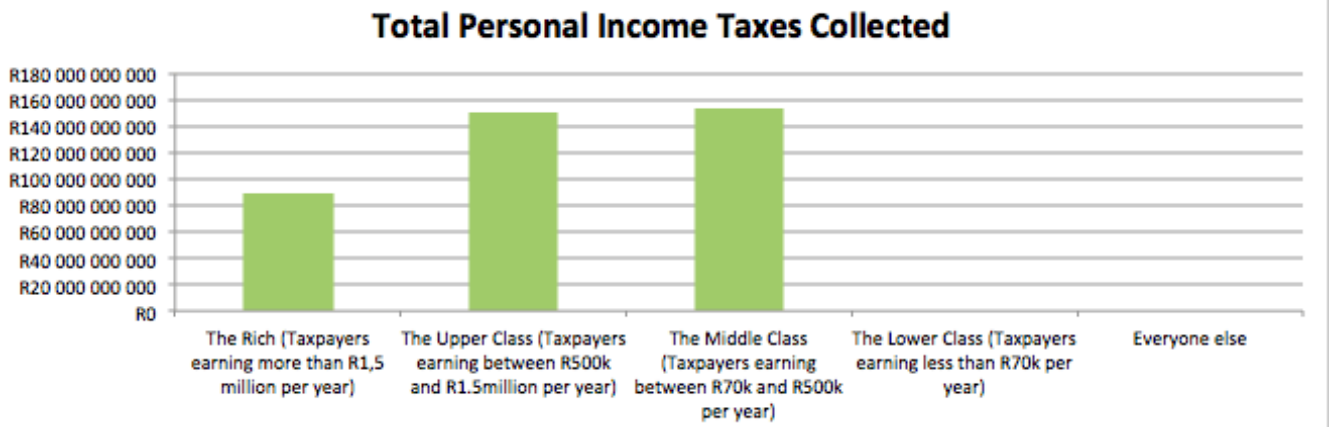
If the population is divided into classes according to annual income earned, 1% of the population earn more than R500 000 per annum (figure 2).



**Figure 2: Division of the population into classes according to annual income**

(Rolling Alpha, 2015)

Figure 3 shows that people earning more than R500 000 per annum contribute most to the country’s tax revenue (Rolling Alpha, 2015).



**Figure 3: Tax payments according to income classes**

(Rolling Alpha, 2015)

The conclusion is that only 1% (taxpayers earning more than R500 000 per annum) of the South African taxpayers are responsible for most of the taxes paid in South Africa. This is an extraordinary burden to lie on such a small portion of the population (Rolling Alpha, 2015). Moreover, if some of the taxpayers in the tax-paying 1% evade tax, the

burden on the rest becomes even heavier. A good example would be the tax evasion case of Irvin Khoza (De Wet, 2002) and the case of *The State v Van der Linde* (2016).

Although South Africa is not seen as one of the countries plagued by excessive tax evasion – at least it is not one of the top ten (Berr, 2011) – roughly R147 billion per year is lost through the illegal movement of money out of the country (Evans, 2014).

#### **4.4. SARS AND TAX EVASION**

##### **4.4.1 Background**

Income tax in South Africa was first introduced in 1914 with the promulgation of the Income Tax Act No 28, an act that had its origins in the New South Wales Act of 1895. The Act has gone through numerous amendments. The latest version is the Income Tax Act No 58 of 1962, section 103(1) and sections 80A to 80L of which contain anti-avoidance rules (Hattingh, Roeleveld & West, 2016).

The Tax Administration Act (TAA) came into effect on 1 October 2012 to provide specific anti-evasion and anti-avoidance rules supplementing the Income Tax Act. The TAA dictates the auditing processes implemented by SARS and authorises SARS to request investigation of a person's tax affairs. It also stipulates the rights of the taxpayers and the channels through which objections and disputes may be lodged (Tax Administration Act, 2012).

In addition to legislation, SARS launched a compliance programme on 1 April 2012. The purpose of the programme is to identify weaknesses in the tax system in terms of non-compliance, in other words, opportunities to evade tax (SARS, 2014). This program was designed based on a behavioural model (Figure 4) according to which a taxpayer will comply if he/she:

- *knows what to do;*
- *has the ability to do it; and*
- *has the right motivation to take action (SARS, 2014:6)*



**Figure 4: SARS behavioural model to evaluate compliance**

#### 4.4.2 Anti-avoidance<sup>1</sup> rules and the Tax Administration Act

According to SARS, tax avoidance has a very destructive impact on the economy of South Africa which includes a “corrosive effect upon taxpayer compliance, the uneconomic allocation of resources, upward pressure on marginal tax rates, an unfair redistribution of the tax burden, and a weakening of the ability of Parliament and the National Treasury to set and implement economic policy” (SARS, 2005:1).

The general anti-avoidance rules were contained in Section 103 (1) of the Income Tax Act no 58 of 1962. The main objective of section 103(1) was to provide a set of criteria to establish whether a transaction was structured in such a way as to obtain a tax benefit (SAICA, 2005). Due to inconsistency and ineffectiveness, section 103(1) was replaced by a new set of sections, 80A to 80L (SARS, 2005), in which the rules are narrowed down to describe specific terms such as an “impermissible arrangement” and also set out the powers the commissioner has to take action against an avoidance scheme (Jordaan, 2015).

Table 3 below sets out and evaluates different anti-avoidance rules, legislation and anti-evasion strategies of SARS against the background of the research question: Are rules, legislation and policies implemented by SARS aimed at preventing tax evasion?

<sup>1</sup> Note that SARS 2005 uses the terms "aggressive tax avoidance" and "impermissible tax avoidance" in his context, which is identical in meaning to "tax evasion" as defined in this study.



**Table 3: Anti-avoidance rules, legislation and anti-evasion strategies implemented by SARS**

<u>Legislation/Rules/ Policies/ Strategies</u>	<u>Details</u>	<u>Reasons for implementation</u>	<u>Examples of success or possible failure in terms of the research question</u>
Section 103(1) of the South African Income Tax Act No. 58 of 1962	<p>This section contained the general anti-avoidance rules. It stipulates that the commissioner may levy tax on any transaction if found that the taxpayer attempted to avoid or delay a tax obligation. This section may only apply if the commissioner can prove that the sole or main purpose was to avoid tax.</p> <p>Section 103(1) was repealed in 2006.</p>	<p>To prevent taxpayers from structuring a transaction or a business in such a way that tax which would otherwise be levied and payable to is avoided or delayed.. In other words, to combat tax avoidance by way of any tax saving scheme.</p>	<p>This section proved to be weak in the sense that it lacks substance with regard to the onus on the commissioner to prove that the sole or main purpose was tax avoidance.</p> <p>SARS failed in a number of court cases to prove that the taxpayer was attempting an impermissible tax avoidance scheme. Examples:</p> <ul style="list-style-type: none"> <li>• ITC 1712 (2000) 63 SATC 499 (G)</li> <li>• CIR v Conhage (Pty) Ltd 1999 (4) SA 1149 (SCA), 61 SATC 391</li> <li>• CIR v Geustyn</li> <li>• CIR v Louw 1983 (3) SA 551 (A), 45 SATC 113</li> </ul>
Section 80A to 80L	<p>These sections replaced section 103(1) and came into effect on 2 November 2006.</p> <p>These sections describe an avoidance arrangement as an impermissible tax arrangement if its sole or main purpose was to obtain a tax benefit. The section gives examples of transactions classified as impermissible tax arrangements. The powers of the commissioner and the consequence of an</p>	<p>Replacement of section 103(1) with well-defined and more comprehensive legislation that may equip SARS with irrefutable arguments.</p> <p>Section 80G puts the onus on the taxpayer to prove the main purpose for the</p>	<p>Sections 80A and 80B only refer to a tax avoidance arrangement as an impermissible arrangement which relates to income tax. No reference is made to any other tax acts.</p>



	impermissible arrangement are set out in section 80B.	scheme was not to avoid tax, as opposed to section 103, where the onus was on SARS.	
Tax Administration Act (TAA) Section 164(6)	An obligation to pay a tax may not be suspended by any taxpayer pending a dispute or an appeal. Also known as the “pay now, argue later” principle. This Act was effective from 1 October 2012.	To prevent taxpayers from lodging flippant disputes and benefitting by postponing a tax payment obligation.	The “pay now, argue later” principle was established in a South African court case ( <i>Mecash Trading Ltd v Commissioner for the South African Revenue Service</i> ). Without this principle, tax collection is delayed, which will have a negative impact on sustaining state revenue.
Section 46 of the TAA	SARS may request supporting documents (“relevant material”) relating to tax matters from a taxpayer.	Supporting documents are requested from taxpayers during a return verification or audit process in order to verify the correctness of the figures submitted to SARS.	Section 46(3) limits the scope of the type of supporting documents which may be requested from a person other than the taxpayer. For example: banks are prohibited by law from disclosing any information about their clients. If SARS requests material from a bank pertaining to a taxpayer, the bank may only submit records maintained by them. This may make it difficult for SARS to conduct a complete audit. It may also weaken the evidence in a tax evasion case.
Amendment Act No 44 of 2014 (TALAA)	This amendment to the TAA broadens the definition of “relevant material” contained in section 46 of the TAA.	The Explanatory Memorandum to the TALAA states that the reason for this amendment is to	This amendment changed the discretion that banks have when submitting documents to SARS to an obligation to submit any



		<p>“prevent protracted disputes around entitlement of information and the consequent waste of resources... the term "foreseeable relevance" does not imply that taxpayers may unilaterally decide relevance and refuse to provide access thereto, which is what is happening in practice”</p>	<p>material SARS requests. Therefore SARS is able to request as much information as needed to enable it to conduct its investigation into possible tax evasion properly.</p>
<p>Section 48 of the TAA. Field Audit or criminal investigation</p>	<p>SARS may request to visit a taxpayer’s place of business and inspect required records when conducting an audit or a criminal investigation.</p>	<p>To enable SARS to conduct an audit or investigation at the premises of the taxpayer.</p>	<p>The limits imposed by this section prohibit SARS from arriving at a taxpayer’s premises without prior written notice of 10 days. The scope of the audit also needs to be described in the notice. If a notice does not comply with the stipulations in section 48, SARS's motive for the audit or investigation may be questionable. This was proven in the Canadian court case <i>MNR v RBC Life Insurance Co</i>, [2013] FCA 50. The court ruled against the tax authority because they did not make “full and frank” disclosure of the scope and purpose of their proposed investigation of the taxpayer. By inserting these notice requirements in Section 48, SARS could have</p>



			compromised its powers to carry out audits and investigations.
Section 235 of the TAA. Criminal offences relating to evasion of tax	This section applies to any person who evades tax for his or her own or for another person's benefit. Therefore tax practitioners and accountants are also bound by this section.  In the subsections, examples of actions are given which qualify as tax evasion as well as punishment in the form of a penalty and possible imprisonment.	This sections sets out the consequences when a taxpayer is found guilty of tax evasion.	It has been argued that this section is in contravention with a taxpayer's constitutional right to a fair trial in terms of section 35(3)(h) of the constitution of the Republic of South Africa Act. It creates a reverse onus of proof presumption. Instead of a person being innocent until proven guilty, this section implies that a person is guilty and has to prove his innocence.  This argument may jeopardise SARS's arguments in court during tax evasion cases.
Section 133 of the TAA. Appeal against a decision of the tax court	A taxpayer or SARS may appeal against a decision of the tax court. The appeal may be to the provincial division of the High Court or to the Supreme Court.	This section allows both a taxpayer and SARS to seek a different judgment than that handed down in the tax court.	This section has proved to be successful. A tax evasion case was overturned in the High Court in favour of SARS. This case was an appeal after the tax court had ruled in favour of a taxpayer penalised for tax evasion. In the appeal hearing <i>Afri-Guard (Pty) Ltd v SARS</i> , the court ordered a 100% tax penalty, with costs to be paid by the taxpayer.
Tax Practitioner registration – SARS and Section 240A of the TAA.	SARS developed a new policy with regard to a person acting on behalf of a taxpayer. Such a person needs to register with SARS as a "Tax Practitioner" as well as with a recognised professional body in	This policy was implemented by SARS to monitor administration processes and to ensure that a person	Since the implementation of the registration process for tax practitioners, SARS has dealt with a number of cases where tax practitioners, although registered, filed

	<p>accordance with section 240A of the TAA. This policy came into effect on 8 September 2014. An attempt to curb tax evasion through schemes conducted by tax practitioners or accountants, for example in the cases of Lusindiso (Chapter 3.5) and Van der Linde (Chapter 3.5)</p>	<p>completing another taxpayer's return is responsible and law abiding.</p>	<p>fraudulent tax returns on behalf of taxpayers. Examples are:</p> <ul style="list-style-type: none"> <li>• Zaidah Kamish Johaar was charged with 98 counts of tax fraud and was convicted and sentenced to 4 years imprisonment.</li> <li>• In a recent tax case 3 SARS officials were convicted of tax fraud costing SARS R11 million.</li> </ul>
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Sources: SARS, 2005; SAICA, 2010; SAICA, 2013; Keulder, 2013; Treurnicht, 2015; Cliffe Dekker Hofmeyr, 2013; Afri-Guard (Pty) Ltd v The South African Revenue Service, 2016; SARS, 2016; SARS, 2015; Le Grange, 2014.

#### **4.4.3 SARS actions against tax evaders**

With regular warnings on their website, SARS are proving to taxpayers that they are focusing on tax evasion and have implemented strict policies over the past 2 years in an attempt to aggressively fight tax evasion.

##### **4.4.3.1. Criminal convictions for tax crimes in South Africa during 2014/2015**

In the past financial year, SARS achieved a 92% conviction rate in tax evasion cases that were handed over to the National Prosecuting Authority. The majority of these cases involved wealthy individuals and fraudulent VAT claims. These convictions illustrate that SARS has the capability to investigate tax crimes effectively (SARS, 2015).

Over the 2014/5 financial year, 256 individuals/entities were convicted in cases involving R96 million, with fines totaling R9,6 million. An effective 555 years of imprisonment, 258 months of correctional supervision and 2480 hours of community service were handed down to those convicted (SARS, 2015).

#### **4.4.3.2. Blaming the tax practitioner**

SARS has very strong views with regard to taxpayers evading tax after the taxpayer relied upon agents (tax practitioners) to file their tax returns. A court case (KBI v Mabotsa, 1993) revealed that it is the taxpayer's responsibility to ensure that his accounting records and tax matters are handled by a qualified person. The court is very clear on the stance it takes on the question whether the taxpayer could blame his/her tax practitioner when charged with tax evasion. The taxpayer cannot merely put the blame on the person who completed the tax return. He should have foreseen that fraudulent information on the tax return was a possibility and be familiar with the contents of his completed tax return before submission to SARS (Van der Walt, 2012).

Taxpayers also need to be aware of the basic tax principles themselves and should not blindly trust another person (ITC 1577, 1991). An excuse of "I did not know" will not hold in court, as the degree of care taken when a tax return was completed is measured against what the taxpayer should have been aware of regarding tax information submitted to SARS. (ITC1489, 1990).

Another element emphasised in courts is the occupation of the taxpayer and his level of education. For example, if a taxpayer is an experienced businessman, he will be expected to be aware of tax implications pertaining to his business. If charged with tax evasion, he will be deemed responsible even if his tax returns were completed and filed by his tax practitioner, and the court will only have to establish whether this businessman had the intention to evade tax (ITC 1576, 1992). This argument was also upheld in court in the tax evasion case of Irvin Khoza (De Wet, 2001).

#### **4.5. CONCLUSION**

Serious action is taken against tax evaders, especially since the Tax Administration Act came into effect, because of the additional powers SARS gained through section 46. SARS became intolerant of people not paying their taxes. Notices were issued on the SARS website warning taxpayers against tax evasion schemes and putting the blame at the door of a tax practitioner or an accountant. SARS is calling on the general public to cooperate by reporting non-compliance through their website or telephonically on the fraud hotline (SARS, 2016).

Although SARS has implemented strict requirements for a person to register as a tax practitioner, there are still qualified practitioners as well as SARS employees evading tax. Even though they get caught and are convicted, the monetary loss caused by their tax evasion has a negative impact on tax revenue collection.

Historical studies suggest that the decision to evade tax depends on various factors, including risk of getting caught, the amount of tax that could be saved and the tax rate itself. But according to convicted tax evaders serving a prison sentence, the decision to evade depends on the attractiveness of the financial benefit and is also influenced by the motivation behind the decision.

## CHAPTER 5: CONCLUSIONS

Considering the 1% of the South African population who contribute the bulk of the country's revenue and the R147 billion of illegal movement of money out of the country during 2015, South Africa should be regarded as having a problem with tax evasion.

From the discussions in this study is evident that SARS realises this and that government is taking action against people evading tax – if they are caught. Interviews with offenders uncovered the reasons why people still evade tax. It is suggested that the focus should be on preventive measures instead of measures to punish tax evaders.

### 5.1. ATTAINMENT OF THE RESEARCH OBJECTIVES

The research questions were answered as follows:

- **Evaluation of historic policies on tax evasion in ancient Egypt, during the Golden Age in Greece and in the Roman Empire**

Egyptian and Roman policies on tax evasion were similar in the way they were implemented and enforced on people. Tax collectors collected taxes from people in the form of produce. Tax evasion was punished by corporal punishment, imprisonment or death, which made it a very primitive tax system compared with the Greek system. The Greek senate implemented a tax system where rich people contributed voluntarily to the improvement of the country's infrastructure. The one thing all three empires had in common is that they all had tax evasion problems. Egyptians fled from the scribes and hid in the temples. The Romans could not maintain their military force due to a lack of state revenue and succumbed to foreign invaders. The Greeks taxed foreigners working in Greece so harshly that people forged their birth certificates in order to prove their citizenship, which exempted them from tax.

- **A discussion of a court cases in the past century where people (with specific reference to Al Capone) were caught and punished for tax evasion**

The tax evasion case of Al Capone was discussed. The relevance of the case and lessons learnt from it are found in the methods used by the law enforcement agency



in order to ensure a successful conviction. The collaboration between the tax authorities and prosecuting agents was the key to an arrest and a successful conviction followed by the imprisonment of Al Capone

- **Critical evaluation of the methods and strategies used by SARS and the South African government in historic court cases to establish whether SARS takes into account previous tax evasion events when conducting an investigation**

Similar collaboration between the different law enforcement agencies as found in the Al Capone case took place in South Africa during the criminal investigations and convictions of Irvin Khoza in 2001, Mhlwatika Lusindiso in 2010 and Ivan van der Linde in 2016. Taxpayers involved in these cases were investigated by SARS for tax evasion. When evidence was found, an exchange of information between SARS, the South African police and the prosecuting authority took place in order to obtain successful convictions.

- **Identification and evaluation of tax evasion policies and deterrent methods implemented by SARS and the South African government to detect tax evasion schemes and punish tax evaders**

Anti-avoidance and anti-evasion rules, policies and legislation were analysed, evaluated and measured against the research question: Are rules, legislation and policies implemented by SARS aimed at preventing tax evasion? Examples of practical application provide evidence that these rules, legislation and policies implemented by SARS, do not prevent tax evasion.

## **5.2. RESPONSE TO THE RESEARCH QUESTION**

The research question guiding this study is:

Are rules, legislation and policies implemented by the revenue authorities (for this study, SARS) aimed at preventing tax evasion?

This study addresses the research question by evaluating history, historic tax court cases, anti-evasion rules and legislation. It was found that rules and legislation implemented by SARS are not aimed at preventing tax evasion, but rather at detecting tax evasion and facilitating convictions.

### 5.3. FINDINGS AND FINAL COMMENTS

South Africa has seen enormous tax policy development over the past century, taking into account that 122 years ago the first tax (native poll tax), paid in the form of physical coins (money), was implemented.

During the past 5 years SARS occupied itself with anti-avoidance and anti-evasion rules by amending the Income Tax Act and implementing a new Act, the Tax Administration Act. It was found in this study that while suspected or actual tax evasion is addressed by SARS's rules, legislation and policies, it is done retrospectively manner. Tax evasion is detected when the crime has already been committed and when SARS has already suffered a monetary loss.

Tacitus, a senator and historian of the Roman Empire, AD 56 once said: "Great empires are not maintained by timidity".

A possible rephrasing could be: Great empires are not maintained by timidity but by bold policy makers.

### 5.4. RESEARCH RECOMMENDATIONS

It could be interesting to conduct further research in the field of tax evasion with specific focus on the psychological decision-making process of a person when completing a tax return. An extended field study (nationwide) in the form of interviews with people serving prison sentences specifically for committing tax crimes is recommended in order to establish the motives behind the decision to evade tax on a national level.

*"Ladies and Gentlemen;*

*We have laid particular stress on steps by the private sector towards increased and more effective self-regulation because this would bring double benefits. It would help to cut crime: but it would also reduce the scale of public resources required to combat tax evasion and fraud. That would strengthen our national drive for fiscal discipline" (Mandela, 1995).*

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