

**TAX ADMINISTRATION: THE DISCRETION OF THE  
COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE  
WHEN UNDERSTATEMENT PENALTIES ARE IMPOSED**

**by**

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*"We contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle."*

Winston S. Churchill

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# CHAPTER 1: INTRODUCTION

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## INTRODUCTION TO THE RESEARCH

The Tax Administration Act, 28 of 2011 ('TAA') has introduced significant changes to the South African tax landscape. The TAA came into effect on 1 October 2012 and introduced a new understatement penalty regime, which although similar in principle to the additional tax regime in the Income Tax Act, 58 of 1962 ('ITA') and the Value Added Tax Act, 89 of 1991 ('VAT Act'), provides for fixed percentage penalties based on taxpayer behaviour at the discretion of the South African Revenue Service ('SARS'), rather than a percentage, as was the case with the additional tax regime.

The old open-ended discretion of SARS, in terms of section 76 of the ITA, to levy additional tax of up to 200% in the event of default or omission by the taxpayer and to reduce the additional tax if it was determined that there were extenuating circumstances, was replaced by a limited discretionary power to remit the new mandatory understatement penalty contained in sections 221 to 224 of Chapter 16 of the TAA.

Croome and Olivier in *Tax Administration*<sup>1</sup> refer to RK Gordon in *Tax Law Design and Drafting*,<sup>2</sup> who describes the purpose of sanctions such as penalties in the following terms:

*'Sanctions are perhaps one of the most overrelied-upon, and poorly understood tools for enhancing tax compliance. Sanctions can also have more than one purpose. First, the most important component of sanctions is their ability to deter unwanted behaviour, so as to bring about greater compliance. Therefore, sanctions should be applied only to behaviour that*

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<sup>1</sup> Croome, B. & Olivier, L. (2015). *Tax Administration*. (2<sup>nd</sup> Ed.) Chapter 17, p 473.

<sup>2</sup> Thuronyi, V. (Ed.) *Tax Law Design and Drafting*. Volume 1 (International Monetary Fund 1996). [Online]. Available at <https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch2.pdf>.

*is reasonably capable of being deterred. Second, sanctions must be fair under the jurisprudential criteria in effect in a particular jurisdiction. Under the jurisprudential principles of most jurisdictions, this means that sanctions should apply only when the sanctioned person is somehow at fault and should not be unduly harsh or disproportional, or imposed in violation of principles of due process.*<sup>3</sup>

Croome and Olivier in *Tax Administration*<sup>4</sup> state that the concern that arises in South Africa is that penalties are imposed primarily as a means of raising revenue and not to deter non-compliant taxpayers and encourage them to comply with the law. The Davis Tax Committee in its *Introductory Report on Base Erosion and Profit Shifting in South Africa*,<sup>5</sup> raised a concern regarding the incentivisation of SARS employees (including the Commissioners for SARS) as follows:

*'The incentivisation system in which gross tax collections are treated as a major indicator of good performance should be stopped as there is a perception that it foster corruption and abuse of the system.'*

An understatement is defined in section 221 of the TAA as any prejudice to SARS or the fiscus as a result of:

- (a) *a default in rendering a return;*
- (b) *an omission from a return;*
- (c) *an incorrect statement in a return; or*
- (d) *if no return is required, the failure to pay the correct amount of tax*<sup>6</sup>

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<sup>3</sup> Thuronyi, V. (Ed.) *Tax Law Design and Drafting, Volume 1* (International Monetary Fund 1996). [Online]. Available at <https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch2.pdf>, par 1 p 117.

<sup>4</sup> Croome, B. & Olivier, L. (2015). *Tax Administration*. (2nd Ed.) Chapter 17.

<sup>5</sup> Davis Tax Committee. (n.d.). *Introductory Report on Base Erosion and Profit Shifting in South Africa*. [Online]. Available at: <http://www.taxcom.org.za/>.

<sup>6</sup> S221 of the TAA.

The new understatement penalty regime has given rise to significant controversy between the taxpayers and SARS. SARS has no discretion to impose an understatement penalty, unless the *bona fide* inadvertent error exception (see discussion herein under) applies, or to impose such a penalty at a lower percentage. SARS further has limited discretionary powers to remit the new mandatory understatement penalty contained in the TAA. Neither the TAA nor SARS's Short Guide to the TAA (2011) ('Short Guide to the TAA, 2011')<sup>7</sup> provides any guidance as to how SARS should exercise its discretion. The lack of comprehensive guidelines during the imposition of understatement penalties may prove to be detrimental to the taxpayer due to inconsistent application of the discretion of SARS and even a possible abuse of powers by SARS.

The Tax Administration Laws Amendment Act<sup>8</sup> ('TALAA') provides substantial changes to the understatement penalty regime, in particular with regard to the levying of understatement penalties in respect of tax returns submitted prior to the commencement of the TAA. In terms of these amendments, where understatements are identified in a verification, audit, or investigation completed on or after 1 October 2012, the understatement penalty regime would apply to the understatements in pre-1 October 2012 returns. This is also a controversial issue as taxpayers may argue that to impose an understatement penalty in respect of any understatement that occurred before the commencement date of the TAA amounts to retrospective application of the Act and is not permitted in terms of the general provisions of our common law and the Constitution of the Republic of South Africa<sup>9</sup> ('the Constitution'). The interpretation by the courts of sections 270(6) to 270D of the TAA pertaining to the transitional rules also have an influence on the imposition of understatement penalties by SARS to an understatement that occurred before the commencement date of the TAA.

This study deals primarily with an analysis of the discretionary powers of the Commissioner for SARS and the execution of its discretion when understatement penalties are imposed.

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<sup>7</sup> SARS. (2013). *Short Guide on the TAA, 28 of 2011*. (5 June 2013). SARS Version 2. [Online]. Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>8</sup> 39 of 2013.

<sup>9</sup> 108 of 1996.



## PROBLEM STATEMENT

This study deals primarily with the execution of the discretion of the Commissioner for SARS when understatement penalties are imposed, including but not limited to, determining whether the *bona fide* inadvertent error exception applies, determining the quantum of the understatement penalty by the behaviour of the taxpayer with reference to the table in section 223(1) of the TAA, the discretion of SARS to remit understatement penalties, and the imposition of understatement penalties to understatements that occurred prior to the commencement of the TAA, including the transitional provisions.

It also deals with the remedies available to aggrieved taxpayers and discusses where the burden of proof lies when understatement penalties are imposed. Further, this study briefly compares the discretion of SARS to remit additional tax imposed under the ITA and the discretion of the Commissioner for SARS to remit understatement penalties imposed in terms of the TAA. It further compares understatement penalties imposed in South Africa and similar penalties imposed in Australia.

The abovementioned issues are a problem as neither the TAA nor SARS's Short Guide<sup>10</sup> on the TAA (2011) provide any guidelines as to how the Commissioner for SARS should exercise its discretion. As a result thereof the imposition of understatement penalties by SARS could lead to controversy, subjectivity, or biased conduct by the SARS officials, which in return could lead to the inconsistent application of the understatement regime.

## RESEARCH OBJECTIVES

This study will be guided by the following specific research objectives:

- To analyse the discretion of the Commissioner for SARS when understatement penalties are imposed;

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<sup>10</sup> SARS. (2013). *Short Guide on the TAA, 28 of 2011*. (5 June 2013). SARS Version 2. [Online]. Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

- To analyse the discretion of the Commissioner for SARS when the taxpayer applies for a remittance of the understatement penalty;
- To discuss and analyse the remedies available to the taxpayer as well as who bears the onus of proof;
- To briefly compare the discretion of the Commissioner for SARS to remit additional penalties in terms of the ITA and the remittance of understatement penalties imposed in terms of the TAA;
- To briefly analyse the imposition of understatement penalties by the Commissioner for SARS to understatements made prior to the commencement of the TAA, including the transitional provisions in terms of the TAA; and
- To briefly compare the imposition of understatement penalties imposed in terms of the TAA and similar penalties imposed in Australia.

## SIGNIFICANCE OF THE RESEARCH

The new understatement penalty regime in terms of the TAA has given rise to significant controversy between taxpayers and SARS. The lack of comprehensive guidelines regarding the process of identifying and ruling out *bona fide* inadvertent errors may prove to be to the detriment of the taxpayer due to possible inconsistent application and possible abuse. The fact that the quantum of the understatement penalty is determined with reference to the taxpayer's behaviour (applying the table in sec 223(1) of the TAA) which is determined by SARS officials in exercising their discretion, could lead to subjectivity or biased conduct by SARS officials and therefore could lead to the inconsistent application of the understatement regime.

The fact that an incentivisation system in which gross tax collections, including the collection of understatement penalties, is treated as a major indicator of good performance has the potential for fostering corruption and abuse of the system.

From a theoretical perspective, this study will make a valuable contribution for tax practitioners, legal practitioners, academics and people within the audit and tax fields with regard to a better understanding of the discretionary powers conferred upon the Commissioner for SARS in imposing understatement penalties, the remission of understatement penalties, the remedies available to taxpayers, and how to deal with understatement penalties imposed for understatements occurring prior to the commencement of the TAA.

From a practical perspective this study should be able to provide the taxpayers with knowledge and awareness enabling them to take the necessary caution when completing and submitting a tax return, and provide tax practitioners with the necessary knowledge when preparing a tax opinion which sets out the grounds for reasonable care taken by the taxpayer when an application is made for the remission of an understatement penalty imposed by SARS.

## **RESEARCH METHODOLOGY**

This study is a theoretical analysis and is primarily literature- and case law-based. The study will be analytical, interpretive, comparative and evaluative in nature.

## **DATA COLLECTION**

In this study the literature from renowned authors, case law, tax books, electronic media, tax guides, memoranda of SARS, the Constitution, and legislation will be the primary data to be used. The data will be analysed and the problem areas with regard to the 'golden thread', namely the discretion of the Commissioner for SARS when understatement penalties are imposed, will be identified and discussed.

## LIMITATIONS

The study deals only with understatement penalties in terms of the TAA (sections 221 to 224) and specifically with the discretion conferred upon SARS when understatement penalties are imposed. It does not deal with administrative non-compliance penalties and fixed amount penalties (chapter 15 of TAA). It does not deal with any interest which SARS may impose on the taxpayer in the event of an understatement (section 89 *quat* of the ITA). Voluntary disclosure programme (sections 225 to 233 of the TAA) will not be discussed due to a prescribed limitation on the length of the study.

## DEFINITION OF KEY TERMS

The following key terms will be referred to:

- **Commissioner:** Commissioner means the Commissioner for the South African Revenue Service appointed to that post in terms of section 6 of the SARS Act by the President of the Republic of South Africa, or the Acting Commissioner designated by the Minister in terms of section 7 of the SARS Act, 34 of 1997.<sup>11</sup>
- **Repeat case:** A repeat case means a second or further case of any of the specific behaviours dealt with in terms of (i) to (ii) of the understatement penalty percentage table set out in section 223 of chapter 16 of the TAA, within five years of the previous case.<sup>12</sup>
- **SARS:** It means the South African Revenue Service established under the SARS Act, 34 of 1997.<sup>13</sup>
- **SARS Act:** It means the South African Revenue Service Act, 34 of 1997.<sup>14</sup>

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<sup>11</sup> S1 of the TAA.

<sup>12</sup> S221 of the TAA.

<sup>13</sup> S1 of the TAA.

<sup>14</sup> S1 of the TAA.

- SARS official: For the purpose of this study, it refers to the Commissioner, an employee of SARS, or a person contracted by SARS for purposes of the administration of a tax Act. The person mentioned in the last instance has to carry out the provisions of a tax Act under the direct supervision, direction and control of the Commissioner.<sup>15</sup>
- Substantial understatement: A substantial understatement means a case where the prejudice to SARS or the fiscus exceeds the greater of 5% of the tax properly chargeable or refunded under a tax Act for the applicable tax period, or R1 000 000.<sup>16</sup>
- Tax: Tax is defined as meaning any tax as defined in section 1 of the TAA, including a penalty and interest.<sup>17</sup>
- Taxpayer: For the purpose of this study it refers to a person chargeable to tax, a representative taxpayer, a withholding agent, a responsible third party, or a person who is the subject of a request to provide assistance under an international tax agreement.<sup>18</sup>
- Tax position: Tax position is defined in section 221 of the TAA to mean an assumption underlying one or more aspect of a tax return, including whether or not-
  - (a) an amount, transaction, event or item is taxable;
  - (b) an amount or item is deductible or may be set-off;
  - (c) a lower rate of tax than the maximum applicable to that class of taxpayer, transaction, event or item applies; or
  - (d) an amount qualifies as a reduction of tax payable.<sup>19</sup>
- Understatement: An understatement is defined in section 221 as any prejudice to SARS or the fiscus as a result of:

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<sup>15</sup> S1 of the TAA.

<sup>16</sup> S221 of the TAA.

<sup>17</sup> S1 of the TAA.

<sup>18</sup> S151 of the TAA.

<sup>19</sup> S221 of the TAA.

- (a) a default in rendering a return;
- (b) an omission from a return;
- (c) an incorrect statement in a return; or
- (d) if no return is required, the failure to pay the correct amount of 'tax.'<sup>20</sup>

## ABBREVIATIONS

Below is a table that contains a list of the abbreviations used in this document:

**Table 1: List of abbreviations used in this document**

Abbreviation	Meaning
Constitution	Constitution of the Republic of South Africa, 108 of 1996
ITA	Income Tax Act, 58 of 1962
PAJA	Promotion of Administrative Justice Act, 3 of 2000
par	Specific paragraph of a research document or paragraph in the document referred to in footnotes
SARS	The South African Revenue Service
SARS Act	The South African Revenue Service Act, 34 of 1997
S	Specific section of an Act referred to in footnotes
TAA	Tax Administration Act, 28 of 2011
TALAA	Tax Administration Laws Amendment Act, 39 of

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<sup>20</sup> S221 of the TAA.

Abbreviation	Meaning
	2013
VAT Act	Value Added Tax Act, 89 of 1991

## STRUCTURE OF CHAPTERS

Chapter 1: This chapter consists of the introduction, problem statement, research objectives, significance of the research, research methodology, data used for purpose of the research, research limitations, definition of key terms, abbreviations used in the study, and the structure of the chapters.

Chapter 2: This chapter focus on the *bona fide* inadvertent error exception, which includes the meaning of the *bona fide* inadvertent error as well as factors to be considered when it is determined, and the understatement penalty percentage table as provided for in section 223(1) of the TAA with reference to the understatement penalty percentage table as on 1 October 2012 as well as on 16 January 2014.

Chapter 3: Chapter 3 consists of a detailed discussion of the behaviour types as listed in items (i) to (v) of the understatement penalty percentage table. The chapter includes a discussion of the discretion conferred on the Commissioner for SARS when understatement penalties are imposed and recommendations.

Chapter 4: Chapter 4 consists of the remedies available to an aggrieved taxpayer when understatement penalties are imposed for an understatement, which include the burden of proof, remission of understatement penalties, objection and appeal proceedings, and a conclusion.

Chapter 5: This chapter deals with a brief comparison between the remittance of additional penalties imposed in terms of section 76(1) of the ITA and the remittance of understatement penalties imposed in terms of section 223(3) of the TAA, as well as a brief discussion of the transitional provisions provided for in terms of the TAA.

Chapter 6: Chapter 6 consists of a brief comparison between understatement penalties imposed in terms of the TAA and similar penalties imposed in Australia. During the drafting of the TAA the Australian administrative tax law was taken, *inter alia*, into account and therefore it is fitting to briefly compare understatement penalties imposed in terms of the TAA and similar penalties imposed in Australia. The wording and phrases used in the TAA are very similar to those used in the Australian administrative tax law.

Chapter 7: In this chapter recommendations are made regarding possible factors that could be considered by SARS when guidelines are compiled to assist the taxpayer and the Commissioner for SARS when understatement penalties are imposed. The chapter also provides a conclusion based on the research study.



## CHAPTER 2: UNDERSTATEMENT PENALTIES: *BONA FIDE* INADVERTENT ERROR AND THE UNDERSTATEMENT PENALTY PERCENTAGE TABLE

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### INTRODUCTION

Chapter 16 of the TAA has the effect that where a taxpayer is guilty of an understatement, they must pay, in addition to the underlying tax due for the applicable tax period, the understatement penalty as provided for in section 222(2) of the TAA unless the understatement arises from a *bona fide* inadvertent error made by the taxpayer.<sup>21</sup> A *bona fide* inadvertent error will be discussed herein under.

Arendse and Williams in *Beware of the new additional tax regime*<sup>22</sup> identify various uncertainties in the application of the new understatement penalty regime and state that it is apparent that the new penalties create significant uncertainty, are harsher than the current additional tax regime in practice, and are likely to operate to the detriment of most taxpayers. They also anticipate that the material reduction at the discretion of SARS to remit penalties will have a net material adverse impact on taxpayers going forward.

Understatement is defined in section 221 of the TAA as any prejudice to SARS or the fiscus as a result of one of four forms of conduct by the taxpayer:

- (a) a default in rendering a return;

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<sup>21</sup> S222 (2) of the TAA.

<sup>22</sup> Arendse, T. & Williams, P. (2012). Beware of the new additional tax regime. *Tax Talk*, Sept/Oct issue, 30-33:

- (b) an omission from a return;
- (c) an incorrect statement in a return; or
- (d) if no return is required, the failure to pay the correct amount of tax'.<sup>23</sup>

The word 'any' makes the understatement penalty excessively wide since it effectively means that, in the light of the mandatory nature, any amount of a shortfall due to an understatement will lead to this penalty being imposed (provided a *bona fide* inadvertent error is ruled out).<sup>24</sup> The Short Guide to the TAA<sup>25</sup> (2011) states that in the case of tax being underpaid because of an understatement made by the taxpayer, the TAA provides for different rates of an understatement penalty be imposed based on the type of behaviour or the degree of culpability by the taxpayer. Each one of these behaviours and degree of culpability will be discussed herein under.

Van Zyl in *The new understatement penalty regime: a sharp sword?*<sup>26</sup> states that it is clear that SARS must consider all the types of behaviour and all the possible conducts of the taxpayer as provided for in the table in section 223(1) of the TAA before imposing an understatement penalty.

As neither the TAA nor the Short Guide to the TAA (2011)<sup>27</sup> provide comprehensive guidelines for the SARS officials as to how to exercise their discretion when imposing the understatement penalties, it is submitted that more guidance is needed to ensure the objectivity of all SARS officials.

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<sup>23</sup> S221 of the TAA.

<sup>24</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 906.

<sup>25</sup> SARS. (2013) *Short Guide to the TAA, 28 of 2011 (Version 2)* par 16.4 p 79 [Online] Available:<http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>26</sup> Van Zyl, L. (2014) The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 905.

<sup>27</sup> SARS. (2013) *Short Guide to the TAA, 28 of 2011 (Version 2)* [Online]. Available: <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

'Discretion' is defined in the Free Dictionary<sup>28</sup> as 'the power or right to make official decisions using reason and judgment; and/or to choose from acceptable alternatives. An abuse of discretion occurs when a decision is not an acceptable alternative. The decision may be unacceptable because it is logically unsound, because it is arbitrary and clearly not supported by the facts at hand, or because it is explicitly prohibited by a statute or rule of law.

In *O'Leary v Salisbury City Council* 1975 3 SA 859 (RA) at 863 the court held as follows:

*'When an official is granted an unfettered discretion, there is a limitation of powers implied by law, that the official will apply his mind properly to the question before him, consider it honestly and bona fide, without any ulterior motive and not impose a condition which no reasonable man so acting could have done.'*<sup>29</sup>

Section 2 of the SARS Act<sup>30</sup> provides as follows:

*'The South African Revenue Service is hereby established as an organ of state within the public administration but as an institution outside the public service.'*

It is clear that SARS is an organ of state as envisaged in section 239 of the Constitution.<sup>31</sup> Many of the decisions taken by SARS constitute 'administrative action', and where a taxpayer is dissatisfied with SARS's decision, they have the right to object to that decision, and then the taxpayer must follow the rules regulating dispute resolution as set out in chapter 9 of the TAA and adhere to the rules promulgated under section 103 of the TAA. Where a decision is made by SARS and that decision is not subject to objection and appeal,

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<sup>28</sup> The Free Dictionary. *Discretion*. [Online]. Available at <http://legal-dictionary.thefreedictionary.com/Discretion+in+Decision+Making>.

<sup>29</sup> 1975 3 SA 859 (RA) at 863.

<sup>30</sup> S2 of 34 of 1997.

<sup>31</sup> S239 of 108 of 1996.

the taxpayer may be entitled to apply to a court to review that decision on the basis that SARS has violated the rules of administrative justice in section 33 of the Constitution and the provisions of the Promotion of Administrative Justice Act, 3 of 2000<sup>32</sup> ('PAJA').

Van Zyl in *The New Understatement Penalty Regime: a sharp 'sword'?*<sup>33</sup> states that it is imperative that comprehensive guidelines be issued expediently in order to prevent inconsistent application by SARS officials, as well as to clarify the alleged automatic penalty position. The conclusion that Van Zyl reaches in respect of the understatement penalty regime is that the sword is very sharp indeed, based on its mandatory nature, the effect of the application of the highest penalty percentage, and the current lack of guidance from SARS, especially regarding the practical application of the new *bona fide* inadvertent error exclusion.

The following phrases will be discussed herein under with specific reference to the behaviours of the taxpayer as set out in the table in section 223(1) of the TAA, which the Commissioner for SARS must consider when understatement penalties are imposed:

- *Bona fide* inadvertent error;
- Substantial understatement;
- Reasonable care not taken in completing return;
- No reasonable grounds for tax position taken;
- Gross negligence; and
- Intentional tax evasion.

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<sup>32</sup> Croome, B. & Olivier, L. (2015). (2<sup>nd</sup> Ed.) *Tax Administration*. Chapter 22 p 571. Act 3 of 2000.

<sup>33</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 905.

## **BONA FIDE INADVERTENT ERROR**

### **2.1.1 Introduction**

Section 25(2) of the TAA requires that a return must contain the information prescribed by a tax Act or the Commissioner, and must be a full and true return.<sup>34</sup> Most taxpayers complete and submit their own income tax returns, without any assistance.

Van Zyl in *The new understatement penalty regime: a sharp 'sword'?*<sup>35</sup> quotes Albert Einstein, when he was asked what he thought when he filled out his income tax form. In 1944, he answered as follows:

*'This is a question too difficult for a mathematician. It should be asked of a philosopher.'*<sup>36</sup>

### **2.1.2 Meaning of bona fide**

Neither the TAA nor SARS's Short Guide to the TAA (2011) defines the phrase '*bona fide* inadvertent error', and therefore the ordinary meaning of the word should be established. In respect of the proper approach to statutory interpretation, Wallis JA in *Natal Joint Municipal Pension Fund v Edumeni Municipality* 2012 4 SA 593 SCA at par [18] held as follows:

*'The present state of the law can be expressed as follows: Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its*

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<sup>34</sup> S25(2) of the TAA.

<sup>35</sup> Van Zyl, L. (2014) *The new understatement penalty regime: a sharp 'sword'?* *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 908.

<sup>36</sup> Einstein, A. (n.d.). *Good Reads*. [Online] Available at <http://www.goodreads.com/quotes/tag/taxws?page=2>.

*coming into existence...The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document'.<sup>37</sup>*

In The Free Dictionary '*bona fide*', a Latin phrase, means 'in good faith; genuine; actual; authentic and acting without the intention of defrauding'.<sup>38</sup> The opposite of good faith is bad faith and this may involve intentional deceit.

'Inadvertent' is not defined in the TAA. The Free Dictionary<sup>39</sup> defines 'inadvertent' as '*marked by or resulting from carelessness; negligent; not deliberate or considered; unintentional and not intending to be so*'. In the Merriam-Webster Dictionary<sup>40</sup> 'inadvertent' has the meaning of '*not focusing the mind; unintentional; and not intended or deliberate*.'

An 'error' from the Latin *error* means 'wandering', and is defined in The Free Encyclopaedia<sup>41</sup> as 'an action which is inaccurate or incorrect; mistake; and a deviation from accuracy or correctness'.

From the definitions *supra* it is clear that SARS cannot impose an understatement penalty if the shortfall results from a genuine and unintentional act by a sincere taxpayer when completing a tax return, which has the effect that something is not correct in the return. SARS must first critically apply its mind to rule out a *bona fide* inadvertent error before it can impose an understatement penalty. It is critical that comprehensive guidance is developed in this regard in order to assist SARS officials when exercising their discretion.

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<sup>37</sup> 2012 4 SA 593 SCA at par [18].

<sup>38</sup> The Free Dictionary. (n.d.). *Bona fide*. [Online]. Available at <http://legal-dictionary.thefreedictionary.com/bona+fide>.

<sup>39</sup> The Free Dictionary. (n.d.). *Inadvertent*. [Online]. Available at <http://www.thefreedictionary.com/inadvertent>.

<sup>40</sup> Merriam-Webster Dictionary. (n.d.). *Inadvertent*. [Online]. Available at <http://www.merriam-webster.Com/dictionary/inadvertent>.

<sup>41</sup> The Free Encyclopaedia. (n.d.) *Error*. [Online] Available at <http://en.wikipedia.org/wik/Error>.

Making *bona fide* errors in completing a tax return would seem quite human in spite of the requirements in section 25(2) of the TAA.

Section 222(1) of the TAA reads as follows:

*'(1) In the event of an 'understatement' by a taxpayer, the taxpayer must pay, in addition to the 'tax' payable for the relevant tax period, the understatement penalty determined under subsection (2) unless the 'understatement' results from a bona fide inadvertent error.'*<sup>42</sup>

In the *Memorandum on the Objects of the Tax Administration Laws Amendment Bill, 2013*<sup>43</sup> SARS states the rationale for the amendment to section 222(1) as follows:

*'Paragraph (a): Amendment of subsection (1): The proposed amendment clarifies when an 'understatement' will not result in a penalty by excluding bona fide inadvertent error. This gives effect to the announcement in this regard in the 2013 Budget Review. The proposed amendment will apply with effect from 1 October 2012, but will also apply to understatements made in a return before 1 October 2012. Due to the broad range of possible errors, the proposal to define the term 'bona fide inadvertent error' has the potential to inadvertently, exclude deserving cases and include undeserving cases. SARS will, however, develop guidance in this regard for the use of taxpayers and SARS officials.'*

To date hereof neither the TAA nor SARS's Short Guide to the TAA (2011)<sup>44</sup> has provided guidance in this regard and it is open to SARS to exercise discretion and apply its mind to rule out a *bona fide* inadvertent error. This underlines the need for comprehensive guidance.

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<sup>42</sup> S 222(1) of the TAA.

<sup>43</sup> SARS. (2013). *Memorandum on the Objects of the Tax Administration Laws Amendment Bill (2013)*, par 2.75 p 40. Available at <http://www.sars.gov.za>.

<sup>44</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011 (Version 2)* [Online] Available: <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx> (Accessed June 2015).

### **2.1.3 Factors to be considered when bona fide inadvertent error is determined**

Croome and Olivier in *Tax Administration*<sup>45</sup> state that during a workshop held by SARS to discuss amendments to the TAA, SARS indicated that it was never its intention to subject a taxpayer to the understatement penalty where the taxpayer makes a *bona fide* mistake. Thus section 222 of the TAA was amended by way of section 75 of TALAA<sup>46</sup> to provide that where a taxpayer has made a *bona fide* inadvertent error no understatement penalty would be imposed.

The practical difficulty that arises is the scope of conduct intended to fall into the term '*bona fide* inadvertent error'. The Draft Memorandum on the Objects of the Tax Laws Amendment Bill, 2013<sup>47</sup> initially explained what conduct would qualify as a *bona fide* inadvertent error. A SARS official could then have regard to these circumstances in which a *bona fide* inadvertent error was made as well other factors such as the following:

In the context of factual errors:

- If the standard of care taken by the taxpayer in completing the return is commensurate with the taxpayer's knowledge, education, experience and skill and the care of a reasonable person in the same circumstances would have exercised;
- The size or quantum, nature and frequency of the error;
- Whether a similar error was made in a return submitted during the preceding years; or
- In the case of an arithmetical error, whether the taxpayer had procedures in place to detect arithmetical errors.

In the case of a legal interpretive error:

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<sup>45</sup> Croome, B. & Olivier, L. (2015). *Tax Administration*. (2nd Ed.) Chapter 17 p 476.

<sup>46</sup> 39 of 2013.

<sup>47</sup> SARS. (2013). The Draft Memorandum on the Objects of the Tax Administration Laws Amendment Laws Amendment Bill, 2013. Published by the National Treasury on its website on 5 July 2013 at 13.



- The relevant provisions of a tax Act is generally regarded as complex;
- The taxpayer took steps to understand it, including following incorrect available explanatory material or making reasonable enquiries; or
- The taxpayer relied on information, that although incorrect or misleading, came from reputable sources and a reasonable person in the same circumstances would be likely to find the relevant information complex.

Unfortunately, in the final version of the explanatory memorandum on the 2013 amendments to the TAA, the abovementioned criteria were removed. SARS has indicated that it will develop guidance regarding the meaning of the phrase '*bona fide* inadvertent error' and will publish that for the use of taxpayers and SARS officials.<sup>48</sup> Thus far SARS has failed to provide the guidance it undertook to make available for the benefit of taxpayers and for its own officials.

It is advised that where taxpayers are subjected to the understatement penalty they should consider if their circumstances can be described as a *bona fide* inadvertent error taking into account the factors listed *supra*. If the taxpayer can satisfy SARS that his/her conduct, objectively measured, constitutes a *bona fide* inadvertent error, SARS is compelled to waive the understatement penalty in full.

As a result of the lack of guidance by SARS regarding the meaning of the phrase 'a *bona fide* inadvertent error' taxpayers are subjected to an inconsistent appliance of the criteria by SARS officials that could result in subjectivity and the imposition of understatement penalties in situations where it was not applicable. In order to ensure that the Commissioner for SARS exercises its discretion with objectivity and more consistency when understatement penalties are imposed, SARS should be compelled to adhere to its undertaking to provide comprehensive guidelines, including the factors to consider, when a decision is taken to impose understatement penalties.

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<sup>48</sup> SARS. (2013). The Draft Memorandum on the Objects of the Tax Administration Laws Amendment Laws Amendment Bill, 2013. Published by the National Treasury on its website on 5 July 2013 at 13.

## UNDERSTATEMENT PENALTY PERCENTAGE TABLE

Section 223(1) of Chapter 16 of the TAA contains the understatement penalty table, which SARS must use when it imposes the understatement penalty. The understatement penalty was introduced with effect from 1 October 2012.

The manner in which the understatement penalty is to be calculated is set out in section 222(2).<sup>49</sup> This section requires that the understatement penalty must be determined by applying the highest applicable understatement penalty percentage contained in the penalty table in section 223(1) to each shortfall established under section 222(3)<sup>50</sup> and (4)<sup>51</sup> of the TAA for each understatement identified in a return filed by the taxpayer.

At the commencement of the TAA the understatement penalty percentage table was as follows:

**Table 2: Understatement penalty percentage table: 1 October 2012<sup>52</sup>**

1	2	3	4	5	6
Item	Behaviour	Standard Case	If obstructive or if it is a 'repeat case'	Voluntary disclosure after notification of audit	Voluntary disclosure before notification of audit
(i)	Substantial understatement	25%	50%	5%	0%
(ii)	Reasonable care not taken in completing return	50%	75%	25%	0%
(iii)	No reasonable	75%	100%	35%	0%

<sup>49</sup> S222(2) of the TAA.

<sup>50</sup> S222(3) of the TAA.

<sup>51</sup> S222(4) of the TAA.

<sup>52</sup> S223(1) of the TAA.

1	2	3	4	5	6
	grounds for 'tax position' taken				
(iv)	Gross negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

The penalty table *supra* was amended by section 76 of the TALAA.<sup>53</sup> The new table took effect from 16 January 2014. It would have been more equitable if the amendment to the percentages of the understatement penalty took effect from the date on which the TAA commenced, namely 1 October 2014. The *Memorandum on the Objects of the Tax Administration Laws Amendment Bill 2013*<sup>54</sup> stated the rationale for the reduction in the penalty table as follows:

*'The proposed amendment reduces the applicable percentage of the penalty in the case of 'substantial understatements', 'reasonable care not taken' or 'no reasonable grounds for tax position taken'. The percentages are now more aligned with comparative tax jurisdictions where largely similar penalty regimes apply. Column 5 and 6 of the understatement penalty table are amended to include the word 'investigation'.'*

The amended penalty percentage table, applicable from 16 January 2014, is as follows:

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<sup>53</sup> S76 of 39 of 2013.

<sup>54</sup> SARS. (2013). *Memorandum on the Objects of the Tax Administration Laws Amendment Bill*, par 2.76 41. Available at <http://www.sars.gov.za>.

**Table 3: Understatement penalty percentage table<sup>55</sup>: 16 January 2014**

1	2	3	4	5	6
Item	Behaviour	Standard Case	If obstructive or if it is a 'repeat case'	Voluntary disclosure after notification of audit or investigation	Voluntary disclosure before notification of audit or investigation
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	Gross negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

When the taxpayer falls within the circumstances set out in Chapter 16 of the TAA, SARS has no discretion but to impose the understatement penalty set out in Table 3 *supra*. SARS must first establish whether the taxpayer's conduct should be regarded as a standard case or whether it is a repeat case. Furthermore, SARS must establish if the taxpayer's conduct constitutes a voluntary disclosure after notification of an audit or an investigation, or if the taxpayer approached SARS voluntarily before receiving notification of an audit or investigation. SARS must then decide whether the taxpayer falls into column 3, 4, 5 or 6 as per Table 3 *supra* and thereafter it must determine how to classify the taxpayer's behaviour as prescribed in Table 3 *supra*.

Once the behaviour of the taxpayer has been established SARS must levy the applicable understatement penalty percentage. It is clear that the quantum of the understatement penalty, which may be levied on a taxpayer is determined by the taxpayer's behaviour, with the level of penalty increasing depending on the degree of severity of that behaviour. Although SARS does not have the discretion to impose an understatement penalty in the

<sup>55</sup>

S223(1) of the TAA.

case of an understatement made by the taxpayer, SARS does have discretion when determining which category of behaviour should be applicable to the taxpayer, as well as to determine the quantum of the understatement penalty to be levied on the taxpayer.

As neither the TAA nor any other SARS' official document provides comprehensive guidelines in this regard to assist the Commissioner for SARS when exercising its discretion, it is debatable whether the understatement penalty regime introduced by Chapter 16 of the TAA is objective at all.

Croome and Olivier in *Tax Administration*<sup>56</sup> state that it would appear that when SARS imposes the understatement penalty the auditor dealing with the taxpayer's case will, as part of the audit into the taxpayer's affairs, call for an explanation from the taxpayer as to why a penalty should not be levied. The auditor will then put forward a submission to the appropriate SARS Penalty Committee setting out what level of penalty should be imposed. The Committee will then evaluate the behaviour of the taxpayer and make a decision as to what percentage of penalty should be imposed. This is evidenced by an internal template used by the Penalty Committee which records the factors taken into account by SARS in reaching its conclusion on the penalty imposed. The template requires the SARS official to answer the following questions:

Did the understatement occur causing a prejudice to SARS result from:

- A default in rendering a return?
- An omission from a return?
- An incorrect statement in a return?
- A failure to pay the correct amount of tax where no return was required?

Furthermore, the template requires the Penalty Committee to document its reasons in detail for the behaviours and conduct selected and reflect the person/s who comprised the Penalty Committee in making the decision.

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<sup>56</sup> Croome, B. & Olivier, L. (2015) *Tax Administration*. (2nd Ed.) Chapter 17 p 497-498.

In practice, SARS informs a taxpayer that he or she may provide written reasons as to why the understatement penalty should not be imposed. SARS then takes the taxpayer's written reasons into account and decides what level of penalty should be imposed. Once the Penalty Committee has decided on an appropriate penalty, an aggrieved taxpayer must follow the ordinary objection and appeal procedures.

The fact that a taxpayer has not been given the opportunity to state his or her case in person before the Penalty Committee has been criticised on the basis that it amounts to unfair administrative action.<sup>57</sup>

In *ITC 1576*<sup>58</sup> the question was raised as to whether the time had not come for the legislature to provide a taxpayer with the right to be heard before a penalty is imposed; that is, the *audi alteram partem* rule. To justify the absence of a hearing before a penalty is imposed, SARS would no doubt argue on the basis of the decision in *Mamabolo v Rustenburg Regional Local Council*,<sup>59</sup> in which it was held that in certain circumstances a hearing may be given *ex post facto*. This is on the basis that a hearing granted *ex post facto* in the form of the right to object and appeal and the fact that a hearing is not provided before a penalty is imposed constitutes a fair administrative practice.

Furthermore, when a taxpayer requests copies of the minutes of the Penalty Committee meeting which decided to impose the understatement penalty or the SARS template which serves as a record of the decision, SARS will decline such requests. The basis for SARS' declining the requests is that the information called for by the taxpayer had been made available either in the letter of audit findings or the letter of assessment. In addition, SARS contends that the template constitutes SARS' confidential information and therefore cannot be made available to the taxpayer.<sup>60</sup>

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<sup>57</sup> Croome, B. & Olivier, L. (2015). *Tax Administration*. (2<sup>nd</sup> Ed.) Chapter 17, p 498. See also: Croome, L. (2003). Imposition of Penalties: Taxpayers and the Commissioner: SARS, *The Taxpayer* 88 at 89, and *ITC 1576* 56 SATC 225 at 235.

<sup>58</sup> *ITC 1576* 56 SATC 225 at 235.

<sup>59</sup> 2001 1 SA 135 (SCA) at par 23.

<sup>60</sup> Croome, B. & Olivier, L. (2015). *Tax Administration*. (2<sup>nd</sup> Ed.) Chapter 17, p 498.

Croome and Olivier are of the opinion that this violates the taxpayer's right to just administrative action in section 33 of the Constitution and the provisions of PAJA.<sup>61</sup> A taxpayer is entitled to understand the basis on which SARS reached the decision to levy the penalty and especially why it was levied at a particular percentage of the tax shortfall.<sup>62</sup>

Each one of the categories of behaviour as set out in table 3 *supra* will be discussed in Chapter 3.

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<sup>61</sup> *Ibid.*

<sup>62</sup> *Ibid*, at p 499.

## CHAPTER 3: UNDERSTATEMENT PENALTY

### PERCENTAGE TABLE: BEHAVIOUR OF TAXPAYER

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#### INTRODUCTION

When a taxpayer fall foul of the circumstances set out in Chapter 16 of the TAA, SARS has no choice but to impose the understatement penalty as set out in Table 3 *supra*. SARS should first establish if the taxpayer's conduct should be regarded as a standard case or a repeat case. Furthermore, SARS must establish if the taxpayer's conduct constitutes a voluntary disclosure after notification of an audit or an investigation, or if the taxpayer approached SARS voluntarily before receiving notification of an audit or an investigation.

SARS must decide whether the taxpayer falls into column 3, 4, 5 or 6 as per Table 3 *supra* and then it must determine how to classify the taxpayer's behaviour prescribed in Table 3 *supra*; i.e. does the behaviour comprise any of the following:

- Substantial understatement;
- Reasonable care not taken in completing return;
- No reasonable grounds for tax position taken;
- Gross negligence; or
- Intentional tax evasion.

It is clear that SARS should consider all the abovementioned types of behaviour and all the conduct before an understatement penalty could be imposed. The SARS officials therefore have a huge responsibility to properly apply their minds in order to ensure that they are objective when a decision is taken regarding the classification of the behaviour of the taxpayer and the percentage of understatement levied.



Khaki explains that the type of behaviour (apart from the 'substantial understatement') has not been defined in the TAA, and that penalties raised in respect of those types of behaviour are subjective, since it depends on the person who is assessing the return.<sup>63</sup>

Van Zyl states that the incidence of such subjectivity is aggravated by the lack of comprehensive guidelines and that more detailed and specific guidelines will have to be issued by SARS to ensure that all of its officers consistently apply the same principles in determining an understatement penalty.<sup>64</sup>

The behaviour types as referred to in Table 3 *supra* are discussed herein under.

## TYPES OF BEHAVIOUR

The types of behaviour as set out in items (i) to (v) of Table 3 *supra* are as follows:

### 3.1.1 *Substantial understatement*

*'Substantial understatement' is defined in section 221 of the TAA as a case where the prejudice to SARS or the fiscus exceeds the greater of five percent of the amount of 'tax' properly chargeable or refundable under a tax Act for the relevant tax period, or R1 000 000.*<sup>65</sup>

Of the four types of behaviour set out in Table 3 *supra*, 'substantial understatement' is the only type of behaviour defined in the TAA. 'Tax' is defined in section 221 of the TAA to

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<sup>63</sup> Khaki, S. (2012). *The problem with SARS' new behavioural penalties*. [Online]. Available at <http://www.thesait.org.za/news/114806/The-Problem-With;SARS-New-Behavioural-Penalties.htm>.

<sup>64</sup> Van Zyl, L. (2014) The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 912.

<sup>65</sup> S221 of the TAA.

mean tax as defined in section 1, excluding a penalty and interest.<sup>66</sup> This is the only behaviour in terms of which SARS is obliged to remit<sup>67</sup> the full understatement penalty if it is satisfied that the taxpayer:

- Made full disclosure of the transaction or the arrangement that gave rise to the prejudice to SARS by no later than the date that the return was due; and
- Was in possession of an opinion by an independent tax practitioner that was issued prior to the return date, which took account of the relevant facts and circumstances and which confirmed that the taxpayer's position was more likely to be upheld if the matter proceeded to court.<sup>68</sup>

Opinions by, for example in-house tax practitioners, will not qualify given their potential vested interests in such matters as in-house tax practitioners are not independent of their employers and are not subject to the same statutory or other sanctions as other practitioners. They are not required to be registered as tax practitioners, since they qualify for an exclusion from registration, and could legally retain their employment even if removed from the rolls of a recognised controlling body.<sup>69</sup>

### **3.1.2 'Substantial understatement' is determined by mathematical calculation**

Van der Zwan states that since the behaviour type of a 'substantial understatement' is based on the quantity of the understatement, as opposed to an actual behaviour (as in the case of behaviour types in (ii) to (v)), there would have been very little a taxpayer could do to manage the risk of a penalty if it was not for section 223(3) of the TAA.<sup>70</sup> Van der Zwan further states that,

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<sup>66</sup> S221 of the TAA.

<sup>67</sup> S223(3) of the TAA.

<sup>68</sup> S223(3)(a) & (b) of the TAA.

<sup>69</sup> SARS. (2013). *Memorandum on the Objects of the Tax Administration Laws Amendment Bill (2013)*, par 2.76 41. Available at <http://www.sars.gov.za>.

<sup>70</sup> Van der Zwan, P. (2013). A taxpayer's right to manage its exposure. *Tax Talk* (Jan/Feb) 8-13 [Online]. Available: <http://www.thesait.org.za/news/116521/A-Taxpayers-Right-to-Manage-its-Exposure.htm>.

*'... although this provision clearly provides taxpayers with a procedural mechanism that it can implement to ensure that it is not exposed to an understatement penalty, the time limitation of 'by the date the return was due' is critical and might prove impractical to meet'.<sup>71</sup>*

Section 223(3) provides a mechanism for remittance of a penalty arising from the behaviour in item (i) of the table. This includes making full disclosure about the transaction in the relevant returns by no later than the date the relevant return was due and obtaining a tax opinion on the matter from a registered tax practitioner. The time constraint 'by the date of return was due' is impractical because the taxpayer would however not have been able to obtain the tax opinion referred to earlier in respect of a return pre-1 October 2012 as it was not yet aware of this requirement. Section 270(6B), now deems the taxpayer to have obtained such an opinion if the return was submitted before 1 October 2012. The taxpayer will therefore be able to claim remittance of a penalty based on 'substantial understatement' if full disclosure of the transaction was made in a pre-1 October 2012 return.

### **3.1.3 Reasonable care not taken in completing return**

The phrase 'reasonable care not taken in completing return' is not defined in the TAA. The Short Guide to the TAA (2011)<sup>72</sup> provides the following guidance:

*'Reasonable care' is not defined, so the ordinary meaning must apply. Taxpayers are legally responsible for their tax affairs. A taxpayer must take reasonable care in keeping records and in providing complete and accurate information to SARS.*

Reasonable care means that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the circumstances of the taxpayer would take to fulfil his or her tax obligations. It means, for example, a taxpayer must try his or her best to lodge a

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<sup>71</sup> Van der Zwan, P. (2013). A taxpayer's right to manage its exposure. *Tax Talk* (Jan/Feb) 2013:8-13 [Online]. Available at <http://www.thesait.org.za/news/116521/A-Taxpayers-Right-to-Manage-its-Exposure.htm>.

<sup>72</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011 par 16.5.3 p 80 (Version 2)* [Online] Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

correct tax return. Although taxpayers are liable for the actions of their employees, the question as to whether the taxpayer has taken reasonable care must still be considered. The 'reasonable care' standard does not mean perfection, but refers to the effort required commensurate with the reasonable person in the taxpayer's circumstances. If the taxpayer uses an advisor to complete a return and the practitioner does not exercise reasonable care, the taxpayer is liable to pay an understatement penalty.

Cliffe Dekker Hofmeyr correctly points out that the guidelines in the Short Guide to the TAA (2011) merely restate the well-known '*man on the Clapham omnibus*' test.<sup>73</sup> The Free Encyclopaedia<sup>74</sup> defines 'the man on the Clapham omnibus' as a hypothetical reasonable person used by courts in English law where it is necessary to decide whether a party has acted as a reasonable person. The 'man on the Clapham omnibus' is a reasonable, educated and intelligent, but nondescript, person, against whom the taxpayer's conduct can be measured.

In *ITC 131 43 SATC 76*<sup>75</sup> Melamet J, in dealing with the taxpayer's obligations to submit honest and accurate tax returns, held as follows:

*'The prescribed penalty is heavy – twice the difference between the tax charged and that which should have been charged – but it is so by design to ensure honest and accurate returns by taxpayers.'*

Since the Short Guide to the TAA (2011) does not provide a comprehensive list of factors to be considered by the SARS officials when they have to determine 'reasonable care not taken in completing return' it is advisable to have regard to the factors considered by the Australian Tax Office's guidance in this regard, since the drafting of the TAA took into account the Australian administrative tax law.

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<sup>73</sup> Van der Walt, J. (2013). *Understatement penalty: What does 'reasonable care not taken in completing return actually mean?* [Online] Available at <http://www.polity.org.za/article/understatement-penalty-what-does-reasonable-care-not-taken-in-completing-return-actually-mean>.

<sup>74</sup> *The Free Encyclopaedia*. (n.d.). *The man on the Clapham omnibus*. [Online] Available at [http://en.wikipedia.org/wiki/The\\_man\\_on\\_the\\_Clapham\\_omnibus](http://en.wikipedia.org/wiki/The_man_on_the_Clapham_omnibus).

<sup>75</sup> *ITC 1331 43 SATC 76* at

In determining whether 'reasonable care' has been taken, the Australian Tax Office considers the following factors in *Miscellaneous Tax Ruling ('MT 2008/1'6)*.<sup>76</sup>

- Understanding of tax laws. To determine the standard of care that is reasonable and appropriate in the circumstances, factors such as the complexity of the law and whether it involves new measures are relevant. Where the taxpayer is uncertain about the correct tax treatment, reasonable care requires that appropriate enquiries be made to arrive at the correct tax judgment. An interpretative position that is frivolous might indicate a lack of reasonable care since it reflects that little or no effort was made to exercise sound judgment;
- Likelihood that a statement is false or misleading;
- Relevance of the size of the shortfall;
- Use of a tax agent or advisor; and
- Relying on information provided by a third person.

The abovementioned Australian guidelines regarding the conduct that will constitute reasonable care taken by a taxpayer should assist taxpayers and SARS officials as to the meaning of the behaviour set out in item (ii) of Table 3 *supra*. In the absence of comprehensive guidance in this regard the SARS officials are bound to exercise their discretion in a subjective, inconsistent and biased manner.

Van Zyl correctly states that SARS will have to prove, objectively and on a balance of probabilities, that the taxpayer did not act as a reasonable man in completing his return by taking into account, *inter alia*, the subjective personal circumstances of the taxpayer, his abilities, characteristics and knowledge of tax law.<sup>77</sup> More guidance is needed to ensure the objectivity of all SARS officials. She furthermore submits that if SARS applies the alleged

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<sup>76</sup> The Government of Australia. (2008). *Miscellaneous Tax Ruling MT 2008/1*. [Online] Available at <http://www.law.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20081/NAT/ATO/0001>.

<sup>77</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 915.

'no reasonable care taken' type of behaviour as an automatic default position without properly applying its mind, SARS will contravene a taxpayer's right to just administrative action in terms of section 33 of the Constitution of the Republic of South Africa, 1996.<sup>78</sup>

To fall into the category '*reasonable care not taken in completing return*' SARS needs to be satisfied that the taxpayer, evaluated objectively, acted in a reasonable manner according to their particular circumstances. If the taxpayer is a professional person, one would expect him or her to act with a higher degree of care than any other person. If a taxpayer uses a tax practitioner to complete a return and the practitioner does not take reasonable care in completing the return, the taxpayer would be held liable and an understatement penalty will be raised on the taxpayer.<sup>79</sup>

Kriel, tax director at Grant Thornton, Cape Town, submits that it appears that SARS has taken a default position in that every additional assessment they issue must be punished with a penalty and that they automatically impose a penalty under the behaviour type in item (ii) of Table 1 (Table 3 *supra*) ('reasonable care not taken in completing the return') in respect of all additional assessments they issue.<sup>80</sup> He further states that it is questionable as to whether it was the intention of the legislature to punish taxpayers for all mistakes they make and that one can only hope that SARS will take a more lenient approach in applying the understatement penalty provisions than what appears to be the case currently.<sup>81</sup>

Van Zyl<sup>82</sup> states that applying an automatic default position is contentious and must therefore be investigated, clarified and rectified (if needed). It will also leave SARS vulnerable to an attack, using the objection and appeal process, on the basis that they have unfairly or incorrectly applied the provisions of the TAA.

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<sup>78</sup> Ibid.

<sup>79</sup> Lumsden, W. (2013) What you need to know about the new Understatement Penalty regime (Part 3). *Compass*, 24:6-7.

<sup>80</sup> Kriel, A. (2012). *Tax Administration Act-mistakes to cost taxpayers dearly* [Online]. Available at <http://www.gt.co.za/publications/2012/12/e-taxing-december-2012>.

<sup>81</sup> Ibid.

<sup>82</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 910.

### **3.1.4 No reasonable grounds for 'tax position' taken**

Item (iii) of Table 3 *supra* deals with the next level of penalty and relates to those cases where SARS reaches the conclusion that the taxpayer has no reasonable grounds for the tax position taken.

'Tax position' is defined in section 221 of the TAA and means an assumption underlying one or more aspects of a tax return, including whether or not:

- (a) an amount, transaction, event or item is taxable;
- (b) an amount or item is deductible or may be set-off;
- (c) a lower rate of tax than the maximum applicable to that class of taxpayer, transaction, event or item applies; or
- (d) an amount qualifies as a reduction of tax payable.<sup>83</sup>

The Short Guide to the TAA (2011)<sup>84</sup> states:

- Where an understatement tax occurs due to a taxpayer's interpretation of the application of a tax Act, an understatement penalty is payable if the taxpayer does not have a reasonably arguable position.
- A taxpayer's interpretation of the application of the law is reasonably arguable if, having regard to the relevant authorities, for example an income tax, a court decision or a general ruling, it would be concluded that what is being argued by the taxpayer is at least as likely as not, correct.
- If the shortfall arises because of a substantive disagreement concerning the application of a taxation provision, this understatement penalty will be imposed if the taxpayer's

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<sup>83</sup> S221 of the TAA.

<sup>84</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011 (Version 2)* par 16.5.4 80 [Online] Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.



position is not based on reasonable grounds. The purpose is not to levy a penalty when SARS disagrees with a position adopted by a taxpayer but to attach a penalty where a taxpayer assumes a position unreasonably. As there is an inherent risk in assuming a tax position, taxpayers are expected to adopt a sensible approach in the process of adopting a tax position and to also have considered the integrity of the tax position taken.

Van der Zwan correctly argues that a taxpayer will be in a position where he has no reasonable grounds for a tax position taken if he is not able to reasonably argue the assumptions made or views taken in respect of any aspect of the mentioned aspects affecting his tax position.<sup>85</sup> Van der Zwan further states that written views, including tax opinions, as to how an assumption or view was arrived at should go a long way in ensuring that the taxpayer can provide reasonable grounds for a tax position taken.<sup>86</sup> Van der Zwan also states that the involvement of a tax specialist may enhance the position of the taxpayer as to the reasonability of these grounds, especially where the views or assumptions deal with a more complex matter.<sup>87</sup>

Croome and Olivier<sup>88</sup> state that where a taxpayer adopts a tax position which was previously followed by the revenue authority and the revenue later changes its mind, the taxpayer should be regarded as having a reasonably arguable position. They furthermore state that taxpayers should consider the fiscal legislation, explanatory memoranda, public rulings and court decisions.<sup>89</sup> The fact that a taxpayer has sought advice from an accountant or lawyer may indicate that the tax position adopted by the taxpayer is reasonably arguable.

The burden is on SARS to prove, objectively and without taking the personal circumstances of the taxpayer into account, that the taxpayer did not have a reasonable or rational

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<sup>85</sup> Van der Zwan, P. (2013). A taxpayer's right to manage its exposure. *Tax Talk* (Jan/Feb) 2013:8-13 [Online]. Available at <http://www.thesait.org.za/news/116521/A-Taxpayers-Right-to-Manage-its-Exposure.htm>.

<sup>86</sup> Ibid.

<sup>87</sup> Ibid.

<sup>88</sup> Croome, B. & Olivier, L. (2015). (2<sup>nd</sup> Ed.) *Tax Administration*, Chapter 17 p 489.

<sup>89</sup> Croome, B. & Olivier, L. (2015) (2<sup>nd</sup> Ed.) *Tax Administration*, Chapter 17 p 489.



argument regarding the interpretation or application of a tax Act. It is not clarified as to the basis that SARS will argue that the taxpayer's argument is at least as likely as not, correct.

### 3.1.5 Gross negligence

Item (iv) of Table 3 *supra* is applicable where SARS is of the opinion that the taxpayer's behaviour constitutes gross negligence.

'Negligence' is defined in *The Free Dictionary*<sup>90</sup> as follows:

*'Law : (a) Failure to use the degree of care appropriate to the circumstances, resulting in an unintended injury to another; (b) an act or omission showing such lack of care.'*

The Short Guide to the TAA (2011)<sup>91</sup> explains 'gross negligence' as follows:

Where a taxpayer is grossly negligent, the result may be that too little tax is paid or payable or a tax refund is overstated. Gross negligence essentially means doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences. The test for gross negligence is objective and is based on what a reasonable person would foresee as being conduct which creates a high risk of a tax shortfall occurring. Gross negligence involves recklessness, but unlike evasion, does not require an element of *mens rea*, meaning wrongful intent or 'guilty mind', or intent to breach a tax obligation. The threshold for gross negligence is much higher than conduct which is regarded as a person not having taken reasonable care.

Van der Zwan<sup>92</sup> clearly states that a person merely failing to take the degree of care that people usually undertake in similar circumstances may be negligent, but not grossly

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<sup>90</sup> *The Free Dictionary*. (n.d.). [Online] Available at <http://www.thefreedictionary.com/negligence>.

<sup>91</sup> SARS. (2013) *Short Guide to the TAA, 28 of 2011 par 16.5.5 80 (Version 2)* [Online]. Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>92</sup> Van der Zwan, P. (2013) A taxpayer's right to manage its exposure. *Tax Talk*, (Jan/Feb) 2013:8-13 [Online]. Available at <http://www.thesait.org.za/news/116521/A-Taxpayers-Right-to-Manage-its-Exposure.htm>.

negligent. He submits that it would be unlikely that a taxpayer would be regarded as being grossly negligent when he or she implements processes with built-in controls that take into account the tax consequences of certain transactions or events. He explains that,

*'... this may be particularly relevant in the case of regular day-to-day activities; for example, a process checking that captured invoices complies with the requirements of the VAT Act to deduct input tax. For less frequent or once-off events, such as structuring of deals or transactions, the risk of being grossly negligent towards the tax consequences should to a large extent be manageable by documenting reasons or arguments for taking positions and showing that those tax consequences have been considered (i.e. not complete lack of intellect in relation to the tax implications of the event).'<sup>93</sup>*

Croome and Olivier<sup>94</sup> state that if a taxpayer and the revenue authority disagree on the manner on which an item should be treated for tax purposes, it cannot on its own be regarded as gross negligence on the part of the taxpayer. They further state that it is clear that the taxpayer is required to make a false statement with the intention of misleading the revenue authority for the taxpayer's conduct to constitute gross negligence.<sup>95</sup>

### **3.1.6 Intentional tax evasion**

The most severe penalty is preserved for cases where a taxpayer has acted with the intention to evade tax as set out in item (v) of Table 3 *supra*.

The investopedia Dictionary<sup>96</sup> defines 'tax evasion' as,

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<sup>93</sup> *Ibid.*

<sup>94</sup> Croome, B. & Olivier, L. (2015) (2<sup>nd</sup> Ed.) *Tax Administration*, Chapter 17 p 494.

<sup>95</sup> *Ibid.*

<sup>96</sup> Investopedia Dictionary. (n.d.). *Tax Evasion*. [Online] Available: [http://www.investopedia.com/terms/t/tax evasion.asp](http://www.investopedia.com/terms/t/tax%20evasion.asp).

*'... an illegal practice where a person, organization or corporation intentionally avoids paying his/her/its true tax liabilities. Those caught evading taxes are generally subject to criminal charges and substantial penalties.'*

The Short Guide to the TAA (2011)<sup>97</sup> explains 'tax evasion' as follows:

- To evade tax includes actions that are intended to reduce or extinguish the amount that should be paid, or which inflate the amount of a refund that is correctly refundable to the taxpayer. Intentional tax evasion can exist where a taxpayer makes a false statement in a return, and where a person does not file a return.
- The most important factor is that the taxpayer must have acted with the intent to evade tax. Intention is a wilful act, that exists when a person's conduct is meant to disobey or wholly disregard a known legal obligation, and knowledge of illegality is crucial. Whether SARS acts on or accepts a false declaration is irrelevant. If SARS does not accept the declaration, but audits the taxpayer and determines the correct tax position, the original intent to evade tax is not excused. Intention may, at times, be difficult to distinguish from an act that is grossly negligent.
- Since the application of tax law to a particular taxpayer may be complex, it may be that a genuine misunderstanding of the practical application of a taxing provision does not indicate intentional tax evasion. If the taxing provision is uncertain, for instance if there are conflicting judgments on the issue, and the taxpayer applies a reasonable interpretation, it is doubtful that intent to evade could be established and that the more appropriate behavioural category would be whether the taxpayer had taken a tax position on unreasonable grounds or, at worst, that the taxpayer had been grossly negligent. This is an area that is also influenced by the nature of the actions that underline an understatement and the circumstances of the taxpayer.

Van Zyl<sup>98</sup> refers to the influence of the Australian administration tax law and points out that the adjective 'intentional' means that something more than reckless disregard of, or

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<sup>97</sup> SARS. (2013) *Short Guide to the TAA, 28 of 2011*, par 16.5.6 p 80 (Version 2) [Online] Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>98</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 918.

indifference to, a taxation law is required. Intentional disregard means that there must be actual knowledge that the statement made is false, the test for intentional disregard is purely subjective in nature, and therefore the actual intention of the taxpayer is therefore crucial.<sup>99</sup> She submits that a subjective test, where SARS, in a manner of speaking, will try to get into a particular person's mind in order to discharge its onus of proof, might prove to hold unique challenges.

Van der Zwan<sup>100</sup> states that intentional tax evasion will exist if taxpayers knowingly fail to comply with the requirements of a tax law in order not to pay the tax that they are legally obliged to pay. He distinguishes between intentional tax evasion, wrongful application of complex legislation, and intentionally doing tax planning to avoid tax in a manner which does not comply with the requirements of the relevant legislation.<sup>101</sup> He submits that taxpayers can protect themselves from being classified under this category of behaviour by providing arguments and documenting proof of the fact that the taxpayer followed the requirements of the relevant tax legislation when he or she was busy tax planning, and that planning was done within the confines of the law.<sup>102</sup>

## CONCLUSION

The combined influence of possible subjectivity and inconsistent application by SARS officials due to a lack of comprehensive guidelines, the impractical time constraint in section 222(3) of the TAA, and the alleged specific automatic default penalty position, might have an unintended negative impact on the extent to which a taxpayer can manage his exposure.

The fact that SARS may only impose an understatement penalty once a *bona fide* inadvertent error is ruled out emphasises the importance of understanding what the *bona*

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<sup>99</sup> *Ibid.*

<sup>100</sup> Van der Zwan, P. (2013). *A taxpayer's right to manage its exposure Tax Talk*, (Jan/Feb) 28-13 [Online]. Available at <http://www.thesait.org.za/news/116521/A-Taxpayers-Right-to-Manage-its-Exposure.htm>.

<sup>101</sup> *Ibid.*

<sup>102</sup> *Ibid.*

*fide* inadvertent error exception means and who bears the onus to prove that this exception does or does not apply. The guidance regarding how a SARS official will determine whether an understatement results from a *bona fide* inadvertent error referred to in the Draft Memorandum was omitted from the Final Memorandum, leaving taxpayers and tax practitioners in the dark in this regard. In order to prevent inconsistent application and a possible abuse of the *bona fide* inadvertent error exception, it is imperative that SARS develops and issues comprehensive guidelines in this regard.

Van Zyl<sup>103</sup> correctly states that the alleged application of the 'reasonable care not taken' behaviour type as an automatic default penalty when SARS issues additional assessments is contentious and causes great concern. She further states that this should be investigated, clarified and rectified.<sup>104</sup> Lacking comprehensive guidelines, the question as to whether SARS has properly applied its mind in order to rule out a *bona fide* inadvertent error, as well as to rule out the other five types of behaviour outlined in Table 1 (Table 3 *supra*), before imposing such automatic default penalty remains critically unanswered. She submits that if SARS applies the 'reasonable care not taken' behaviour type as an automatic default penalty position as alleged, without first properly applying its mind in all regards, SARS will contravene a taxpayer's right to just administrative action in terms of section 33 of the Constitution of the Republic of South Africa, 1996.<sup>105</sup>

A lack of comprehensive guidelines by SARS to assist the SARS officials when they exercise their discretion in this regard may prove to be to the detriment of taxpayers. Van Zyl<sup>106</sup> suggests that a complete standardised list of factors and questions to be asked be taken into account by SARS officials when applying Table 1 (Table 3 *supra*). This must be issued by SARS in order to assist its officials to minimise the influence of bias or subjectivity and to ensure consistent application by, and the objectivity of, all SARS officials. This will also ensure consistent treatment of taxpayers in comparable circumstances.

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<sup>103</sup> Van Zyl, L. (2014) The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 919.

<sup>104</sup> *Ibid.*

<sup>105</sup> *Ibid.*

<sup>106</sup> *Ibid.*, at 920.

## **CHAPTER 4: REMEDIES**

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### **INTRODUCTION**

SARS has no discretion to impose an understatement penalty in circumstances where an understatement is made by the taxpayer, and is obliged in terms of the TAA to impose the penalty. The Commissioner for SARS does have discretion to determine in which category (items (i) to (v) of the table in section 223(1) of the TAA) the taxpayer falls in order to determine the applicable penalty percentage. There are circumstances where the taxpayer can have SARS remit an understatement penalty or have the rate of the penalty reduced.

As many of the decisions taken by SARS constitute 'administrative action', a taxpayer, if dissatisfied with SARS's decision, may have the right to object against that decision and if so the taxpayer must follow the rules regulating dispute resolution set out in Chapter 9 of the TAA and adhere to the rules promulgated under section 103 of the TAA. Where a decision is made by SARS and that decision is not subject to objection and appeal, the taxpayer may be entitled to apply to a court to review that decision on the basis that SARS has violated the rules of administrative justice in terms of section 33 of the Constitution and the provisions of PAJA.

As this study primarily deals with the discretion of the Commissioner for SARS when an understatement penalty is imposed, only a brief discussion of possible remedies available to the aggrieved taxpayer will follow. This study will not discuss the voluntary disclosure programme as set out in sections 225 to 233 of the TAA. Matters relating to remedies such as the burden of proof, remittance of an understatement penalty, objection and appeal will be briefly discussed herein under.

### **BURDEN OF PROOF**

In most civil matters it is generally incumbent upon the party instituting any action to prove

his or her case on a balance of probabilities. In terms of section 102(1)<sup>107</sup> the taxpayer bears the burden of proving, on a balance of probabilities, that any decision made by SARS, which is subject to objection and appeal, is incorrect. Where SARS decides to impose any administrative non-compliance penalty the burden of proof rests upon the taxpayer to show that such a decision is incorrect.<sup>108</sup>

Section 102(2) of the TAA provides for an exception to the above in the event that SARS imposes understatement penalties. Section 102(2)<sup>109</sup> reads as follows:

*'(2) The burden of proving whether an estimate under section 95 is reasonable or the facts on which SARS based the imposition of an understatement penalty under Chapter 16, is upon SARS.'*

It is clear from section 102(2) of the TAA that SARS will have to prove, on a balance of probabilities, the facts justifying the imposition of the understatement penalty, the existence of the various behaviours, and the conduct on the part of the taxpayer when understatement penalties are imposed.<sup>110</sup>

Arendse and Williams in *Beware of the New Additional Tax Regime*<sup>111</sup> state that no procedural guidelines are provided for in the TAA in relation to the manner in which SARS should discharge this onus. De Koker and Williams<sup>112</sup> correctly state that the party bearing the onus of proof must establish the facts from which the desired inference can and should properly be drawn, and that in judicial proceedings those facts must be established by way

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<sup>107</sup> S102(1) of the TAA.

<sup>108</sup> S102(1)(f) of the TAA.

<sup>109</sup> S102(2) of the TAA.

<sup>110</sup> Silver, M. & Beneke, C. (2013). *Deloitte VAT Handbook*. 9th Ed. Durban: LexisNexis, at par 20.8 at 225.

<sup>111</sup> Arendse, T. & Williams, P. (2013). *Beware of the New Additional Tax Regime*. *Tax Talk*, (Sept/Oct) 30 at 31.

<sup>112</sup> De Koker, A. & Williams, R.C. (Eds.) (2014). *Silke on South African Income Tax*, at par 18.146.

of admissible evidence.

Van Zyl in *The New Understatement Penalty Regime: A Sharp 'Sword'?*<sup>113</sup> correctly submits that section 102(2) – burden of proof, *inter alia*, includes that SARS must, on a balance of probabilities, prove the correctness of its decision to impose the understatement penalty. She further submits that section 102(2) and 222(1) of the TAA read together place an additional 'implied burden of proof' on SARS regarding a *bona fide* inadvertent error.<sup>114</sup> This is because an understatement penalty can be imposed by SARS only as a result of something other than a *bona fide* inadvertent error. She further states that what SARS must do in order to discharge this 'implied burden of proof' is an open question and the issuing of guidelines in this regard is imperative.<sup>115</sup>

## REMISSION OF UNDERSTATEMENT PENALTIES

The only behaviour type in Table 3 *supra* in respect of which SARS is permitted to remit the penalty is that of 'substantial understatement'. Section 223(3)(a) and (b)(i)(ii)(iii) of the TAA provides that SARS must remit a 'penalty' imposed for a 'substantial understatement' if SARS is satisfied that the taxpayer:

- '(a) *made full disclosure of the arrangement, as defined in section 34, that gave rise to the prejudice to SARS or the fiscus by no later than the date that the relevant return was due; and*
- (b) *was in possession of an opinion by an independent registered tax practitioner that-*
  - (i) *was issued by no later than the date that the relevant return was due;*
  - (ii) *was based upon full disclosure of the specific facts and circumstances of the arrangement and, in the case of any opinion regarding the applicability*

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<sup>113</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 909.

<sup>114</sup> *Ibid.*

<sup>115</sup> *Ibid.*



- of the substance over form doctrine or anti-avoidance provisions of a tax Act, this requirement cannot be met unless the taxpayer is able to demonstrate that all of the steps in or parts of the arrangement were fully disclosed to the tax practitioner, whether or not the taxpayer was a direct party to the steps or parts in question; and*
- (iii) *confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court.*<sup>116</sup>

The Memorandum on the Objects of the TAA (2013)<sup>117</sup> states that the proposed amendment clarifies that, for purposes of a remittance request for a 'substantial understatement penalty', the opinion in issue must have been given by a tax practitioner that is independent of the taxpayer. Opinions by, for example in-house tax practitioners, will not qualify given their potential vested interests in such matters. The TALAA<sup>118</sup> took effect from 16 January 2014.

Khaki states that 'substantial understatement' is the only behaviour that has been defined quite specifically and clearly states what will be seen as 'substantial understatement'.<sup>119</sup>

## OBJECTION AND APPEAL

Section 224<sup>120</sup> of the TAA provides that the imposition of an understatement penalty by SARS under section 222 or a decision not to remit an understatement penalty under section 223(3) is especially subject to objection and appeal in accordance with the provisions set out

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<sup>116</sup> 223(3)(a) and (b)(i)(ii)(iii) of the TAA.

<sup>117</sup> SARS. (2013). *Memorandum on the Objects of the Tax Administration Laws Amendment Bill (2013)*, par 2.76 p 41. [Online]. Available at: <http://www.sars.gov.za>.

<sup>118</sup> 39 of 2013.

<sup>119</sup> Khaki, S. (2012). *The problem with SARS' new behavioural penalties*. [Online]. Available: <http://www.thesait.org.za/news/114806/The-Problem-With-SARS-New-Behavioural-Penalties.htm>.

<sup>120</sup> S224 of the TAA.

in Chapter 9 of the TAA. This section was amended by section 77 of the TALAA<sup>121</sup> with effect from 1 October 2012 to clarify that a taxpayer may object to the imposition of the understatement penalty and not only where SARS fails to remit the penalty in section 223(3) of the TAA.

Where the correctness of the discretionary decision, which is subject to objection and appeal is contested in the Tax Court, there is a re-hearing of the whole matter by the Tax Court.<sup>122</sup> In *Commissioner of Inland Revenue v Da Costa* 1985 2 All SA 335 (A) at 337 the Appellant Division (as it then was) referred to *Rand Ropes (Pty) Ltd v Commissioner for Inland Revenue* 1944 AD 142 where Centlivres AJ at 150 held:

*'That the Legislature apparently thought that it was necessary to give a special right of appeal in cases where a matter is left to the discretion of the Commissioner appears from a number of instances where that special right is conferred...In all these cases it seems to me that the Legislature intended that there should be a re-hearing of the whole matter by the Special Court and that that Court could substitute its own decision for that of the Commissioner. For, as CURLEWIS JA pointed out in Bailey v Commissioner for Inland Revenue (1933 AD at 220), the Special Court is not a Court of appeal in the ordinary sense: it is a Court for revision.'*<sup>123</sup>

Accordingly the Tax Court can consider the issue afresh and substitute the Commissioner's decision in that regard.<sup>124</sup>

Under section 133<sup>125</sup> of the TAA, the taxpayer or SARS is granted the right to appeal, in the manner provided for in the TAA, against a decision of the Tax Court under section 129<sup>126</sup>

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<sup>121</sup> 39 of 2013.

<sup>122</sup> *Rand Ropes (Pty) Ltd v Commissioner for Inland Revenue* 1944 AD 142 at 150.

<sup>123</sup> *Commissioner of Inland Revenue v Da Costa* 1985 2 All SA 335 (A) at 337.

<sup>124</sup> *C:SARS v Fosker (Pty) Ltd* 3 All SA (SCA) at 506, par [51]. See also: *Commissioner for Inland Revenue v Da Costa* 1985 2 All SA (A) 335 at 337.

<sup>125</sup> S133 of the TAA.

<sup>126</sup> S129 of the TAA.

and 130.<sup>127</sup> The appeal against the decision of the Tax Court lies either with the full bench of the High Court or directly with the Supreme Court of Appeal, with the leave of the President of the Tax Court who heard the appeal in the first instance. If the President of the Tax Court denies leave to appeal to the Supreme Court of Appeal, the aggrieved party may decide to petition the Chief Justice for leave to appeal to that court.

## CONCLUSION

Taxpayers are therefore not without remedy and can avail themselves of the remedies referred to *supra* when aggrieved by the decision of the Commissioner for SARS when understatement penalties are imposed.

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<sup>127</sup> S130 of the TAA.

# **CHAPTER 5: A BRIEF COMPARISON BETWEEN THE REMITTANCE OF ADDITIONAL PENALTIES IMPOSED IN TERMS OF SECTION 76(1) OF THE ITA AND THE REMITTANCE OF UNDERSTATEMENT PENALTIES IMPOSED IN TERMS OF SECTIONS 223(3) OF THE TAA AND THE TRANSITIONAL PROVISIONS IN TERMS OF THE TAA**

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## **INTRODUCTION**

The TAA came into effect on 1 October 2012 and essentially replaced the 'old' penalty provisions previously contained in section 76(1) of the ITA with the 'new' provisions set out in sections 221 to 224 of the TAA. This Chapter will only briefly compare the discretion of the Commissioner for SARS in terms of section 76 of the ITA and the discretion of the Commissioner for SARS in terms of section 223(3) of the TAA when the remission of understatement penalties is determined.

### **A BRIEF COMPARISON BETWEEN THE REMITTANCE OF ADDITIONAL PENALTIES IMPOSED IN TERMS OF SECTION 76(1) OF THE ITA AND THE REMITTANCE OF UNDERSTATEMENT PENALTIES IMPOSED IN TERMS OF SECTION 223(3) OF THE TAA**

#### ***5.1.1 Remittance of additional penalties imposed in terms of section 76(1) of***

## ***the ITA***

Section 76(1)<sup>128</sup> of the ITA provides that a taxpayer:

*“shall be required to pay in addition to the tax chargeable in respect of his taxable income:*

- (a) if he makes a default in rendering a return in respect of any year of assessment, an amount equal to twice the tax chargeable in respect of his taxable income for the year of assessment; or*
- (b) if he omits from his return any amount which ought to have been included therein, an amount equal to twice the difference between the tax as calculated in respect of the taxable income returned by him and the tax properly chargeable in respect of his taxable income as determined after including the amount omitted;*
- (c) if he makes an incorrect statement in any return rendered by him which results or would if accepted result in the assessment of the normal tax at an amount equal to twice the difference between the tax as assessed in accordance with the return made by him and the tax which would have been properly chargeable.’*

Dachs in *Penalties – Tax Administration Act or Income Tax Act?*<sup>129</sup> refers to ITC 1430 50 SATC 51 regarding the purpose of additional tax levied by section 76 of the ITA, where Mullins J stated at 54 *inter alia* that:

*‘It seems to me that the imposition of such additional charges, as well as any decision to remit portion thereof, involves three factors, namely the punishment of the taxpayer, the deterrent effect on the taxpayer himself and the deterrent effect on*

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<sup>128</sup> S 76(1) of the ITA 58 of 1962.

<sup>129</sup> Dachs, P. (2013). *Penalties – Tax Administration Act or Income Tax Act? The Taxpayer*, 62, Nov issue, 206 to 207.

*other taxpayers.*<sup>130</sup>

If penalties are imposed in terms of the provisions of section 76 of the ITA, section 76(2)(a) provided as follows:

*'The Commissioner may remit the additional charge imposed under subsection (1) or any part thereof as he may think fit: Provided that, unless he is of the opinion that there were extenuating circumstances, he shall not so remit if he is satisfied that any act or omission of the taxpayer referred to in paragraph (a), (b) or (c) of subsection 1 was done with intent to evade taxation.'*<sup>131</sup>

Dachs states that in terms of section 76(2)(a) of the ITA, the Commissioner accordingly had a discretion to remit the additional tax, or any part thereof, 'as he may think fit'.<sup>132</sup> However, the Commissioner shall not remit additional tax if he is satisfied that the taxpayer acted with an intention to evade tax, except where the Commissioner is satisfied that there were extenuating circumstances.<sup>133</sup>

Van Zyl<sup>134</sup> submits that, even though the imposition of the section 76 penalty was not discretionary *per se*, the court used in *CIR v Di Ciccio 1985 47 SATC 199* at 205<sup>135</sup> the words '*discretionary imposition*' in light of the previous wide discretion SARS had to remit or reduce a penalty so imposed.

It is clear from section 76 of the ITA that the first enquiry of the Penalty Committee was whether the taxpayer had the intent to evade tax. If intent to evade tax existed, no part of

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<sup>130</sup> *ITC 1430 50 SATC 51* at 54.

<sup>131</sup> S76(2)(a) of the ITA.

<sup>132</sup> Dachs, P. (2013). Penalties – Tax Administration Act or Income Tax Act? *The Taxpayer*, 62, Nov issue, 206-207.

<sup>133</sup> *Ibid.*

<sup>134</sup> Van Zyl, L. (2014) The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 908.

<sup>135</sup> *CIR v Di Ciccio 1985 47 SATC 199* at 205.

the additional tax could be remitted unless the Penalty Committee was satisfied that extenuating circumstances did in fact exist; these circumstances were taken into account in setting the amount of additional tax to be imposed. If there was no intent to evade tax, the Penalty Committee took into account any mitigating factors in determining whether any remission was justified. Thus, the provisions in section 76 of the ITA were subject to the discretion by the Commissioner, and determined by taking account of subjective criteria.<sup>136</sup>

### **5.1.2 Remittance of understatement penalties imposed in terms of sections 223(3) of the TAA**

The open-ended discretion of SARS, in terms of section 76 of the ITA, to remit additional tax of up to 200% in the event of default or omission by the taxpayer, was replaced by a limited discretionary power to remit the new mandatory understatement penalty set out in sections 221 to 224 of the TAA.

Arendse and Williams<sup>137</sup> identify various uncertainties in the application of the new understatement penalty regime and state that it is apparent that the new penalties create significant uncertainty, are harsher than the current additional tax regime in practice, and are likely to operate to the detriment of most taxpayers. They also anticipate that the material reduction in the discretion of SARS to remit penalties will have a net material adverse impact on taxpayers going forward.<sup>138</sup>

In terms of section 222(1) of the TAA:

*'In the event of an 'understatement' by a taxpayer, the taxpayer must pay, in addition to the 'tax' payable for the relevant tax period, the understatement penalty*

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<sup>136</sup> De Koker, A. & Williams, R.C. (Eds.) (2012). *Silke on the Income Tax Act*, par 7.3.

<sup>137</sup> Arendse, T. & Williams, P. (2012). Beware of the new additional tax regime. *TaxTalk*, Sept/Oct issue, 30 at 31.

<sup>138</sup> *Ibid.*

*determined under subsection (2).*<sup>139</sup>

In terms of section 221 of the TAA, an 'understatement' means:

*'... any prejudice to SARS or the fiscus in respect of a tax period as a result of-*

- (a) a default in rendering a return;*
- (b) an omission from a return;*
- (c) an incorrect statement in a return; or*
- (d) if no return is required, the failure to pay the correct amount of 'tax'.*<sup>140</sup>

Unlike the provisions of section 76 of the ITA, SARS will only remit a penalty under the understatement penalty provisions in terms of the TAA if such penalty was imposed for a 'substantial understatement' and if SARS is satisfied that the taxpayer made full disclosure of the arrangement that gave rise to the prejudice to SARS by no later than the date that the relevant tax return was due, and that the taxpayer was in possession of an opinion by a registered tax practitioner stating, *inter alia*, that the taxpayer's position was more likely than not to be upheld if the matter proceeded to court.<sup>141</sup>

In all other circumstances as set out in the understatement penalty percentage table, SARS may not remit any such penalties. A decision by SARS not to remit an understatement penalty will be applicable to objection and appeal in terms of section 224 of the TAA.

### **5.1.3 Conclusion to this section**

It is clear that the scope for remission of an understatement penalty is much more limited

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<sup>139</sup> S221(1) of the TAA.

<sup>140</sup> S221 of the TAA.

<sup>141</sup> S 223(3)(a) and (b)(i)(ii)(iii) of the TAA.



than was the case prior to the implementation of the TAA.<sup>142</sup>

## TRANSITIONAL PROVISIONS

Chapter 20 of the TAA contains a number of transitional provisions, aimed at ensuring the smooth transition of the administrative provisions in the various fiscal statutes to the new rules in terms of the TAA. The transitional rules were introduced to regulate the various SARS' actions which commenced under the administrative provisions contained in the various fiscal statutes but which had not yet been completed by the date on which most of the provisions of the TAA took effect; namely, 1 October 2012.<sup>143</sup>

Chapter 20 of the TAA deals with those actions which commenced prior to the TAA and not yet completed by 1 October 2012 that must be continued and concluded under the provisions of the TAA as if taken or instituted under the TAA itself.

In terms of section 270(2) the following actions or proceedings taken or instituted under the repealed provisions of a tax Act, but not completed by the commencement date of the equivalent provisions of the TAA, must be continued and finalised under the TAA as if taken or instituted under the TAA:

- (a) *a decision by a SARS official in terms of a statutory power to do so;*
- (b) *a request by a person for the withdrawal or amendment of a decision or notice by SARS, registration for tax, form of record keeping, information, taxpayer record, advance ruling, refund, reduced assessment, suspension of a disputed tax debt, deferral, write off, compromise or waiver of a tax debt and the remittance of interest or a penalty;*
- (c) *an objection, appeal to the tax board, tax court or higher court, alternative dispute resolution, settlement discussions or other related High Court*

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<sup>142</sup> De Koker, A. & Williams, R.C. (Eds.) (2012). *Silke on the Income Tax Act*, par 7.3.

<sup>143</sup> Government of South Africa. (2012). *Government Notice 51*. Published in Government Gazette 35687 of 14 September 2012 in terms of s 272 of the TAA.

- application;*
- (d) *recovery of a tax debt, including the appointment of an agent to satisfy a tax debt, execution of a civil judgment or sequestration, liquidation or winding-up instituted by SARS or any other related court application.*<sup>144</sup>

Section 270(6) deals with the imposition of additional tax, penalties and interest, and how matters relating thereto are to be dealt with in respect of, for example, tax returns filed by a taxpayer before 1 October 2012 and SARS subsequently audits those returns and issues amended assessments.

It is clear that where a taxpayer files a return after 1 October 2012 the new understatement penalty rules contained in Chapter 16 of the TAA will be applicable. However, if the taxpayer had filed a 2009 tax return during 2010 and SARS audits that return and adjusts the taxpayer's taxable income, should additional tax be levied under the erstwhile section 76 of the ITA, which was repealed with effect from 1 October 2012, or should the new understatement penalty rules in terms of the TAA be applicable?

The legislature amended the transitional rules in section 270(6) of the TAA in their entirety by way of section 86 of the Tax Administration Laws Amendment Act<sup>145</sup> ('TALAA'). The TALAA was promulgated on 16 January 2014 and the amendments to section 270(6) took effect from 1 October 2012.<sup>146</sup>

As a result of uncertainties relating to the imposition of the understatement penalty, various subsections are introduced to section 270(6) of the TAA.

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<sup>144</sup> S270(2)(a) to (g) of the TAA.

<sup>145</sup> 39 of 2013.

<sup>146</sup> The Government of South Africa. (2014). *Government Gazette* 37236 of 14 January 2014; s88 which provided that most provisions took effect on 1 October 2014.

The new subsections introduced to section 270(6) of the TAA are as follows<sup>147</sup>:

- Section 270(6A) of the TAA clarifies that the purpose of section 270(6) was that additional tax may be imposed if capable of being imposed which would only be the case where the verification or audit necessary to determine the additional tax, penalty or interest had been completed before the commencement date of the TAA, namely 1 October 2012.
- Section 270(6B) of the TAA seeks to address those cases where a taxpayer was not in a position to comply with the tax opinion requirement contained in section 223 of the TAA by virtue of the fact that the tax return was filed prior to the enactment of the TAA. The requirement in section 223, that no penalty may be imposed where the taxpayer obtains an opinion in the prescribed manner before the filing of the tax return in question, is done away with in respect of tax returns filed before 1 October 2012. Thus, where the taxpayer obtains an opinion after the return was filed it will assist in mitigating the penalty which could otherwise have been imposed.
- Section 270(6C) of the TAA provides that where taxpayers made a voluntary disclosure before 1 October 2012 they may qualify for relief from an understatement penalty if the audit or tax affairs were conducted after 1 October 2012.
- Section 270(6D)(a) of the TAA was introduced to allow a senior SARS official who considers an objection by the taxpayer against an understatement penalty imposed as a result of an understatement made in a return in terms of the ITA, but excluding those rendered under the Fourth Schedule to the ITA, submitted before 1 October 2012 to reduce that penalty if he is satisfied that there were extenuating circumstances. The TAA does not define the term 'extenuating circumstances'. It is a term used in section 76 of the ITA and it is therefore appropriate to revert to the various cases which considered what circumstances should be regarded as extenuating.<sup>148</sup>

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<sup>147</sup> Croome, B. & Olivier, L. (2010) *Tax Administration*. (2nd Ed.) Chapter 21, pp 561 to 563. See also s 270(6A), 270(6B), 270(6C) and 270(6D)(a) of the TAA.

<sup>148</sup> Commissioner for Inland Revenue v Da Costa 47 SATC 87  
Commissioner for Inland Revenue v Di Ciccio 47 SATC 199

#### **5.1.4 Conclusion to this section**

It is clear that the TAA has retrospective application and that the amendments to section 270(6) of the TAA took effect from 1 October 2012.

## **CHAPTER 6: A BRIEF COMPARISON BETWEEN UNDERSTATEMENT PENALTIES IMPOSED IN TERMS OF THE TAA AND PENALTIES IMPOSED IN AUSTRALIA**

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### **INTRODUCTION**

This Chapter will briefly compare penalties imposed in South Africa and Australia, but will not endeavour a comprehensive comparison. The comparison is limited due to the prescribed limitation on the length of the study.

### **SOUTH AFRICA**

In this regard reference is made to the penalty percentage table in section 223(1) (as amended) of the TAA. The table will not be repeated in this Chapter, but reference should be made to Table 3 *supra*.

### **AUSTRALIA**

The TAA was drafted taking, *inter alia*, the Australian administrative tax law into account.

The wording in the TAA is very similar to that of Australia.<sup>149</sup>

The Australian administrative tax law uses the phrases 'reasonable care', 'position which is not reasonably arguable', 'recklessness and intentional disregard' in comparison to the phrases in the TAA such as 'reasonable care not taken in completing return', 'no reasonable grounds for tax position taken', 'gross negligence' and 'intentional tax evasion'. The TAA does not define any of the abovementioned phrases.

### **6.1.1 Reasonable care versus reasonable care not taken in completing return**

The Short Guide to the TAA (2013)<sup>150</sup> gives limited guidelines as to what is expected from a taxpayer regarding 'reasonable care not taken in completing return'. Reasonable care is not defined, so the ordinary meaning must apply. The Short Guide<sup>151</sup> merely states that 'reasonable care' means that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the circumstances of the taxpayer would take to fulfil his or her tax obligations.

In the Australian case of *Federal Commissioner of Taxation v Traviati* [2012] 205 FCR 136<sup>152</sup> it was held that 'reasonable care' is an objective test linked to a reasonable person but the particular (and subjective) circumstances relevant to the taxpayer are to be considered in applying the test.

The Australian Tax Office ('ATO') gives further guidance on the meaning of 'reasonable

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<sup>149</sup> Pt 4 – 25 of the Taxation Administration Act 1953 (Cth). Smailes, A, & McDermott, PM. (2013). *The Uniformity of Taxation penalties in Australia*. Monash University Law Review, Vol 39 No 1. [Online]. Available at <http://www.austlii.edu.au/au/journals/MonashULawR2/2013/8.pdf>.

<sup>150</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011* par 16.5.3 80 (Version 2) [Online] Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>151</sup> *Ibid.*

<sup>152</sup> *Federal Commissioner of Taxation v Traviati* [2012] 205 FCR 136.

care' in Miscellaneous Tax Ruling ('MT 2008/1')<sup>153</sup> as follows:

- Taking 'reasonable care' in the context of making a statement to the Commissioner means giving appropriately serious attention to complying with the obligations imposed under a taxation law (2008: par 27).
- The reasonable care test requires an entity to take the same care in fulfilling their tax obligations that could be expected of a reasonable ordinary person in their position. This means that even though the standard of care is measured objectively it takes into account the taxpayer's circumstances (2008: 28).
- The objective test does not depend on the actual intentions of the taxpayer; it is not a question of whether the taxpayer actually foresaw the impact of the act or failure to act, but whether a reasonable person in all the circumstances would have foreseen it (2008: par 34).
- The reasonable care test has a clear link to the principle applied in the law of negligence, and 'reasonable' does not connote the highest possible level of care or perfection. Perfection or the use of increased knowledge or experience embraced in hindsight after the event should form no part of the components of what is reasonable in all the circumstances (2008: par 35).
- The appropriate standard of care required in making a statement is not immutable but takes account of the particular characteristics of the person concerned. Because there is no 'one size fits all' standard, the standard of care that is appropriate in a particular case necessarily takes account of:
  - personal circumstances (such as age, health and background);
  - level of knowledge, education, experience and skill; and
  - understanding of the tax laws (2008: par 45).

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<sup>153</sup>

The Government of Australia. (2008). *Miscellaneous Tax Ruling MT 2008/1*. [Online] Available at <http://www.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20081/NAT/ATO/00001>.

Van Zyl<sup>154</sup> correctly states that if one has regard to the Australian administrative tax law guidelines it seems that SARS will have to prove, objectively and on a balance of probabilities, that the taxpayer did not act as a reasonable man in completing his return by taking into account, *inter alia*, the subjective personal circumstances of the taxpayer, his abilities, characteristics and knowledge of tax laws. She submits that more guidance is needed to ensure the objectivity of all SARS officials.<sup>155</sup>

### 6.3.2 Reasonable arguable position versus no reasonable grounds for tax position

The equivalent for the Australian behavioural type 'reasonably arguable position' in the TAA is 'no reasonable grounds for tax position taken'.

The ATO in MT 2008/1<sup>156</sup> explains that the 'reasonably arguable position' test focuses solely on the merits of the position taken. The reasonably arguable position test is a purely objective standard involving an analysis of the law and application of the law to the relevant facts and personal circumstances are taken into account. It was held in the Australian case of *Federal Commissioner of Taxation v R & D Holdings Pty [2007] 160 FCR 248*<sup>157</sup> that, on a balance, the taxpayer's argument must be one which can be objectively said to be one that, while wrong, could be argued on rational grounds to be right.

Although there seem similarities between the Short Guide on the TAA, 2011<sup>158</sup> and the MT 2008/1,<sup>159</sup> it remains to be seen whether the guidelines developed by SARS or the South African case law will follow the Australian law and case law.

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<sup>154</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 914 to 915.

<sup>155</sup> *Ibid.*

<sup>156</sup> Government of Australia. (2008). *Miscellaneous Tax Ruling MT 2008/1*, par 39 - 40 [Online] Available at <http://www.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20081/NAT/ATO/00001>.

<sup>157</sup> *Federal Commissioner of Taxation v R & D Holdings Pty [2007] 160 FCR248*.

<sup>158</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011*, par 16.5.4 80 (Version 2) [Online]. Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>159</sup> The Government of South Africa. (2008). *Miscellaneous Tax Ruling MT 2008/1*, par 39 - 40 [Online] Available:<http://www.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20081/NAT/ATO/00001>.



### **6.3.3 Recklessness versus gross negligence**

The phrase 'recklessness' in the Australian administrative tax law is equivalent to 'gross negligence' in the TAA. The Short Guide to the TAA (2011)<sup>160</sup> explains 'gross negligence' to mean doing or not doing something in a way that, given all the circumstances, suggests or implies complete or a high level of disregard for the consequences. It further states that the test for gross negligence is objective and is based on what a reasonable person would foresee as being conduct which creates a high risk of a tax shortfall occurring.

Van Zyl<sup>161</sup> states that the risk of inconsistent application by SARS officials, due to lack of comprehensive guidelines, exists and should be addressed expediently; especially in light of the high percentage for this type of behaviour.

The phrase 'gross negligence' in the Short Guide to the TAA (2013)<sup>162</sup> was possibly taken from the ATO in MT 2008/1, which refers to 'recklessness'. 'Recklessness' means disregard of, or indifference to, a risk that is foreseeable by a reasonable person.

In the Australian case of *Shawinigan Ltd v Volkins & Co Ltd 1 [1961] W.L.R. 1206* at 1214 it was held that the degree of the risk and the gravity of consequences need to be weighed in deciding whether the conduct is reckless and that each case has to be viewed on its own particular facts and not by reference to any formula.

### **6.3.4 Intentional disregard versus intentional tax evasion**

In terms of the Short Guide to the TAA (2013)<sup>163</sup> the most severe penalty is reserved for

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<sup>160</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011*, par 16.5.5 80 (Version 2) [Online]. Available <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>161</sup> Van Zyl, L. (2014). The new understatement penalty regime: a sharp 'sword'? *Journal of Economic and Financial Sciences*, 3 7 (Oct) 905 at 917.

<sup>162</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011*, par 16.5.5 80 (Version 2) [Online]. Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

<sup>163</sup> SARS. (2013). *Short Guide to the TAA, 28 of 2011*, par 16.5.6 81 (Version 2) [Online]. Available at <http://www.sars.gov.za/Legal/TaxAdmin/Pages/Guide.aspx>.

cases where a taxpayer has acted with the intention to evade tax. To evade tax includes actions that are intended to reduce or extinguish the amount that should be paid, or which inflate the amount of a refund that is correctly refundable to the taxpayer. The most important factor is that the taxpayer must have acted with intent to evade tax. Intention is a wilful act that exists when a person's conduct is meant to disobey or wholly disregard a known legal obligation, and knowledge of illegality is crucial.

If the taxing provision is uncertain, for instance if there are conflicting judgments on the issue, and the taxpayer applies a reasonable interpretation, it is doubtful that intent to evade could be established. In such a case a more appropriate behavioural category would be whether the taxpayer had taken a tax position on unreasonable grounds or, at worst, that the taxpayer has been grossly negligent.

The influence of the Australian administrative tax law is evident by MT 2008/1<sup>164</sup> pointing out that the adjective 'intentional' means that something more than reckless disregard of or indifference to a taxation law is required. It further states that intentional disregard means that there must be actual knowledge that the statement made is false, that the test for intentional disregard is purely subjective in nature, and that the actual intention of the taxpayer is therefore crucial.<sup>165</sup>

In *Weyers v Federal Commissioner of Taxation* [2006] FCA 818; 2006 ATC 4523; (2006) 63 ATR 268<sup>166</sup> the court held that evidence of the taxpayer's intention should be found through direct evidence or by inferences from all surrounding circumstances, including the taxpayer's conduct.

The Australian administrative tax law states that to establish disregard, the entity must understand the effect of the relevant legislation and how it operates in respect of the entity's affairs and make a deliberate choice to ignore the law. It further affirms that dishonesty is a

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<sup>164</sup> The Government of Australia. (2008). *Miscellaneous Tax Ruling MT 2008/1*, par 39 - 40 [Online] Available at <http://www.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20081/NAT/ATO/00001>.

<sup>165</sup> *Ibid.*

<sup>166</sup> *Weyers v Federal Commissioner of Taxation* [2006] FCA 818; 2006 ATC 4523; (2006) 63 ATR 268.

requisite feature of behaviour that shows intentional disregard for the operation of the law, and further it points out the significant difference between this type of behaviour and behaviour that shows a lack of reasonable care or recklessness where dishonesty is not an element.<sup>167</sup>

### **6.3.5 Australian penalty percentage levels**

A shortfall penalty in Australia of 25% may be imposed on taxpayers where they do not take reasonable care or adopt a position which is not reasonably arguable. A penalty of 50% may be imposed if the taxpayer is reckless and 75% in the case of intentional disregard of the tax law.<sup>168</sup>

## **CONCLUSION**

Although it appears that there are similarities between penalties imposed in terms of the TAA and penalties imposed in terms of the Australian administrative tax law, it is clear that the Australian tax administrative law and case law give more guidelines in respect of the factors to be considered when the revenue officials have to exercise their discretion in determining how to select the relevant category of behaviour type in the case of an understatement made by the taxpayer.

It is clear from a comparison between the shortfall penalties levied in Australia and the understatement penalty percentage table contained in section 223 that South African taxpayers face a greater degree of penalty for similar defaults.

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<sup>167</sup> The Government of Australia. (2008). *Miscellaneous Tax Ruling MT 2008/1*, par 39 - 40 [Online] Available at <http://www.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20081/NAT/ATO/00001>.

<sup>168</sup> Deutsch, R. *et al.* (2014). *The Australian Tax Handbook 2014*. Australia: Thomson Reuters, par 54020 at p 1818.

## CHAPTER 7: RECOMMENDATIONS AND CONCLUSION

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### 7.1 INTRODUCTION

The TAA , which came into effect on 1 October 2012, has introduced significant changes to the South African tax landscape. Although the new understatement penalty regime is in principle similar to the additional tax regime in the ITA and VAT Act, it provides for fixed penalties based on the taxpayer's behaviour rather than a percentage at the discretion of SARS, as was the case with the additional tax regime.

Arendse and Williams<sup>169</sup> state that it is accordingly apparent that the new penalties create significant uncertainty; are harsher than the current additional tax regime in practice; and are more likely to operate to the detriment of most taxpayers.

The mandatory nature of the new understatement penalty regime, the limited discretionary power of SARS to remit understatement penalties, and the absence of definitions contained in the TAA regarding the *bona fide* inadvertent error exception and the behaviour types listed in items (ii) to (v) set out in Table 1 (Table 3 *supra*) in section 223(1) of the TAA, as well as the lack of comprehensive guidelines by SARS in this regard may be to the detriment of taxpayers due to possible inconsistent application of the discretion conferred upon the Commissioner for SARS when understatement penalties are imposed.

### 7.2 RECOMMENDATIONS

Based on this study the following recommendations are made:

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169 Arendse, T. & Williams. P. (2012). Beware of the new additional tax regime. *Tax Talk*, Sept/Oct issue, p 31.

- The phrases 'bona fide inadvertent error', 'reasonable care not taken in completing return', 'no reasonable grounds for tax position taken', 'gross negligence' and 'intentional evasion' should be defined in the TAA.
- A standardised list of factors to be taken into account, and questions to be asked by the SARS officials when applying Table 1 in section 223(1) of the TAA, should be issued by SARS in order to assist its officials, minimise the influence of bias or subjectivity, and ensure consistent application by, and the objectivity of, all SARS officials when understatement penalties are imposed.
- In terms of the TAA, a request for a remission of an understatement penalty can only be lodged by a taxpayer who has been issued with a substantial understatement penalty. It is recommended that provision be made for the request for remission against any of the understatement penalties raised. The criteria as set out in section 223(3)(b)(i)-(ii) should be applicable to all other understatement penalties.
- The taxpayer should be provided with the right to be heard and to appear before the Penalty Committee before an understatement penalty is imposed. SARS should comply with the *audi alteram partem* rule before imposing an understatement penalty.
- SARS should take into account the means of the taxpayer when imposing the understatement penalty - as penalties in general must be within the offender's ability to pay.
- SARS should have regard to comparative foreign tax legislation on the subject of penalties and the factors to be considered when penalties are imposed.
- SARS should take into account judicial pronouncements. It is recommended that SARS officials should be guided by judicial decisions when exercising their discretion to impose understatement penalties.
- It is recommended that SARS should not regard the imposition and enforcement of understatement penalties as a means of raising revenue. It should be imposed primarily to deter non-compliant taxpayers and encourage them to comply with the fiscal laws of the country.
- It is recommended that SARS should do away with the system of incentivisation of SARS employees in which gross tax collections are treated as a major indicator of good performance as it could foster corruption and abuse of the system.

The study does not endeavour to provide an exhaustive list of recommendations.

### 7.3 CONCLUSION

Based on this study it is clear that the new understatement penalty regime in terms of the TAA has given rise to significant controversy between taxpayers and SARS.

The lack of comprehensive guidelines regarding the process of identifying and ruling out a *bona fide* inadvertent error may prove to be to the detriment of the taxpayer due to possible inconsistent application and possible abuse. The fact that the quantum of the understatement penalty is determined with reference to the taxpayer's behaviour (applying Table 1 in section 223(1) of the TAA), which is determined by SARS officials in exercising their discretion, could lead to subjectivity or biased conduct by SARS officials and could lead to inconsistent application of the understatement regime.

In order to ensure objective and consistent application of the understatement penalty regime, comprehensive guidelines are imperative as recommended *infra*.

Word count: 17 785

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