# Legal Counsel

## Tax Administration

# Guide to Understatement Penalties

(Issue 2)

South African Revenue Service

# GUIDE TO UNDERSTATEMENT PENALTIES

## Preface

This guide is a general guide on understatement penalties under **Chapter 16** of the Tax Administration Act 28 of 2011 (TA Act). It does not delve into the precise technical and legal detail that is often associated with tax, and should therefore not be used as a legal reference. It is not an "official publication" as defined in section 1 of the TA Act and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 89 of the TA Act. Should an advance tax ruling be required, visit the SARS website for details of the application procedure.

The guide is based on the legislation as at date of issue.

For more information you may –

- visit your nearest SARS branch;
- visit the SARS web site at **www.sars.gov.za** or the SARS Tax Administration web page **here**;
- contact your own tax adviser or tax practitioner;
- e-mail your interpretation enquiries to **TAAinfo@sars.gov.za;**
- contact the SARS National Contact Centre –
  - ➢ if calling locally, on 0800 00 7277; or
  - ➢ if calling internationally, on +2711 602 2093 (between 8am and 4pm South African time).

Comments on this guide may be sent to **TAAinfo@sars.gov.za**.

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# GENERAL PRINCIPLES FOR THE INTERPRETATION OF THE TAX ADMINISTRATION ACT

The Tax Administration Act 28 of 2011 contains generic provisions that administers the taxes imposed under the legislation listed in the definition of "tax Act" in **section 1**. It states that, "tax", "for purposes of administration under this Act, includes a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act". The definition of "tax Act" includes, among others, the TA Act and the Value-Added Tax Act 89 of 1991, but customs and excise legislation is specifically excluded.[1] This does not mean that the principles discussed in any guide on the TA Act will never find application in the customs and excise environment at all. The TA Act is applicable in this environment to the extent that customs and excise activities give rise to value-added tax obligations, and is applicable in cases where the TA Act specifically incorporates customs and excise legislation,[2] or when the customs and excise legislation specifically makes the TA Act applicable.[3] It follows that any guide on provisions of the TA Act that are applicable to the customs and excise environment in this way will assist users in this environment.

Tax is charged under various Acts, each one dealing with specific types of taxes – income tax under the Income Tax Act 58 of 1962, value-added tax under the Value-Added Tax Act, and so forth. These Acts, and, in some cases, other Acts that exclusively deal with the administration of certain tax types,[4] ("**taxation Acts**")[5] contain administrative provisions, but only those that are unique or additional to the tax type specified in each Act. On the other hand, to simplify and harmonise tax administration, the TA Act incorporates into one piece of legislation administrative provisions generic to all the tax types. It is the primary vehicle for, and only deals with the administration of all the tax types.

**Example 1 – TA Act provisions generic to all tax types**

The provisions of certain taxation Acts that dealt with what was known as "additional tax penalties" were deleted and understatement penalties are now imposed on all tax types only under Chapter 16 of the TA Act.

Consequently, administrative provisions applicable to a type of tax may be contained in the taxation Act, if applicable, in its administration taxation Act, in the TA Act, or a combination of these. The taxation Act(s) as well as the TA Act must consequently be read together to determine all the provisions that apply to a tax type.

[1] Customs and excise legislation consists of the Customs and Excise Act 91 of 1964 which is presently in operation. This Act will, at a future date, be replaced with the Customs Control Act 31 of 2014, the Customs Duty Act 30 of 2014 and the Excise Duty Act 91 of 1964 (that is, the Customs and Excise Act, 1964 as amended) – for more information click **here**.

[2] Examples of this are contained in in sections 68, 69, and 191 of the TA Act.

[3] This can be seen from sections 705, 862, and 900 of the Customs Control Act 31 of 2014.

[4] Such as the Securities Transfer Tax Administration Act 26 of 2007.

[5] As explained in the paragraph above, "tax Act" includes the TA Act. To avoid confusion in this guide, the term "taxation Act" as opposed to "tax Act" is used to indicate that in such instances reference to the TA Act is excluded.

**Example 2 – Administrative provisions in more than one Act**

In addition to the record-keeping requirements of the TA Act, the Value-Added Tax Act contains additional requirements that are unique to value-added tax.

To avoid interpretative difficulties or inconsistencies arising from the interaction between the TA Act and the taxation Acts, the Acts provide tools to assist interpretation.

The first is that when the TA Act uses a term that is defined in a taxation Act but is silent on its meaning, the defined meaning in the taxation Act applies, unless the context where the term is used indicates otherwise.[6]

**Example 3 – Defined terms, used but undefined in the TA Act**

- Notwithstanding being used in the TA Act, the term "vendor" is not defined. It is however defined in the Value-Added Tax Act. Where the term is used in the former Act, it has the meaning as defined in the latter. This is equally true, for example, of the terms "capital gain", "capital loss", and "connected person" as defined in the Income Tax Act.
- However, although the word "director" is defined only in the Income Tax Act, it does not always have this meaning when used in the TA Act. When the provision in which it is used is applied to income tax, it will have the same meaning but when it is applied to, for instance, value-added tax the Income Tax Act definition will *not* be applicable. In such a case, the ordinary meaning of the word determined by the context will apply because it has no defined meaning in either the Value-Added Tax Act or the TA Act.

  In addition, when "director" is used in the TA Act when referring to the National Director of Public Prosecutions or the Director-General of the National Treasury, the context indicates the exact meaning.
- In the Income Tax Act, the term "dividend" is defined and used to refer to amounts paid by a company for the benefit of a shareholder.[7] However, when the term is used in the TA Act, it is used in context of a liquidator or trustee paying creditors.[8] The context where the term is used in the TA Act therefore indicates that, even when the provision is applied in respect of income tax, it will not have the meaning defined in the Income Tax Act.

Flowing from the first interpretation rule is the converse – an undefined term used in a taxation Act that is defined in the TA Act has this defined meaning unless the context where the term is used indicates otherwise.[9]

[6] This can be seen from **section 1** of the TA Act.
[7] "Dividend" is defined in section 1 of the Income Tax Act.
[8] It is used without a definition in section 198 of that Act.
[9] This is clear from various sections of the taxation Acts, including section 1(2) of both the Income Tax and the Value-Added Tax Acts.

**Example 4 – Defined terms, used but undefined in the taxation Act**

The term "return" is defined in the TA Act but not in the Value-Added Tax Act. When it is used in the Value-Added Tax Act in context of administrative requirements, such as the obligation to submit a return, it will have the meaning defined in the TA Act. However, when the Value-Added Tax Act speaks of the "return of goods" the defined meaning from the TA Act will not apply.

It also follows that if a term is defined in both the TA Act and a taxation Act, it will bear the meaning as defined in the TA Act in which it is used unless the context indicates otherwise, or the definitions are so similar that it makes no difference, which one is used.

**Example 5 – Defined terms, used and defined in any Act**

- Although similarly defined, the term "Commissioner" appears in some taxation Acts as well as in the TA Act.
- The term "fair market value" is defined in both the TA Act and in the Income Tax Act. Although used in various other provisions in the Income Tax Act, it is only defined for purposes of Part V of Chapter II. Consequently, the term will bear the TA Act meaning except when used in this Part, or when the context in which it appears in the Income Tax Act indicates otherwise.

Although the idea was to avoid any inconsistencies between the TA Act and the taxation Acts, the second interpretation rule does cater for such eventualities – the taxation Act will determine the correct position, that is, in the event of any inconsistency between the TA Act and a taxation Act, the latter will prevail.[10]

Defined terms in the TA Act may cause additional interpretative difficulties. Defined meanings of terms in section 1 are applicable throughout the TA Act – that is unless, as explained above, the context indicates otherwise. However, there are also Chapters and Parts of the TA Act that contain defined terms, the definitions of which only apply to that Chapter or Part.[11] These terms are defined in the first section of the relevant Chapter or Part and when the definition is applicable, the term appears in single quotation marks.

[10] This can be seen from **section 4(3)** of the TA Act.

[11] Chapter 7 (Advance Rulings), Chapter 9 (Dispute Resolution), Chapter 16 (Understatement Penalty), Chapter 18 (Registration of Tax Practitioners and Reporting of Unprofessional Conduct).

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## Glossary

For the purpose of this guide, unless the context indicates otherwise –

- **"administrative non-compliance penalty"** means a fixed amount or percentage-based penalty under Chapter 15 of the TA Act;
- **"anti-avoidance rules"** means the statutory prohibitions of the avoidance, reduction or postponement of tax liability contained in Part IIA of Chapter III of the Income Tax Act, section 73 of the Value-Added Tax Act and similar provisions of the taxation Acts;
- **"Commissioner"** means the Commissioner of SARS;
- **"Diamond Export Levy (Administration) Act"** means the Diamond Export Levy (Administration) Act 14 of 2007;
- **"Estate Duty Act"** means the Estate Duty Act 45 of 1955;
- **"Fixed amount penalty"** means a penalty under Part B of Chapter 15 of the TA Act and includes a reportable arrangement penalty (sections 210 to 212);
- **"Income Tax Act"** means the Income Tax Act 58 of 1962;
- **"listed behaviours"** means the items listed in column 2 of rows (i) to (vi) of the understatement penalty table;
- **"Mineral and Petroleum Resources Royalty (Administration) Act"** means the Mineral and Petroleum Resources Royalty (Administration) Act 29 of 2008;
- **"penalty percentage"** means a percentage contained in the understatement penalty percentage table;
- **"percentage-based penalty"** means a penalty under Part C of Chapter 15 of the TA Act (section 213);
- **"prescribed circumstances"** means the items listed in the second row of columns 3 to 6 of the understatement penalty table;[12]
- **"prescribed rate"** means the rate fixed by the Minister of Finance under section 80(1)(*b*) of the Public Finance Management Act 1 of 1999, 10.5% per annum at date of publication in Notice No. 259 in *Government Gazette* 39960 on 29 April 2016;[13]
- **"SARS"** means the South African Revenue Service established by section 2 of the South African Revenue Service Act 34 of 1997;
- **"Securities Transfer Tax Administration Act"** means the Securities Transfer Tax Administration Act 26 of 2007;

12 This term is referred to as conduct in the audit environment.

13 As defined in **section 1** read with **section 189(3)** of the TA Act; section 1 of the Income Tax Act, and section 1 of the Value-Added Tax Act. The TA Act definition is used in the Securities Transfer Tax Administration Act, and the Mineral and Petroleum Resources Royalty (Administration) Act levies interest in accordance with **Chapter 12** of the TA Act. The Income Tax Act definition is used in the Skills Development Levies Act, the Unemployment Insurance Contributions Act, and the Diamond Export Levy (Administration) Act. In accordance with section 89*quin*(2) of the Income Tax Act, section 11(2) of the Skills Development Levies Act, and section 12(2) of the Unemployment Insurance Contributions Act, the Commissioner may however by notice in the *Government Gazette* prescribe that interest be calculated on the daily balance owing and compounded monthly.

- **"Skills Development Levies Act"** means the Skills Development Levies Act 9 of 1999;
- **"TA Act"** means the Tax Administration Act 28 of 2011;
- **"taxation Act"** means an Act, or portion of an Act, referred to in section 4 of the South African Revenue Service Act 34 of 1997 excluding the TA Act and the customs and excise legislation;[14]
- **"Transfer Duty Act"** means the Transfer Duty Act 40 of 1949;
- **"understatement penalty"** means the penalty imposed under Chapter 16 of the TA Act;
- **"understatement penalty table"** means the understatement penalty percentage table contained in section 223(1) of the TA Act;
- **"Unemployment Insurance Contributions Act"** means the Unemployment Insurance Contributions Act 4 of 2002;
- **"Value-Added Tax Act"** means the Value-Added Tax Act 89 of 1991; and
- **"VAT"** means value-added tax.

[14] In **section 1** of the TA Act, the definition of "tax Acts" includes the TA Act but for the purpose of this guide, the term "taxation Act" is used to indicate that the TA Act is excluded.

# 1. Purpose

The purpose of this guide is to assist people who use it to gain an understanding of the understatement penalties contained in **Part A of Chapter 16** of the TA Act.

# 2. Background

The purpose of penalties under the TA Act is to encourage voluntary compliance and deter unwanted behaviour such as non-compliance and tax evasion. A rational person will not undertake an activity if the punitive sanctions flowing from it outweigh the prospective gain to be had from engaging in it.[15] Financial sanctions under the TA Act consist of administrative non-compliance penalties (Chapter 15) and understatement penalties (**Part A of Chapter 16**) which, together with criminal sanctions (Chapter 17), provide a comprehensive framework for the deterrence of such behaviour.

Administrative non-compliance penalties under the erstwhile section 75B of the Income Tax Act were deleted and are now imposed in accordance with Chapter 15 of the TA Act. They relate to failures to comply with tax administrative requirements imposed under taxation Acts and the TA Act. Fixed amount penalties (Part B) consist of reportable arrangement penalties and other penalties for failures, listed in public notices.[16] To avoid administrative "double jeopardy", these failures exclude those that incur penalties under Part C of Chapter 15, for understatements, or for reportable arrangements. Percentage-based penalties (Part C) predominantly deal with late payment. Although the provisions of Chapter 15 apply across taxes, Part C must be read together with the taxation Act to determine the applicable penalty percentage for each tax type.

The discretion to impose "additional tax" of up to 200% under various provisions of the taxation Acts[17] was replaced with the more equitable and consistent understatement penalty regime in **Part A of Chapter 16**. This Chapter contains terms with definitions[18] that only apply when such terms are used in the Chapter in single quotation marks. Although these are discussed in appropriate places in this guide, the term 'tax' deserves a special mention. Throughout the TA Act, tax includes "a tax, duty, levy, royalty, fee, contribution, penalty, interest, and any other moneys imposed under a tax Act"[19] which collectively refers to all amounts imposed under tax legislation. However, for the purpose of Chapter 16, penalties and interest are excluded from the definition of "tax" as understatement penalties are only imposed on understated tax and not on penalties and interest.

A flow diagram of the financial sanctions under the TA Act and the interaction between the TA Act and the taxation Acts follows.

[15] Victor Thuronyi, *Tax Law Design and Drafting*, USA: International Monetary Fund, 1996 edition, at page 117 to 134.

[16] These are contained in the visual representation that follows.

[17] Repealed section 76 of the Income Tax Act but also sections 61(*h*) and 64B(11) of the same Act, and paragraph 6(2A) of the Fourth Schedule to it. Additional tax was also levied under section 60 of the Value-Added Tax Act, section 17A of the Transfer Duty Act, section 12(3) of the Skills Development Levies Act, and section 13(2) of the Unemployment Insurance Contributions Act.

[18] In accordance with the last principle discussed in the preamble to this guide, the defined terms for Chapter 16 are contained in **section 221**.

[19] The definition of "tax" is contained in **section 1**.

**Financial sanctions under the Tax Administration Act**

**Part A of Chapter 16:** Understatement Penalties

**Chapter 15:** Administrative Non-Compliance Penalties

**Failure to disclose reportable arrangements**

**Fixed Amount Penalties (Part B)**

**Percentage Based Penalties (Part C)**

**Other than failures that lead to percentage based, understatement or reportable arrangement penalties, failure to comply with obligations in Tax Act, listed in public notice, presently failure:**

- by natural person to submit income tax returns (http://www.sars.gov.za/AllDocs/LegalDoclib/SecLegis/LAPD-LSec-TAdm-PN-2012-04%20-%20Notice%20790%20GG%2035733%201%20October%202012.pdf);
- to meet FATCA reporting obligations (http://www.sars.gov.za/AllDocs/LegalDoclib/SecLegis/LAPD-LSec-TAdm-PN-2015-04%20-%20Notice%20597%20GG%2038983%2010%20July%202015.pdf); and
- to meet OECD common reporting standard obligations (http://www.sars.gov.za/AllDocs/LegalDoclib/SecLegis/LAPD-LSec-IT-GN-2017-02%20-%20Notice%20193%20GG%2040660%203%20March%202017%20Incidences%20of%20non-compliance%20subject%20to%20a%20fixed%20amount%20penalty.pdf)

**Income Tax Act**

- 10% for late payment of witholding tax on sale of immovable property by non-resident seller (section 35A(9)(b))
- 10% for late payment of employees' tax (paragraph 6(1) of the Fourth Schedule)
- 10% for non-submission of EMP501 (paragraph 14(6) of the Fourth Schedule)
- 10% for underestimation of provisional tax (paragraph 20(1) read with 20(2B) of the Fourth Schedule)
- 10% for late payment of provisional tax (paragraph 27(1) of the Fourth Schedule)
- 20% for underestimation of taxable turnover by micro business (paragraph 11(6) of the Sixth Schedule)

**Value-Added Tax Act**

- 10% for late payment of VAT (section 39(1))
- 10% for late payment of tax on import of goods (section 39(4))
- 10% for late payment of excise duty or environmental levy (section 39(5))

**Transfer Duty Act**

- 10% for late payment of transfer duty (section 4(1))

**Skills Development Levies Act**

- 10% for late payment of levies (section 12(1))

**Unemployment Insurance Contributions Act**

- 10% for late payment of contribution (section 13(1))

**Securities Transfer Tax Administration Act**

- 10% for late payment of tax (section 6A)

**Mineral and Petroleum Resources Royalty (Administration) Act**

- 10% for underestimation of royalties (section 14(1))

# 3. Transition from additional tax

The TA Act did not introduce the regime to penalise understatements. Additional tax, levied under repealed provisions of various taxation Acts,[20] was a penalty and not tax as the name suggests (which would be on income or a transaction).[21] Much like the understatement penalty regime that has replaced it, additional tax penalties resulted from a failure to submit a return, or an omission or incorrect statement in a return. The amount of the penalty was likewise calculated as a percentage of the amount of the shortfall occasioned by the understatement, up to a maximum of 200%. However, although influenced by behaviour (in the form of "extenuating circumstances"), the percentage of the penalty was determined by what was regarded as a reasonably unfettered discretion. Herein lies the fundamental difference – under the understatement penalty regime, the discretion to determine the percentage of the penalty is based on prescribed objective criteria.[22] This ensures more certainty with regard to the imposition of penalties and the consistent treatment of taxpayers in comparable circumstances.

The TA Act commenced on 1 October 2012. It contains provisions to ensure a smooth transition from the law applicable before that date to the law applicable after its commencement.[23] The general principle is that the provisions of the taxation Acts that were amended or repealed by the TA Act, applied as they read prior to amendment or repeal until 30 September 2012 and thereafter the TA Act applies.


The TA Act is retrospective or retrospective in a "weak" sense, as contrasted with retroactive or retrospective in a "strong" sense.[24] These concepts are explained by Elmer A Driedger:[25]

> "A retroactive statute is one that operates as of a time prior to its enactment. A retrospective statute is one that operates for the future only. It is prospective, but it imposes new results in respect of a past event. A retroactive statute operates backwards. A retrospective statute operates forwards, but it looks backwards in that it attaches new consequences for the future to an event that took place before the statute was enacted. A retroactive statute changes the law from what it was; a retrospective statute changes the law from what it otherwise would be with respect to a prior event."[26]

[20] These provisions are listed in footnote 17.

[21] As was held by the South African courts on more than one occasion in, for example, *Israelsohn v CIR* 1952(3) SA 529 (AD) at 539-540 and *CIR v McNeil* 1959(1) SA 481 (AD) at 487F.

[22] Which were derived from extenuating circumstances under the additional tax regime, how such circumstances were shaped by case law, and the criteria used in comparable jurisdictions.

[23] These provisions are contained in Chapter 20.

[24] See paragraph 35 of *National Director of Public Prosecutions SA v Carolus and others* [2000] 1 All SA 302 (A).

[25] In an article in (1978) 56 Canadian Bar Review 264 at 268–9 quoted from B*enner v Canada (Secretary of State)* (1997) 42 CRR (2d) 1 (SCC) at 17 by the C*ourt in National Director of Public Prosecutions SA v Carolus and others* at 34.

[26] Also see discussion at 16 of *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and another* [2017] 4 All SA 175 (GP).

The rationale[27] for the TA Act to impose new results in respect of past events is to facilitate the rapid implementation of the legislative reform intended by the TA Act and, by avoiding the need for different processes and systems, reduce the cost of tax administration substantially.

For the application of this principle to the subject matter under discussion, it must be born in mind that because additional tax penalties were and understatement penalties are determined by the behaviour associated with the understatement, their imposition was and is contingent on the finalisation of verifications, audits, or investigations by SARS. It therefore follows that an additional tax penalty had to be imposed on understatements in tax periods which SARS had verified, audited, or investigated by 30 September 2012, as, until this date, the taxation Acts applied as they read prior to amendment or repeal by the TA Act. Because these penalties were imposable at the time (that is, the verification, audit or investigation was complete),[28] the fact that the assessment had not been issued by 30 September 2012 does not affect this position.

Based on the same principle, from 1 October 2012, the TA Act applies to any verification, audit, or investigation and likewise to the penalties that may result therefrom. In this way, subject to the limitation period for the issuance of assessments[29] and the concessions discussed below, an understatement penalty is imposable on an understatement, *irrespective of the tax period to which it relates*, if the verification, audit, or investigation necessary to establish its presence, is undertaken from 1 October 2012. As these proceedings are subject to the TA Act, they must result in the imposition of understatement penalties, as the additional tax penalty provisions, by their repeal, are no longer operative. An extension to this general principle is where the verification, audit, or investigation[30] was in progress at 30 September 2012 but had not been completed by 1 October 2012. In such instances, an understatement penalty is imposable as the proceedings “must be continued and concluded under the provisions of this Act as if taken or instituted under this Act”.[31]

[27] The Court in *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and another*, at 80, held the rationality test to be the first test for the constitutional validity of retrospective legislation. It requires that “the means chosen in legislation are rationally connected to the ends sought to be achieved.”

[28] **Section 270(6)** read with **270(6A)** makes it clear that this is so.

[29] These are contained in section 99.

[30] Being a “proceeding taken” “before the commencement date of this Act [the TA Act]”, “under the provisions of a tax Act repealed by this Act but not completed by the commencement date of the comparable provisions of this Act” in accordance with **section 270(1)** read with **section 270(2)(*c*)**.

[31] See **section 270(2)**.

However, if the return was submitted or due by 30 September 2012 and an understatement penalty is imposed, in the interest of equity and fairness,[32] certain concessions are made to equalise changes in the legislation, which because these were unknown at the time, may negatively affect taxpayers.[33] These concessions are discussed in appropriate places in this guide. They relate to the remittance of a penalty for substantial understatement,[34] the reduction of the penalty percentage in the event of voluntary disclosure obtained under repealed provisions of the taxation Acts,[35] the reduction or waiver of penalties under certain circumstances,[36] and the date from which interest accrues.[37] They retain the remedies and recourses that the additional tax regime provided within the more equitable and consistent understatement penalty regime.[38]

As an exception to the principle discussed above, if an understatement occurred before 1 October 2012 and an understatement penalty cannot for any reason otherwise be imposed, the TA Act allows for the imposition of additional tax penalties under the taxation Acts as they read prior to amendment or repeal by the TA Act.[39]

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[32] Although it must be noted that the Court in *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and another*, at 36, suggested that when considering the retrospective effect of legislation, 'fairness' need not in all circumstances be the overriding consideration.

[33] These concessions are contained in **sections 270(6B) to (6E)**. They align the understatement penalty regime to the additional tax regime thereby ensuring that it does not "unreasonably or unfairly impairs the ability of those bound by the law to regulate their conduct in accordance therewith" as per the quote in *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and another* at 47. It is however noted that this quote is in any event qualified as follows:

> … there are obviously degrees of unfairness and not all laws are "fair" and the real question would be whether a law is "unjust" ie whether it passes constitutional muster, ie was the law, accepting its language is clear, passed for a rational reason? I do not agree, if that was suggested, that "unfair impairment" is the appropriate test in our constitutional dispensation.

[34] As discussed in **8.4**, taxpayers who submitted a return up to 30 September 2012 would not have been aware that, for the remittance of substantial understatement, they must be in possession of an opinion by a registered tax practitioner. This concession therefore allows the taxpayer to rely on an opinion obtained after the relevant return was submitted.

[35] As set out in **9**, taxpayers who made voluntary disclosure by 30 September 2012, also qualify for relief under the TA Act if the audit of their affairs was commenced before but concluded after 1 October 2012.

[36] As can be seen from **11**, a senior SARS official may reduce an understatement penalty in whole or in part for an understatement in a return submitted by 30 September 2012. The official must be satisfied that there were extenuating circumstances in the case of a return in terms of the Income Tax Act, and in all circumstances other than intentional tax evasion (item vi) in the case of a return in terms of the Value-Added Tax Act.

[37] As discussed in **10**, penalties on understatements incurred by 30 September 2012, only accrue interest from 1 October 2012.

[38] In accordance with *Pienaar Brothers (Pty) Ltd v Commissioner for the South African Revenue Service and another* at 80, the second test for the constitutional validity of retrospective legislation is reasonableness or proportionality. This test, which requires that the limitation must be shown to be justifiable under section 36 of the Constitution, only applies when legislation limits fundamental right in the Bill of Rights. Although fundamental rights are not at play here, these concessions eliminate any variance between the rights of taxpayers under the additional tax as opposed to the understatement penalty regime.

[39] This is clear from a reading of **section 270(6)(*b*)**.

## 4. An understatement

An understatement is defined in section 221 of the TA Act:

> " **'understatement'** means 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;
>
> (*d*) if no return is required, the failure to pay the correct amount of 'tax'; or
>
> (*e*) an 'impermissible avoidance arrangement."

The actions or inactions in (*a*) to (*e*) (hereinafter referred to as "triggers") must therefore result in prejudice to SARS or the *fiscus* for an understatement to arise.

### 4.1 The triggers

The main purpose of the understatement penalty regime is to deter unwanted behaviour that causes non-compliant reporting. Such reporting includes direct reporting of the actual tax chargeable, such as in the value-added tax environment, or when no return is required, the payment of tax (that is, self-assessment); as well as indirect reporting of matters that impact tax chargeable, such as in the income tax environment (that is, SARS assessment). To reflect this purpose, the triggers are actions or inactions that negatively affect the submission or content of returns, that is, the reporting obligations of a taxpayer.

The Court in *TCIT13725 DBN*[40] that:[41]

> "Items (*a*), (*b*) and (*c*) of the definition deal with the case of returns. If you omit something from the return (paragraph (*b*)), or make a false statement in it (paragraph (*c*)), there is no doubt that you have made an "understatement" (assuming that the requirement of prejudice is satisfied). No other default with respect to a return appears to me to be possible except that embodied in the failure to submit the return at all. A default in rendering a return (paragraph (*a*)) must be a failure to render one when it is due."

With regards to the failure to pay the correct tax when no return is required [paragraph (*d*)], the amount that is paid or not paid, essentially reflects the tax declared by the taxpayer.[42] Additionally, from the way in which impermissible avoidance arrangements [paragraph (*e*)] are dealt with in accordance with the taxation Acts,[43] it is evident that they are likewise reflected in returns.

Whether the trigger has occurred is a matter of fact, which SARS must establish on a case-by-case basis.[44] It can even find that in any given tax period there has been more than one trigger. Each one that is found to have caused any prejudice to SARS or the *fiscus* will be an understatement in its own right. It follows that, provided the requirements below are met, a person who "fails to submit a return as required" or "submits a return or information that is incorrect or inadequate" will incur an understatement penalty[45] when SARS makes an

[40] This case is available on the SARS website as *TCIT13725 TCVAT1426 TCIT13727 TCVAT1096 DBN*. It has been shortened for the sake of brevity.

[41] At 26.

[42] In accordance with the definition of "return" read with "self-assessment" in **section 1**.

[43] These sections are referenced in the definition of "impermissible avoidance arrangement" in **section 221**.

[44] In accordance with **section 102(2)**, SARS bears the onus of proving the facts on which understatement penalties are based.

[45] The penalty will be imposed in accordance with **section 223(2)**.

assessment based on an estimate.[46] If the tax is overdue, the taxpayer will additionally incur a percentage-based penalty. On the other hand, if the requirements for the imposition of the understatement penalty are not met, in addition to the percentage-based penalty, a fixed amount penalty maybe appropriate, the imposition of both understatement and fixed amount penalties for the same non-compliance being legislatively prohibited.[47]

## 4.2 Prejudice to SARS or the *fiscus*

The English Oxford Living Dictionaries defines "prejudice" as "harm or injury that results from some action or judgement" and lists synonyms as disadvantage, damage, injury, hurt, impairment, and loss.[48] In context of the definition of "understatement", the "action or judgement" is of course one of the triggers discussed above, and SARS must determine the "harm or injury" that it causes in consideration that "**any**" prejudice to SARS or the *fiscus*" will qualify the trigger as an understatement.[49] For instance, in reference to the adverse effects on the State budgeting process, on the facts in *TCIT13725 DBN*, the Court held that "prejudice to SARS and the *fiscus* is implicit in the failure … to render returns, and the consequent failure … to pay the tax due under those returns at the time when it was supposed to be paid."[50] On similar considerations,[51] in *TCIT 14247 JHB* where a refund was due, the Court held that omissions from and defaults in rendering returns would cause SARS and the *fiscus* prejudice –

> "… in the form of the opportunity cost occasioned by its delayed recovery of the income tax and VAT amounts due to it. Although SARS had the funds in its possession, throughout, it was not entitled to the use thereof as the funds were reflected as a credit in the account of the taxpayer. Indeed, the interest that accrued to the funds during the time when SARS had the funds in its possession was for the taxpayer's account".[52]

These extracts should however not be construed as to imply that an understatement does not occur if it was discovered before the tax or refund was payable or that the prejudice need only be actual financial loss.[53] The opposite is quite true. In both the abovementioned cases the Courts additionally held "that prejudice includes the resource allocation flowing from the taxpayer's aforesaid "omission" and "default" ",[54] and that "the application of resources to audits of the affairs of taxpayers like the appellants is in itself prejudice to SARS."[55]

46 Such assessments can be imposed in accordance with **section 95**.
47 In accordance with the description of non-compliance in **section 210(2)(*b*)**.
48 These are the legal definitions at **https://en.oxforddictionaries.com/definition/prejudice**.
49 In accordance with the requirement that section 221 sets.
50 At 43 which is for the sake of completeness followed by,

> The State's budgeting process is based upon the proposition that taxes will be paid at the time when they are due to be paid. In the case of a failure to render a return upon which tax would have been assessed as payable, the State (using that term loosely to encompass SARS and the fiscus) is prejudiced by being kept out of the contribution to its year's expenditure which would have been available if there had been no default in the rendition of the return in question.

51 These considerations are set out in paragraphs 42 to 45.
52 At 41, and see discussion at 42 to and 43 where the budgeting process is also discussed, as well as 44 and 45 where the Court has similar views on provisional tax refunds.
53 *Western Credit Bank Ltd v Kajee* [1967] 4 All SA 228 (N) at page 237 and the case law referenced there and *Miele Et Cie GmbH & Co v Euro Electrical (Pty) Ltd* [1988] 2 All SA 244 (A) at page 253.
54 See *TCIT 14247 JHB* at 46.
55 See *TCIT13725 DBN* at 45.

Ultimately, because **any** prejudice will qualify the trigger as an understatement, the word must be given the wide interpretation ascribed to it by the Court in *TCIT13725 DBN*: [56]

> "The word 'any' is 'a word of wide and unqualified generality. It may be restricted by the subject-matter or the context, but *prima facie* it is unlimited.' (Per Innes CJ in *R v Hugo* 1926 AD 268 at 271). There is nothing in the context of the provisions of the Act relating to understatement penalties to suggest that the word was used in a limited sense in section 221. On the contrary, a comparison of the sense of the words 'means ... prejudice to SARS or the *fiscus'*, with and without the insertion of the word 'any', suggests that its insertion indicates that the broadest range of prejudice must be taken into account when considering whether any of the stated defaults have resulted in prejudice to SARS or the *fiscus*."

Without limiting the "range of prejudice" to be taken into account, such considerations must include the impact of any trigger[57] on the ability of SARS to administer tax legislation, or otherwise fulfil its functions. This *inter alia* entails that SARS must –[58]

- obtain full information about the identity of taxpayers, their tax liability, taxable events, and their compliance obligations;
- assess the correctness of returns, collect tax debts, and refund overpayments;
- investigate tax offences and provide assistance to prosecute such offences;
- enforce and perform its powers, duties, and other administrative functions under the taxation Acts and the TA Act; and
- give effect to international tax standards and the obligation of the Republic under international tax agreements.

A trigger that impedes SARS' ability to do the above may very well be a source of prejudice to SARS and the *fiscus*.

## 4.3 The shortfall

Because the understatement penalty regime addresses the negative effect of triggers on the true amount of tax payable, each trigger that has caused prejudice (an understatement) is quantified by a shortfall. As a representation of the magnitude of "the nature of the wrongdoing for which the taxpayer is responsible",[59] the shortfall is essentially the difference between the correct amount of tax and the tax that was reported in a tax period,[60] that is, the negative effect expressed in monetary terms. For each understatement it is calculated as the sum of –[61]

- the difference between the tax properly chargeable and the tax that was reported as chargeable [**section 222(3)(*a*)**];
- the difference between the amount properly refundable and the amount that was reported as refundable [**section 222(3)(*b*)**]; and

---

56 At 45.
57 In *TCIT13725 DBN*, the Court used the term "stated defaults".
58 This is how section 3 of the TA Act describes the administration of a "tax Act", which in this instance includes the TA Act.
59 *TCIT13725 DBN* at 41.
60 See discussion in **4.1**.
61 **Section 222(5)**.

- the result of the maximum tax rate applied to the difference between the assessed loss or other benefit to the taxpayer properly carried forward from one tax period to the next and the assessed loss or benefit that was reported as carried forward [**section 222(3)(*c*)**]. The tax rate is the maximum one applicable to the taxpayer, ignoring any assessed loss or other benefit to the taxpayer carried forward from one tax period to the next.

With regard to a default in rendering a return, including the failure to pay any tax when a return is not required, in the matter of *TCIT13725 DBN*, the Court rightly held:[62]

> "The word 'accepted' in the context of section 222(3)(*a*) means the circumstance that SARS proceeds upon the assumption that there has been no 'understatement' as defined. It 'accepts' as correct the apparent position, whether that involves a mis-stated return or the absence of one altogether. Once the understatement is discovered and acted upon, the resultant tax position must be compared to the one which would have obtained if the 'understatement' (as defined) had not been acted upon. In the case of a return not rendered when it was due, the shortfall on which the penalty is charged is the difference between the tax found due and the position which would have obtained if SARS had not realised and acted upon the fact that the taxpayer failed to render a return at all: i.e. a zero tax position."

**Take Note**

For illustrative purposes, a standard tax rate of 28% is used in all the examples in this guide.

**Example 6 – Tax chargeable shortfall**

A taxpayer declares R1 000 taxable income in their return. They have therefore reported R280 tax chargeable. It transpires that the taxable income is actually R1 500 and the tax chargeable R420.

| | | | |
|---|---|---|---|
| Tax properly chargeable | | R | 420 |
| Tax reported as chargeable | - | R | 280 |
| **Paragraph (*a*) shortfall** | | **R** | **140** |

**Example 7 – Tax refundable shortfall**

A vendor submits a VAT return that reflects a refund of R1 200. However, the calculation excludes output VAT of R700 and the VAT properly refundable is actually R500.

| | | | |
|---|---|---|---|
| VAT reported as refundable | | R | 1 200 |
| VAT properly refundable | - | R | 500 |
| **Paragraph (*b*) shortfall** | | **R** | **700** |

62 At 36.

**Example 8 – Assessed loss or other benefit shortfall**

A taxpayer declares a loss of R1 000 in their return but because the calculation excludes income of R700, the actual assessed loss is R300.

| | | | |
|---|---|---|---|
| Assessed loss reported | | R | 1 000 |
| Actual assessed loss | - | R | 300 |
| Difference | | R | 700 |
| Tax rate | x | | 28 % |
| **Paragraph (*c*) shortfall** | | **R** | **196** |

In the event that the trigger causes a difference under more than one paragraph, the shortfall is the sum of the amounts calculated under each.

**Example 9 – The sum of the shortfalls**

A vendor submits a VAT return that reflects a refund of R100 but the calculation excludes output VAT of R500 and the VAT properly chargeable is actually R400.

| | | | |
|---|---|---|---|
| VAT properly chargeable | | R | 400 |
| VAT reported as chargeable | - | R | 0 |
| **Difference under paragraph (*a*)** | | **R** | **400** |
| VAT reported as refundable | | R | 100 |
| VAT properly refundable | - | R | 0 |
| **Difference under paragraph (*b*)** | | **R** | **100** |
| Sum of paragraph (*a*) + (*b*) | | R | 400 |
| | + | R | 100 |
| **Shortfall** | | **R** | **500** |

**Example 10 – The sum of the shortfalls**

A taxpayer declares a loss of R1 000 in their return. However, the calculation excludes income of R1 200 and the actual taxable income is R200, amounting to R56 tax properly chargeable.

| | | | |
|---|---|---|---|
| Tax properly chargeable | | R | 56 |
| Tax reported as chargeable | - | R | 0 |
| **Difference under paragraph (*a*)** | | **R** | **56** |
| Assessed loss reported | | R | 1 000 |
| Actual assessed loss | - | R | 0 |
| Difference | | R | 1 000 |
| | x | | 28 % |
| **Result under paragraph (*c*)** | | **R** | **280** |
| The sum of paragraph (*a*) + (*c*) | | R | 56 |
| | + | R | 280 |
| **Shortfall** | | **R** | **336** |

However, the differences in paragraphs (*a*) and (*b*) could be as a result of a duplication and therefore, in the interest of equity, the TA Act allows for the reduction of the resultant shortfall by the amount of this duplication.[63]

**Example 11 – Reduction for duplication**

In their return, a taxpayer declares taxable income of R1 000, amounting to R280 tax chargeable. They make a provisional tax payment of R800 during the tax period, which, if accepted, would entitle them to a refund of R520. It however transpires that the taxable income is actually R1 500 and the tax properly chargeable, R420, resulting in a proper refund of R380.

| | | | |
|---|---|---|---|
| Tax properly chargeable | | R | 420 |
| Tax reported as chargeable | - | R | 280 |
| **Difference under paragraph (*a*)** | | **R** | **140** |
| Amount refundable if understatement accepted | | R | 520 |
| Amount properly refundable | - | R | 380 |
| **Difference under paragraph (*b*)** | | **R** | **140** |
| The sum of paragraph (*a*) and (*b*) | | R | 280 |
| Reduction for duplication | - | R | 140 |
| **Shortfall** | | **R** | **140** |

**Example 12 – Reduction for duplication**

Although a taxpayer declares a loss of R1 000 in their return, the calculation excludes income of R1 200, and the actual taxable income is R200. As they have reported no tax chargeable, a provisional tax payment of R100 during the tax period would entitle them to a refund of the entire amount. Because the tax properly chargeable is R56, the amount properly refundable is actually R44.

| | | | | |
|---|---|---|---|---|
| Tax properly chargeable | | R | 56 | |
| Tax reported as chargeable | | R | 0 | |
| **Difference under paragraph (*a*)** | | **R** | **56** | |
| Amount refundable if understatement accepted | | R | 100 | |
| Amount properly refundable | - | R | 44 | |
| **Difference under paragraph (*b*)** | | **R** | **56** | |
| Assessed loss reported | | R | 1 000 | |
| Actual assessed loss | - | R | 0 | |
| Difference | | R | 1 000 | |
| | X | | 28 | % |
| **Result under paragraph (*c*)** | | **R** | **280** | |
| The sum of paragraphs (*a*), (*b*) and (*c*) | | R | 392 | |
| Reduction for duplication | - | R | 56 | |
| **Shortfall** | | **R** | **336** | |

[63] This concession is contained in **section 222(4)**.

**Take Note**

A return could contain a number of triggers that negatively affect the true amount of tax payable. The prejudice is quantified by the shortfall (the sum of (*a*) + (*b*) + (*c*)) for each trigger to determine whether it has caused an understatement. There can consequently be a number of understatements in one return, each with their own shortfall. Example 13 below illustrates such a situation.

**Example 13 – Multiple understatements**

In their return, a taxpayer declares taxable income of R1 000, amounting to R280 tax chargeable. It however transpires that they have not declared taxable income of R400 and have incorrectly claimed capital expenses of R100. The taxable income is actually R1 500, and the tax properly chargeable, R420.

| | | | | |
|---|---|---|---|---|
| **<u>Taxable income not declared</u>** | | | | |
| Tax properly chargeable | | R | 392 | 28% of R1 400 |
| Tax reported as chargeable | - | R | 280 | |
| **Shortfall** | | **R** | **112** | |
| **<u>Capital expenses claimed incorrectly</u>** | | | | |
| Tax properly chargeable | | R | 308 | 28% of R1 100 |
| Tax reported as chargeable | - | R | 280 | |
| **Shortfall** | | **R** | **28** | |

In short, an "understatement" is prejudice, to SARS or the *fiscus* caused by a non-compliant or dishonest reporting trigger, which may incur a penalty if the magnitude of the wrongdoing by the taxpayer can be quantified as a shortfall. This is of course so "unless the 'understatement' results from a *bona fide* inadvertent error."[64]

## 5. *Bona fide* inadvertent error

In *Natal Joint Municipal Pension Fund v Endumeni Municipality*, the Court held: [65]

> "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 coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. … 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."

[64] The definition of "understatement" in **section 221** read with **section 222(1)** of the TA Act.

[65] [2012] 2 All SA 262 (SCA) at 18.

As stated, the purpose of the understatement penalty regime is to deter unwanted behaviour and the background to its preparation and production is discussed in **2** above. Significantly, in its design, the additional tax regime was purposefully restructured to provide for prescribed objective criteria[66] that remove the perceived unfettered discretion under that regime thereby ensuring more certainty with regard to the imposition of penalties and the consistent treatment of taxpayers. For this reason, the understatement penalty regime no longer allows for a discretionary approach to understatements, it only sanctions the behaviour specifically listed in rows (i) to (vi) of the understatement penalty table.

In accordance with the instructions of the aforementioned Court, it is against this background that the desire not to punish understatements that result from *bona fide* inadvertent errors must be understood and the language of the provision, given meaning. The English Oxford Living Dictionaries defines "error" as "a mistake", and lists fallacy, misconception, and delusion as synonyms;[67] and "inadvertent" as "not resulting from or achieved through deliberate planning", with unintentional, accidental, unpremeditated, unplanned, unmeant, uncalculated, unthinking, unwitting, and involuntary among its synonyms.[68] Although it has been argued that "inadvertent error" is tautology, in consideration that all understatements "result from" triggers that have been determined to be mistakes, this is not the case. Such an error is differentiated from others that result in understatements by the term "inadvertent". In other words, the understatement must result from an unintentional default, an accidental omission, an unplanned statement, an involuntary failure to pay the correct tax, and an unpremeditated impermissible avoidance arrangement.

The phrase is then qualified by "*bona fide*", which in accordance with the aforementioned dictionary is defined as "genuine" and "real" with synonyms listed to include authentic, true, actual, legitimate, valid, and proper.[69] Although the Court in *ITC 1890* added "with good faith" and "without intention to deceive" to the definition, it lost sight of the fact that an error cannot have good or bad faith, and cannot have the intention to deceive.[70] In fact, all these definitions and synonyms must be grammatically contextualised – the **trigger** must be *bona fide* inadvertent, not the person who made it.

This application is further supported by the purpose, background, and framework of the regime, the salient features of which were admirably described in *TCIT13725 DBN*:[71]

> "The quantum of an understatement penalty is determined by the nature of the wrongdoing for which the taxpayer is responsible; expressed as a percentage, that factor is then applied to the amount of tax concerned. For a given amount of tax in effect withheld, the penalty will be higher or lower, depending not on the prejudice suffered by SARS or the *fiscus*, but on the level of blameworthiness attributed to the conduct."

66 Which are contained in the table in **section 223(1)**.

67 These are the definitions and synonyms of the noun, which is available at **https://en.oxforddictionaries.com/definition/error**.

68 These are the definitions and synonyms of the adjective, which is available at **https://en.oxforddictionaries.com/definition/inadvertent**, and mirrored in *ITC 1890* 79 SATC 62 at 44.

69 These are the definition and synonyms for the adjective, which is available at **https://en.oxforddictionaries.com/definition/bona_fide**.

70 79 SATC 62 at 44, the Court added these meanings, which would only be applicable if *bona fide* was an adverb in the phrase "*bona fide* inadvertent error". For this reason and others, SARS disagrees with and will not follow the application of the law in this judgement, which it is entitled to do as tax court judgements, although often instructive, have no binding effect.

71 At 41.

For purposes of the imposition of a penalty, in addition to prejudice, SARS must examine the "blameworthiness attributed" to the taxpayer to establish whether a penalty is appropriate, and significantly, by operation of the regime, it will not be able to impose one if the trigger is motivated by behaviour other than those listed.[72] It would therefore be contrary to its purpose and frankly unnecessary, for the regime to exempt an understatement from a penalty based on taxpayer "conduct". In the same vein, it would defeat the purpose of the regime if a taxpayer could escape a penalty notwithstanding having engaged in listed behaviour. Consequently, the language of the phrase,[73] "read in context and having regard to the purpose of the provision and the background to the preparation and production"[74] of the regime, indicates that the regime recognises that on occasion circumstances apart from the conduct of the taxpayer can lead to an understatement. SARS must consider the factual circumstances under which the error was made, and should the *bona fides* of the taxpayer be relevant to its existence, it cannot be said to be a *bona fide* inadvertent error – the faith, good or bad, and intention of the taxpayer presupposing some application of mind, which must then be judged against the listed behaviours. Any other conclusion would, be contrary to "the ordinary rules of grammar and syntax", would undermine the purpose of the regime, and could lead to "insensible or unbusinesslike results".[75]

Such a result was achieved in *ITC 1890* where, what the Court termed a misstatement in a return was held to be a *bona fide* inadvertent error, notwithstanding that the tax opinion upon which the misstatement was purportedly based, was obtained long after the error was made and could not possibly have been its source. The Court held that a *bona fide* inadvertent error is "an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive."[76] A taxpayer who acts in good faith, without the intention to deceive, will escape a penalty, not because the trigger is necessarily a *bona fide* inadvertent error, but because the regime is designed not to punish such behaviour. Additionally, an error that reflects an opinion that is intentionally obtained cannot be said to be *bona fide* inadvertent, or, using some of the synonyms above, a real involuntary mistake. The opposite is actually true, especially when, as in this case, the opinion is merely congruous with the error that had already been made. Be that as it may, even when the true source of an error is the inadvertent interpretation of the opinion, the default, omission, incorrect statement, failure to pay the correct tax, or impermissible avoidance arrangement itself would have been made voluntary. A taxpayer who makes this kind of error may be found to have exercised reasonable care or assumed a reasonable tax position, but could not be said to have made a *bona fide* inadvertent error. An inadvertent error is one that does not result from deliberate planning, and a *bona fide* inadvertent error is one that genuinely does not result from deliberate planning. Importantly, the lack of deliberate planning must relate to the error, that is, the default, omission, incorrect statement, failure to pay the correct tax, or impermissible avoidance arrangement must be genuinely involuntary.

72 For anything other than these behaviours, there is no penalty percentage to apply.

73 The definition and meaning of '*bona fide*' as an adjective, and how it modifies the compound noun 'inadvertent error', clearly indicates that the error is under scrutiny.

74 *Supra* footnote **Error! Bookmark not defined.**.

75 *Ibid*.

76 This explanation appears at 45, and, in addition to what follows, does not incorporate 'inadvertent' in its application.

In light of the above, it then becomes difficult to conceive of an example where the conclusion of an impermissible avoidance arrangement would be an unintentional action, never mind an actual uncalculated one. Even if the tax consequences of the arrangement are accidental, it is nonetheless inconceivable that the arrangement itself is concluded unwittingly. In a similar vein, for example, the payment of an amount of tax when a return is not required, or deductions of capital expenses in returns, presupposes the application of forethought. Even when this forethought is based on *bona fide* incorrect reasoning, or an opinion incorrectly interpreted without the intention to deceive, the payment, non-payment, or incorrect statement itself cannot be said to be validly unmeant. Only if the amount captured or its location on the return does not coincide with the actual intent of the taxpayer, could such an error possibly be regarded as an authentically unthinking mistake.

From the foregoing, it seems likely that the only errors that may fall within the *bona fide* inadvertent class are typographical mistakes – but only properly involuntary ones. This does not mean that a lack of reasonable care will be excused. An error cannot be said to be legitimately unplanned, when for instance, a clerk makes a capturing error that results in an understatement, and as it should be, the return is reviewed by their supervising public officer or tax practitioner, and this person, misses the error because they are anxious to attend the golf day organised by a supplier. In such an instance, the choice not to take the reasonable care appropriate to their station cannot be said to be truly unpremeditated.

## 6. An understatement penalty

The primary aim of the understatement penalty regime is to deter the unwanted reporting behaviours specifically listed in rows (i) to (vi) of the understatement penalty table.[77] Albeit in negative form, these behaviours emphasise the standard expected from taxpayers when fulfilling their tax obligations, and illustrate that the regime is designed to sanction an understatement only when the trigger that causes it springs from culpable or blameworthy behaviour. It consequently not only exempts understatements from a penalty if they result from a genuinely involuntary mistake, but also precludes by operation, the imposition of a penalty when the understatement arises from behaviour that meets the expected standard.

Each understatement in a tax period is investigated to determine which, if any, of the listed behaviours applies to the trigger, or whether, on the facts of it, it was merely *bona fide* inadvertent. The amount of the penalty is calculated as a percentage of the shortfall occasioned by each understatement and this percentage is dictated by two sets of criteria: the listed behaviours and the prescribed circumstances of the case contained in columns 3 to 6 of the understatement penalty table.[78] If the act or omission of the taxpayer is not encapsulated in any of the listed behaviours, there is no basis for the determination of a penalty and consequently there can be no penalty.

[77] The table contained in **section223(1)**.
[78] **Section222(2)** read with **section223(1)**.

**Example 14 – Reasonable care taken**

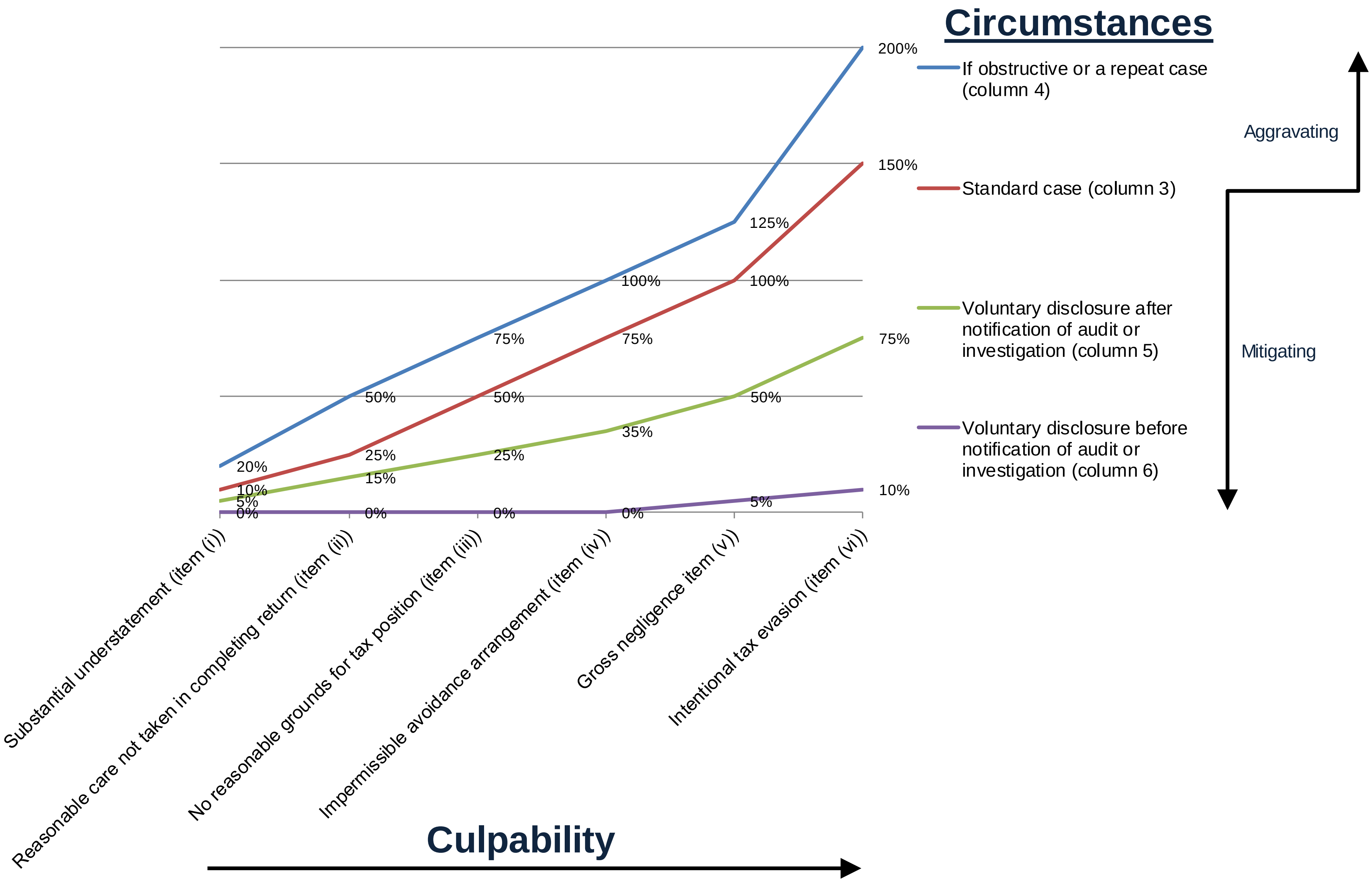
Based on a statement obtained from a charity, the taxpayer filed a return that included a deduction of R2 500 for a donation. It later transpires that the charity's system developed an error and the deduction should only have been for R1 000. Although clearly a mistake, the incorrect statement is precluded from the ambit of a *bona fide* inadvertent error as the amount was deliberately captured in the return, and a penalty must be imposed. However, none of the listed behaviours in the table encapsulates the cause of the understatement. In fact, the opposite is true – the taxpayer took reasonable care when completing his return (the positive from of item (ii)). He relied on information and documentation that, although incorrect, came from reputable sources. In the absence of other relevant factors, a reasonable person in the same circumstances would likely have acted in a similar fashion. A penalty cannot be imposed, although interest will be payable on the underpaid tax.

## 7. Criteria for the determination of the penalty percentage

The criteria that determine the penalty percentage appropriate to each understatement were derived by considering those used under the additional tax penalty system, how these were shaped by case law, and the criteria used internationally in comparable circumstances. The understatement penalty regime sanctions the listed behaviours progressively: the higher the degree of culpability, the more severe the penalty.[79] They are listed in ascending order of culpability, or, in the words of the Court in *TCIT13725 DBN*, "level of blameworthiness",[80] from item (i) (substantial understatement), where culpability is lowest, to item (vi) (intentional tax evasion), where culpability is highest. If any one of these behaviours is responsible for the trigger that results in an understatement, the appropriate percentage in the row of that behaviour is determined by the prescribed circumstances of the case. Although other circumstances, such as that of the taxpayer, do play a role in identifying the behaviour that led to the understatement,[81] the prescribed ones – aimed at encouraging voluntary compliance – mitigate or aggravate the severity of the penalty in all cases. "Substantial understatement" is unique in that, although it is listed with and treated like the behaviours (that is, the penalty percentage is mitigated or aggravated by the presence of the prescribed circumstances), it is not strictly speaking behaviour. It is also a circumstance of the case, the existence of which is sanctioned. It is included as behaviour in recognition of the severity of the prejudice that SARS and the *fiscus* suffer because of triggers that culminate in the substantial understatement of tax.

A visual representation of the understatement penalty table and the interaction between these criteria follows.

79 See discussion in **8.1**.
80 *Supra* footnote 71.
81 See discussion in **8** generally.


Circumstances
If obstructive or a repeat case (column 4)
Standard case (column 3)
Voluntary disclosure after notification of audit or investigation (column 5)
Voluntary disclosure before notification of audit or investigation (column 6)
Aggravating
Mitigating
200%
150%
125%
100%
100%
100%
75%
75%
75%
50%
50%
50%
35%
25%
25%
20%
15%
10%
10%
5%
5%
0%
0%
0%
0%
Substantial understatement (item (i))
Reasonable care not taken in completing return (item (ii))
No reasonable grounds for tax position (item (iii))
Impermissible avoidance arrangement (item (iv))
Gross negligence item (v))
Intentional tax evasion (item (vi))
Culpability

# 8. The listed behaviours

Taxpayers generally make a first assessment of their tax liabilities, in many cases the last word on the subject. They are held responsible for their own tax affairs; must keep complete and accurate information and records to substantiate these; and, when required, timeously provide such information and records to SARS. These obligations remain with taxpayers regardless of whether they engage a third party to structure their tax affairs or prepare their tax returns. The listed behaviours, in negative form, emphasise the standard of behaviour expected from taxpayers when fulfilling these obligations.

## 8.1 The standard

In *Kruger v Coetzee*, it was held that:[82]

> "For the purposes of liability *culpa* arises if –
>
> (a) a *diligens paterfamilias* in the position of the defendant –
>
> (i) would foresee the reasonable possibility of his conduct injuring another in his person or property and causing him patrimonial loss; and
>
> (ii) would take reasonable steps to guard against such occurrence; and
>
> (b) the defendant failed to take such steps.
>
> This has been constantly stated by this Court for some 50 years. Requirement (a)(ii) is sometimes overlooked. Whether a diligens paterfamilias in the position of the person concerned would take any guarding steps at all and, if so, what steps would be reasonable, must always depend upon the particular circumstances of each case. No hard and fast basis can be laid down. Hence the futility, in general, of seeking guidance from the facts and results of other cases."

The standard of behaviour that is expected from taxpayers when fulfilling their tax obligations is that of a "*diligens paterfamilias*": a hypothetical juristic or natural person of ordinary intelligence, knowledge, care, and good judgement in circumstances comparable to that of the taxpayer (hereinafter referred to as the "reasonable person"). What would this reasonable person have done in the circumstances that caused the understatement? Would they have foreseen "the reasonable possibility" that the trigger would result in an understatement, and if so would they have taken "reasonable steps to guard against such occurrence"? Although the test to determine reasonableness is objective (that is, what was the correct course of action), it takes the circumstances of both the taxpayer and the case into account (that is, what was the correct course of action from the viewpoint of a reasonable person in comparable circumstances to the taxpayer).[83] Examples of such circumstances follow, which as with all examples in this guide, are not exhaustive, and because, the facts of each case will dictate what is relevant, must not be understood to lay down a "hard and fast basis" for determining what is relevant in all cases.[84]

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[82] [1966] 2 All SA 490 (A) at page 491.

[83] See *Philotex (Pty) Ltd and others and Braitex and others v Snyman and others* [1998] JOL 1881 (A) at page 8 where the Court, albeit in reference to recklessness held that the test "is objective in so far as the defendant's actions are measured against the standard of conduct of the notional reasonable person and it is subjective in so far as one has to postulate that notional being as belonging to the same group or class as the defendant, moving in the same spheres and having the same knowledge or means to knowledge: *S v van As* 1976 (2) SA 921 (A) at 928CE."

[84] *Supra* footnote **Error! Bookmark not defined.**.

**Example 15 – Circumstances of the taxpayer and the case**

- Circumstances of individual taxpayers – Level of education and knowledge about tax; the effort made to understand tax liabilities; age, experience, skill, health, social, and cultural background; previous history of compliance
- Circumstances of businesses – Characteristics and complexity (size, nature, taxable activities); the manner in which affairs are conducted (including the appropriateness of records, procedures, practices, and systems); the diligence employed to guard against the errors occurring (including the effort to understand tax liabilities)
- Circumstances of the case – Size, quantum, nature, frequency of the error (from one transaction or a number of similar ones); significance of error (made in a single or various similar transactions viewed together); period of time between errors; complexity of the law and the transaction; effort employed to understand obligations; period of time between failure to report on the error and its discovery; previous interaction between taxpayer and SARS on similar issues

## 8.2 Reasonableness

For purposes of the understatement penalty regime, all taxpayers are expected to act as reasonably as a reasonable person in comparable circumstances to themselves would have acted, specifically in the care that they employ when completing returns [item (ii)] and the grounds they rely on for the adoption of a particular tax position [item (iii)]. A 'tax position' is an assumption underlying one or more aspect of a tax return, which includes assumptions regarding whether or not an amount, transaction, event, or item is taxable; an amount or item is deductible or may be set-off; a lower rate of tax applies; or an amount qualifies as a reduction of tax payable.[85] To determine whether the trigger results from the adoption of a tax position or merely because reasonable care was not employed, SARS must scrutinise the reasons for the default, omission, incorrect statement, failure to pay the correct tax, or impermissible avoidance arrangement. A trigger such as an incorrect statement, which is based on the assumption that goods or services are tax exempt, would involve the adoption of a tax position, whereas the same statement, carelessly made, would involve merely the reasonable care standard.[86]

What the reasonable person would have done is compared to what the taxpayer did. As explained by the Court in *Transnet Ltd t/a Portnet v the Owners of the Mv "Stella Tingas" and another*, it is not a question of whether, for the purposes of this discussion, the taxpayer knew of or anticipated the risk that their behaviour would cause an understatement.

> "Despite *dicta* which sometimes seem to suggest the contrary, what is now clear, following the decision of this Court in *S v Van Zyl* 1969 (1) SA 553 (A), is that it is not consciousness of risk-taking that distinguishes gross negligence from ordinary negligence.[87] (See also *Philotex (Pty) Ltd and others v Snyman and others* 1998 (2) SA 138 (SCA) at 143CJ.) This must be so. If consciously taking a risk is reasonable there will be no negligence at all. If a person foresees the risk of harm but acts, or fails to act, in the unreasonable belief that he or she will

[85] See definition in **section 221**.

[86] When read in conjunction with **5**, it is clear that the assumption that forms its basis is the reason that the adoption of a particular tax position can never amount to a *bona fide* inadvertent error. Even when the assumption is made in good faith, the trigger that reflects the position will be premeditated.

[87] Negligence would include the failure to take reasonable care in completing returns or the lack of reasonable grounds for the assumption of a particular tax position.

be able to avoid the danger or that for some other reason it will not eventuate, the conduct in question may amount to ordinary negligence or it may amount to gross negligence (or recklessness in the wide sense) depending on the circumstances. (Van Zyl's case (*supra*) at 557AE.) If, of course, the risk of harm is foreseen and the person in question acts recklessly or indifferently as to whether it ensues or not, the conduct will amount to recklessness in the narrow sense, in other words, *dolus eventualis*; but it would then exceed the bounds of our modern-day understanding of gross negligence.[88] On the other hand, even in the absence of conscious risk-taking, conduct may depart so radically from the standard of the reasonable person as to amount to gross negligence (Van Zyl's case (supra) at 559DH.) **It follows that whether there is conscious risk-taking or not, it is necessary in each case to determine whether the deviation from what is reasonable is so marked as to justify it being condemned as gross.**"[89]

(Emphasis added)

The above illustrates that, for the purpose of reasonableness, the severity of the deviation from the standard determines the listed behaviour that will apply – the further removed from that of the reasonable person, the less reasonable and consequently more culpable the behaviour. The behaviour will be culpable (that is, reasonable care would not have been taken or the tax position would not have been adopted on reasonable grounds) if a reasonable person in the position of the taxpayer would have foreseen the possibility that the trigger would result in an understatement and taken steps to prevent it from happening.[90] As the level of care associated with what the taxpayer did decreases, culpability increases (that is, to gross negligence), and increases even further when, to reduce tax liability, the behaviour is intentionally contrary to how the reasonable person would have behaved (in which case the behaviour will amount to intentional tax evasion).[91]

The steps that a reasonable person may take to prevent a trigger from resulting in an understatement include enlisting the assistance of SARS,[92] or employing an accountant, tax practitioner, or other tax professional to complete returns, or from whom to obtain advice before completing a return with entries that are not understood or adopting a position with tax implications. However, the fact that such services or advice is obtained is not definitive proof of reasonableness. Appropriate services and advice can only be provided if all the relevant information and material facts pertinent to the tax liabilities are supplied to the professionals. Additionally, even though reliance on professional advice is usually indicative that the taxpayer has acted reasonably, its use must be sensible and reliance on dubious advice will not be. Whether such reliance is reasonable, must be judged in reference to the circumstances of the taxpayer and the complexity of the issue on which advice is obtained. The competence of the taxpayer "to discern error in the substantive advice of an accountant or attorney", or even from SARS, will determine whether reliance on such advice is reasonable.[93] It is however not reasonable to abdicate tax compliance in favour of professionals, the accountability, in the final analysis, lying with the taxpayer.

[88] It would then amount to tax evasion.

[89] Emphasis added to [2003] 1 All SA 286 (SCA) at 7, and approved of in *TCIT 14247 JHB* at 66 and 67 albeit not quoted fully.

[90] *Supra* footnote **Error! Bookmark not defined.**.

[91] See illustration in **7**.

[92] SARS can be approached at its various Contact Centres, branches, and Mobile Tax Units. The SARS website can also be consulted **here** to obtain official publications, interpretation notes, guides, and other available information.

[93] See footnote 30 in *ITC 1880* 78 SATC 103.

As the Court in *ITC No 1898* said:[94]

> "A taxpayer cannot disavow himself/herself of tax responsibilities by relying on an accountant or tax practitioner as the tax practitioner is only obliged to declare information on tax returns as provided by the taxpayer."

### 8.2.1 Reasonable care not taken in completing return

When completing a return, the standard of reasonableness appropriate to the reasonable person is judged with particular reference to the circumstances of the taxpayer.

**Example 16 – Reasonable care and the circumstance of the taxpayer**

An aged pensioner without any commercial training or experience invests money in a savings account. Transaction codes identify the interest payments on her bank statements and she carefully extracts the amounts reflected against these codes for inclusion in her income tax return. She however omits one amount, which was marked with a different code because within her understanding it was not applicable. Although the omission cannot be classified as a *bona fide* inadvertent error because the amount was purposefully omitted, the failure to report the interest was not because the taxpayer did not take reasonable care. She carefully gathered and examined the relevant records and information, and completed the tax return with due diligence. On the face of it, a reasonable person of a similar age, with a concomitant lack of experience in financial matters, would not have foreseen that reliance on the codes would have resulted in an underpayment of tax.

The situation will of course be different if the taxpayer was a retired Chartered Accountant with all her faculties intact and an employment history in banking. Such a taxpayer cannot be said to lack experience in financial matters, would, all things being equal, definitely have known that her action would result in an underpayment of tax, and cannot be said to have completed her tax return with reasonable care. In the absence of other relevant circumstances, a penalty will be appropriate.

Although the appropriate standard is determined in context of the circumstances of the taxpayer, the circumstances of the case do play a role. For instance, when completing an employee income tax return, whether on eFiling or at a branch office, taxpayers can check their source documentation against the information, prepopulated on SARS' systems, to ensure accuracy, and can utilise the tax calculator provided to verify that the recorded declarations match the disclosures made. Considering the resources at their disposal, in the absence of other relevant factors, such as the personal circumstances of the taxpayer, SARS may find that a taxpayer did not exercise reasonable care if they make a mistake when completing a return. Moreover, because tax is an integral part of trade, a reasonable person whose affairs become more complex as their business expands, will exert more effort to understand their reporting obligations and take the necessary steps to ensure that they accurately report to SARS. On the face of it, SARS may find that a taxpayer has not employed reasonable care or may even be considered more culpable, if they complete returns inaccurately because of unsuitable systems, or deficiencies in governance structures.

[94] 79 SATC 266 at 73.

### 8.2.2 No reasonable grounds for 'tax position' taken

On the other hand, although relevant, the circumstances of the taxpayer must be weighed against additional considerations when determining the standard of reasonableness that must underscore the grounds for the adoption of a particular "tax position".[95] Whether the law applies in a particular way is judged mainly on an analysis of the relevant provisions of the tax legislation, seen in context of other relevant provisions that may affect the position,[96] and the application of these to the circumstances of the case. Relevant circumstances are, for example, the steps taken to understand the risks associated with the tax position, the reasoning for its adoption, the complexity, and financial implications of the underlying transaction and the law, as well as the resources at the disposal of the taxpayer. However, the investigation focuses on the merits of an argument in support of a particular tax position, rather than the effort in reaching it. It is not a question of whether a person thinks or believes that their position is reasonable or for that matter, whether SARS disagrees with the application of the law – the fact that a person adopted an interpretation that differs from that of a ruling will not necessarily mean that an unreasonable tax position has been adopted. The question is simply whether a reasonable person in the circumstances of the taxpayer would have concluded that within their understanding it was likely correct or have assumed a different position. The answer lies in having regard to appropriate authorities available at the time that the position was taken (such as court decisions, academic writing, and rulings issued by SARS). Although subsequent development in case law or rulings may clarify the position, should such clarification not support the one adopted, it will not necessarily mean that the position was unacceptable. Reliance may for instance, have been placed on a court case that was later overturned. The position is judged on the information available at the time of its taking and there can be no sanction for relying on law that supported the position at the time. Additionally, even if there are no authorities to support a position, there may still be an acceptable interpretation. In such cases, as in the case where the interpretation differs from a ruling by SARS, the interpretation must be a sensible and well-reasoned one.

It is evident that having reasonable grounds for the adoption of a particular tax position is a higher standard than for taking reasonable care. There may not be reasonable grounds for the way in which the law has been applied notwithstanding reasonable care having been taken. For instance, if a person seeks advice from a tax professional and follows it, subject to what is said in the opening remarks to this paragraph, SARS would normally accept that reasonable care has been exercised. However, this does not mean that the grounds upon which the tax position is based will automatically be regarded as reasonable. This depends not on the fact of seeking advice but on its content, the sensibleness of the approach, and the integrity of the tax position, judged in reference to the circumstances of the taxpayer.

95 For an explanation of what a 'tax position' is, see the opening remarks of **8.2**.

96 Such as legislated anti-avoidance rules.

### 8.2.3 Gross negligence

Whether completing a return or taking a tax position, the further taxpayers move away from the appropriate standard of reasonableness, the more culpable or blameworthy their behaviour and the more severe the penalty. Gross negligence [item (v)] is any one of the aforementioned behaviours to "so extreme a degree as to merit the epithet of 'gross'".[97] It displays an "extreme departure from the standard of a reasonable person which departure must demonstrate complete obtuseness of mind or total failure to take care".[98] Although in *Transnet Ltd t/a Portnet v the Owners of the Mv "Stella Tingas" and another* it was said that gross negligence is not an exact concept capable of precise definition, in addition to pronouncements replicated in **8.2**,[99] the Court concluded:[100]

> "It follows, I think, that to qualify as gross negligence the conduct in question, **<u>although falling short of *dolus eventualis*</u>**, must involve a departure from the standard of the reasonable person to such an extent that it may properly be categorised as extreme; it must demonstrate, where there is found to be conscious risk-taking, a complete obtuseness of mind or, where there is no conscious risk-taking, a total failure to take care. If something less were required, the distinction between ordinary and gross negligence would lose its validity."

(Emphasis added)

Gross negligence therefore not only includes an utter failure to take care when completing a return or taking a tax position, it could also encompass an extreme failure to give appropriate thought to or be totally indifferent to the consequences of doing so. Much like the concept of gross carelessness in the New Zealand Tax Administration Act 1994, it means, "doing or not doing something in a way that, in all the circumstances, suggests or implies a complete or high level of disregard for the consequences."[101] It has been described as similar to recklessness.[102] In accordance with the discussion in **8.2**, the test is not whether the person had actual knowledge of wrongdoing but whether a reasonable person would have foreseen the dangers of an understatement, considered it unjustifiable, and taken legitimate steps to mitigate the risk.

Gross negligence is clearly a more serious deviation from the standard set by a reasonable person than those discussed above. Where such behaviour is less likely, depending on the circumstances of the case, it may be found that reasonable care was not taken or a reasonable tax position was not adopted.

97 *Rex v Myers* [1948] 1 All SA 354 (A) at page 360.

98 Claassen RD, *Dictionary of Legal Words and Phrases*, LexisNexis South Africa

99 Followed by a well worth the read explanation on the Roman notion of gross negligence, which, unlike the modern-day concept included consciousness of risk-taking or *dolus eventualis*, and further citations from case law on what constitutes gross negligence.

100 *Supra* footnote 89.

101 Section 141C of this Act deals with gross carelessness penalties, conceptually comparable to understatement penalties for gross negligence. For a general discussion on gross carelessness see *Case W4* (2003) 21 NZTC 11,034 particularly paragraphs 44 to 49.

102 In various cases, including *Rosenthal v Marks* 1944 TPD 172 at page 180; *S v Smith en Andere* [1973] 1 All SA 176 (T) – where reckless driving was deemed grossly negligent; *S v Dhlamini* [1988] 2 All SA 106 (A) at page 111; the New Zealand *Case W4* (2003) 21 NZTC 11,034; *Philotex (Pty) Ltd and others and Braitex and others v Snyman and others* [1998] JOL 1881 (A) at page 7 to 9; as well as the other case law referenced there.

## 8.3 Tax avoidance and evasion

In addition to conducting their tax affairs reasonably, all taxpayers are expected to do so within the confines of the law. This does not mean that they are barred from arranging their financial affairs in ways that minimise their tax burden.[103] However, if they employ illicit means to reduce or eradicate their tax liability, a penalty may be appropriate.

### 8.3.1 Impermissible avoidance arrangement

Avoidance arrangements [item (iv)] fall somewhere between legitimate tax planning and tax evasion. Their sole or main purpose is to obtain a tax benefit and they are consequently prohibited by the anti-avoidance rules. SARS can rectify the effects of such arrangements by applying these rules and if appropriate, issue an assessment. If it does, an understatement penalty for impermissible avoidance arrangement must be imposed.[104] That is unless the behaviour is found to amount to gross negligence or intentional tax evasion, in which case the highest penalty percentage appropriate to the understatement will apply.[105]

### 8.3.2 Intentional tax evasion

Intentional tax evasion [item (vi)] is the most serious form of non-compliance. As it requires an element of intent, the test is precisely whether the taxpayer knew or anticipated the risk that their behaviour would cause an understatement.[106] If they did, a penalty will be imposed. Intent will be present not only when an understatement is deliberately orchestrated, but also if the taxpayer foresees or even suspects that, in the circumstances, their behaviour could result in an understatement and they ignored the risk and proceeded or did nothing anyway. Knowledge of wrongdoing or even the lack of an honest belief in the correctness of an act or an omission is what differentiates intentional tax evasion from the other behaviours. A belief is not honest when it is –[107]

> "… itself the outcome of fraudulent diligence in ignorance – that is, of a wilful abstention from all sources of information which might lead to suspicion, and a sedulous avoidance of all possible avenues to the truth, for the express purpose of not having any doubt thrown on what he desires and is determined to, and afterwards does (in a sense) believe."

When a taxpayer displays "conduct which shows that the representor does not know what the truth is in regard to the statements which he makes and is indifferent whether his representations are true or not, or, not knowing, wilfully omits to make any enquiries", such

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[103] See *Commissioner for Inland Revenue v Estate Kohler and Others* [1953] 3 All SA 7 (A) at page 8 to 9, *Secretary for Inland Revenue v Hartzenberg* [1966] 1 All SA 626 (A) pat page 628, *Hicklin v Secretary for Inland Revenue* [1980] 1 All SA 301 (A) at page 311, *Commissioner for Inland Revenue v Conhage* (Pty) Ltd (formerly Tycon (Pty) Ltd [1999] JOL 5363 (A) at 1 and *CSARS v NWK Ltd* [2011] 2 All SA 347 (SCA) at 42.

[104] The definition of "impermissible avoidance arrangement" in **section 221** of the TA Act came into operation on 19 January 2017. In accordance with the transitional principles discussed in **3**, a penalty based on this trigger can be imposed on all understatements discovered from this date, regardless of the date on which the understatement occurred.

[105] This is so because, in accordance with **section 222(2)** of the TA Act, "the highest applicable understatement penalty percentage" must be applied.

[106] See discussion in **8.2**.

[107] Halsbury quoted in *Rex v Myers* [1948] 1 All SA 354 (A) at page 360 and M*ilne, NO v Singh, NO, and Others* [1960] 3 All SA 295 (D) at page 312.

conduct could amount to intentional tax evasion. Such a person may be "wilfully false"[108] or be engaging in "wilful blindness".[109]

It may be difficult to discern intentional tax evasion from grossly negligent behaviour. There are few if any cases where a person will admit to intentional tax evasion; it is more commonly inferred. Inferences could be drawn from the nature of the acts or omissions that cause the understatement as well as from the circumstances of the taxpayer – the most important of which is their knowledge, or the intentional neglect of the available means of knowledge at their disposal. The taxpayer must have known or suspected that their act or omission was a breach of a tax obligation and have made a conscious decision to ignore such knowledge. In the absence of such evidence, a lesser behaviour may be applicable. Some examples of behaviour that may indicate intentional tax evasion follow. As with other examples, these are merely illustrative and the facts of each case will dictate what is germane.

**Example 17 – Intentional tax evasion**

- Falsified returns, books, accounts, records, or documents
- Counterfeit or simulated transactions
- Non-disclosure of income or inflation of deductible expenditure by making a false statement in a return or not filing a return at all

Whether SARS acts on or accepts an untruthful return is irrelevant and when SARS determines the correct tax liability, the original intent to evade tax is not excused.

**Take Note**

Administrative double jeopardy is avoided, in that a fixed amount penalty may not be imposed for non-compliance in respect of which an understatement penalty has been imposed.[110] However, the existence of the penalty regime does not preclude the possibility of criminal prosecution for tax evasion.[111]

In criminal prosecutions, tax evasion must be proven beyond a reasonable doubt but the imposition of an understatement penalty it need only be proven on a balance of probabilities. In both instances, should SARS meet the required onus of proof; the taxpayer will have to present proof that refutes the *prima facie* case that SARS has established.

[108] *Rex v Myers* [1948] 1 All SA 354 (A) at page 362 to 363.

[109] *Attorney General of Canada v Villeneuve and others*, 2004 FCA 20 at 6 and 8, where, although the Court ruled the behaviour to be gross negligence, it found that the taxpayer possessed wrongful intent and imposed a penalty for misrepresentation under section 163(2) of the Canadian Income Tax Act.

[110] **Section 210(2)(*b*)**.

[111] Criminal sanctions may be appropriate under the common law or Chapter 17 of the TA Act.

## 8.4 Substantial understatement

> " '**substantial understatement**' means a ***case*** where the **prejudice to SARS or the *fiscus*** exceeds the greater of five percent of the amount of the 'tax' properly chargeable or refundable under a tax Act for the ***relevant tax period***, or R1 000 000."[112]

(Emphasis added)

Substantial understatement is not an understatement. If it was intended to be such, the definition would state that "'substantial understatement' means an 'understatement'", as opposed to what it does say, "'substantial understatement' means a **case**". The English Oxford Living Dictionaries defines "case" as "an instance of a particular situation", and lists occurrence, and manifestation, as some of its synonyms.[113] Therefore, in instances where, for a tax period, the harm or injury to SARS or the *fiscus* exceeds the threshold amount, or manifests in excess of that amount, substantial understatement is present. Significantly, although not strictly speaking such, substantial understatement is listed with and treated as a behavioural criterion. In context, the language of the provision consequently indicates that it is a factual circumstance, the presence of which, along with the other listed behaviours, contributes to determining the appropriate penalty percentage to apply to individual understatements.[114]

Additionally, the use of the word "**any**" in the definition of "understatement" indicates that, for the purposes of identifying the existence of an understatement, the prejudice to SARS or the *fiscus*, in the words of the Court in *TCIT13725 DBN*, is *prima facie* unlimited. It held "that its insertion indicates that the broadest range of prejudice must be taken into account when considering whether any of the stated defaults have resulted in prejudice to SARS or the fiscus."[115] However, here the range of the prejudice is limited to monetary terms. Therefore, although the scepticism of the abovementioned Court regarding the ability to quantify prejudice financially is shared,[116] to determine the occurrence of substantial understatement, SARS has taken the approach of confining such to the 'tax' that SARS will impose in addition to what the taxpayer has reported, that is, the amount reflected in the additional assessment. It follows that the individual understatements to which this penalty percentage is applied do not need to equate to an above threshold amount, the shortfall that quantifies each not being the financial or other prejudice suffered by SARS or the *fiscus* but reflecting the "level or blameworthiness attributed to the conduct."[117]

In summary, in instances where the additional assessment (P) exceeds the greater of 5% of the tax properly chargeable or refundable (5%), or R1 000 000 (R1m) for a tax period substantial understatement exists. Since (P) must exceed the greater of the other two, (P) of less than R1 000 000 cannot result in a substantial understatement. A substantial understatement = R1m < P always and if (5% > R1m) < P

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112 Definition of "substantial understatement" in **section 221** of the TA Act.

113 These are the definitions and synonyms of the noun at **https://en.oxforddictionaries.com/definition/case**.

114 See *Natal Joint Municipal Pension Fund v Endumeni Municipality* at 18, replicated in **5**.

115 At 45, the full quote is available in **4.2**.

116 At 41, where the Court, continuing from the quote contained in **5** says:

> There is no room for an argument that monetary compensation, sufficient to compensate for the financial prejudice caused by the default (assuming such a calculation could be made), and provided through interest augmented by an administrative penalty, would render conduct originally constituting an "understatement" something other than what is hit by Chapter 16.

117 See quote *supra* **5**.

| Example 18 | Not substantial understatement | Not substantial understatement | Substantial understatement |
|---|---|---|---|
| Tax properly chargeable<br>5%<br>Tax reported as chargeable<br>Prejudice (P) | R 30 000 000<br>R 1 500 000<br>R 29 100 000<br>R 900 000<br>R1m > P and (5% > R1m) > P | R 30 000 000<br>R 1 500 000<br>R 28 900 000<br>R 1 100 000<br>R1m < P and (5% > R1m) > P | R 30 000 000<br>R 1 500 000<br>R 28 400 000<br>R 1 600 000<br>R1m < P and (5% > R1m) < P |

A taxpayer will incur a penalty for substantial understatement, mitigated or aggravated by the prescribed circumstances, for understatements where only this circumstance prevails. If one or more understatements are found to result from any of the other listed behaviours, each will incur a penalty appropriate to the level of culpability of the taxpayer in relation to that understatement. This is because the understatement penalty regime requires that the highest penalty percentage be applied to the shortfall associated with each understatement and the percentages in relation to substantial understatements are the lowest.[118] The following examples serve to illustrate.

| Example 19 – One understatement | | VAT reported refundable | VAT properly refundable | Shortfall | Listed behaviour |
|---|---|---|---|---|---|
| VAT refund | R 2 000 000 | R 2 000 000 | | | |
| Output VAT | R 1 200 000 | | R 800 000 | R 1 200 000 | > R1m |
| Assuming a standard case (column 3 of the understatement penalty table), the understatement will attract a penalty of 10% of R1 200 000 for substantial understatement provided that the understatement did not result from a *bona fide* inadvertent error. However, if it is found that the output VAT was excluded due to gross negligence, the penalty will be 100% of the shortfall. | | | | | |

| Example 20 – More than one understatement | | Tax reported chargeable | Tax properly chargeable | Shortfall | Listed behaviour |
|---|---|---|---|---|---|
| Taxable income | R 100 000 000 | R 28 000 000 | | | |
| Income | R 50 000 000 | | R 42 000 000 | R 14 000 000 | No reasonable ground for tax position |
| Capital expenses | R 3 200 000 | | R 42 896 000 | R 896 000 | |
| Total | | R 28 000 000 | R 42 896 000 | R 14 896 000 | > 5% |

118 **Section 222(2)** requires that the "highest applicable understatement penalty" be applied to the understatement.

Assuming a repeat case (column 4 of the understatement penalty table), the understatement resulting from not declaring income because of an unreasonable tax position will attract a penalty of 75% of R14 000 000. Additionally, even though there may have been a reasonable explanation for claiming the capital expenses incorrectly, this understatement will incur a substantial understatement penalty of 20% of R896 000.

'Substantial understatement' highlights the fact that the standard of care expected from the reasonable person is raised exponentially in circumstances where large amounts of money are involved. This is evident from the fact that, provided the understatement has not resulted from a *bona fide* inadvertent error, a taxpayer can incur a penalty for substantial understatement even if SARS is of the opinion that they have met the required standard of reasonableness expected from all taxpayers. On the other hand, the only one of the penalties that can be remitted is the one for substantial understatement. The circumstances of remittance both illustrate the level of care expected and acknowledge when it has been attained. SARS must remit a penalty imposed for substantial understatement if it is satisfied that the prejudice to SARS or the *fiscus* was due to an arrangement under section 34 of the TA Act[119] that was fully disclosed to SARS by the date that the relevant return was due, and the arrangement was based on an opinion by a registered tax practitioner.[120] The opinion must have been issued and in the possession of the taxpayer when the return was due. It must be based on full disclosure of the facts and circumstances specific to the arrangement; and confirm that the taxpayer's position is "more likely than not to be upheld if the matter proceeds to court". In other words, the position must be sufficiently substantiated to support the expectation that, should it be challenged, a Court could rule in favour of such a position being taken. In the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance rules, all of the steps in or parts of the arrangement must be fully disclosed to the tax practitioner, regardless of whether the taxpayer was a direct party to the steps or parts in question.[121] It is evident that the mere existence of such an opinion does not establish compliance with these requirements; only the content does.

**Take Note**

A substantial understatement in a return submitted before the commencement of the TA Act on 1 October 2012 will attract an understatement penalty (as opposed to an additional tax penalty) if the verification, audit, or investigation necessary to determine the penalty was not complete or had not commenced before this date. However, in addition to other concessions that may be applicable,[122] because the previously legislation did not require it, taxpayers are able to obtain the opinion described above after the return was due.[123]

119 Defined in that section as "any transaction, operation, scheme, agreement or understanding (whether enforceable or not)".
120 See Chapter 18 of the TA Act for details about registered tax practitioners.
121 **Section 223(3)**.
122 See discussion in **3**.
123 **Section 270(6B)**.

## 9. The prescribed circumstances

The circumstances of a case, prescribed in columns 3 to 6 of the understatement penalty table, influence the amount of the penalty by mitigating or aggravating the penalty percentage. A standard case (column 3) is the mean that applies if none of the other circumstances is present. In order to give taxpayers the opportunity to correct undesirable behaviour, this classification is applied to all understatements discovered during an initial verification, audit, or investigation, whether they arise from the same or other listed behaviours and even if they occur in more than one tax period. This is of course so unless the taxpayer is obstructive, in which case column 4 will apply. However, within a five-year cycle of this initial encounter, a subsequent understatement, even if ascribable to other listed behaviours, will become a repeat case.[124]

**Example 21 – Repeat case**

A taxpayer who has never been audited files his 2013 and 2014 returns at the same time. Because he did not take reasonable care, he claims depreciation on an asset that was written off in 2012 in both returns. Both returns will incur an understatement penalty for a standard case of reasonable care not taken in completing a return (25%).

If the same taxpayer in 2017 experiences cash flow problems and decides to file a return that reflects less income than he actually earned in order to reduce his tax liability, this understatement will be treated as a repeat case; possibly involving intentional tax evasion (200%).

Along with obstructiveness, a repeat case (column 4) aggravates the penalty – the penalty percentage is most severe under such circumstances. Conversely, to promote voluntary compliance in the interest of the good management of the tax system and the best use of the resources of SARS, participation in the voluntary disclosure programme (columns 5 and 6) mitigates the penalty. The programme allows taxpayers to come forward if they have been non-compliant in order to avoid criminal prosecution and to reduce or avoid penalties.[125] For understatements, the penalty percentage is substantially reduced when a taxpayer qualifies for voluntary disclosure relief (column 5) and reduced even further should they do so before SARS commences an audit or investigation (column 6). Information about the voluntary disclosure programme is available **here**.

**Take Note**

Understatements in returns submitted before the commencement of the TA Act will incur understatement penalties (as opposed to additional tax penalties) if the audit or investigation was underway before but only concluded after the commencement date of the TA Act. However, taxpayers who previously qualified for voluntary disclosure relief under repealed provisions of the taxation Acts, in addition to the other concessions that may be applicable,[126] will also qualify for the reduction of the penalty percentage in accordance with columns 5 and 6.[127]

[124] See definition of "repeat case" in **section 221** of the TA Act.
[125] **Section 229**.
[126] See discussion in **3.**
[127] **Section 270(6C)** and discussion in **3**.

## 10. Interest

As with other administrative provisions generic to all taxes, when the TA Act came into operation on 1 October 2012, it amended or repealed provisions regulating interest in the taxation Acts and replaced these with a consolidated interest regime in **Chapter 12**. However, notwithstanding being enacted, the provisions of Chapter 12 that regulate interest have not yet commenced,[128] and the concomitant changes to the taxation Acts have, to the extent that they relate to interest, not yet been put into effect. Until the interest regime under Chapter 12 is fully operational, interest on outstanding tax is levied and remitted in terms of the provisions of the taxation Acts that dealt with interest,[129] and in the case of interest on understatement penalties, those that dealt with additional tax penalties, before they were amended or deleted by the TA Act.[130] Although this guide does not discuss such provisions, they are, for convenience, summarised in **Annexure B**.

**Take Note**

Interest on understatement penalties committed before the commencement date of the TA Act, where the verification, audit, or investigation necessary to determine the amount of the penalties was incomplete or had not yet commenced by this date, will incur understatement penalties but interest on such penalties will only accrue from 1 October 2012.[131]

From the date that Chapter 12 and the changes to the interest provisions of the taxation Acts are promulgated, the accrual, payment, and remittance of interest on tax and understatement penalties will be governed by Chapter 12. Interest will then accrue on understatement penalties imposed after such date, at the prescribed rate from the date from when interest accrues on the understated tax[132] and a senior SARS official will be able to direct that interest on understatement penalties is not payable if the accrual of this interest is attributable to circumstances beyond the taxpayer's control. These circumstances are however limited to natural or human-made disasters, civil disturbances or disruptions in services, or serious illness or accident.[133]

## 11. Objection and appeal

Any "potential adjustments of a material nature" identified upon conclusion of an audit, will likely be caused by understatements, and should these result from listed behaviours and not *bona fide* inadvertent errors, SARS will be obliged to impose an understatement penalty. Under such circumstances, SARS must inform the taxpayer accordingly, and provide grounds for the proposed assessment.[134] As the response from the taxpayer and evidence gathered during the audit process will be considered before an understatement penalty is

[128] Sections 187(2), (3)(*a*) to (*e*) and (4), 188(2) and (3) and 189(2) and (5).
[129] Date to be determined by the President by proclamation – **section 272(1) and (2)** of the TA Act read with Proclamation No. 51 of 14 September 2012 published in *Government Gazette* No. 35687.
[130] **Section 270(6E)**.
[131] **Section 270(6E)** and discussion in **3**.
[132] **Section 187(1)** read with **section 187(3)(*f*)**.
[133] **Section 187(6)** and **187(7)** read with **section 187(1)**.
[134] For more information on the meaning and content of 'grounds for assessment', consult paragraph 5.1 of the Dispute Resolution Guide available **here**.

imposed, this is the first formal opportunity for the taxpayer to address both the existence of an understatement and the imposition of a possible penalty.[135]

An additional assessment that includes an understatement penalty, whether issued upon conclusion of the above process or otherwise, will in any event not be fully based on a return submitted by the taxpayer.[136] SARS must therefore, in the notice of assessment, provide "a statement of the grounds for the assessment", including the grounds for the imposition of the penalty.[137] These should enable the taxpayer to utilise the remittance process for substantial understatements,[138] or object and appeal against the assessment, including any other understatement penalties, in the normal course. The Dispute Resolution Guide[139] and the guide on "What to do if you dispute your tax assessment"[140] will provide guidance in this regard. The taxpayer can also object or appeal against a decision not to remit a substantial understatement penalty, in which case the taxpayer bears the onus of proving that this decision is incorrect.[141]

If, on objection or appeal, the assessment of the understated tax is overturned, it follows that the penalty will likewise be reversed. In the event of an impermissible avoidance arrangement penalty the correlation between the assessment and the penalty means that such a penalty stands or falls on the application of the anti-avoidance rules.[142] The only way to successfully object to or appeal against such a penalty is to challenge the conclusion that the arrangement underlying the understated tax contravenes the anti-avoidance rules.

On appeal, the Tax Court is not limited to considering merely the appropriateness of the penalty percentage that SARS has chosen, it may consider the imposition of understatement penalties anew. Based on the evidence, the Court may confirm, reduce, or overturn its imposition.[143]

**Take Note**

Understatements in a return submitted before the commencement of the TA Act will attract understatement penalties (as opposed to additional tax penalties) if the verification, audit, or investigation necessary to determine the penalty was incomplete or had not yet commenced by 30 September 2012. However, if such a return was submitted under the Income Tax Act (excluding returns required under the Fourth Schedule), a senior SARS official must reduce, and may even waive the penalty if satisfied that there were extenuating circumstances. For such returns under the Fourth Schedule or the Value-Added Tax Act, a senior SARS official must waive the penalty unless it was based on intentional tax evasion (item (vi) in the understatement penalty table).[144]

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135 In accordance with **sections 42(2)(*b*) and (3)**, both SARS and the taxpayer have 21 business days which may be extended by SARS if the audit is complex.
136 This is particularly so when a penalty is imposed.
137 **Section 96(2)**.
138 See discussion in **8.4**.
139 *Supra* footnote 134.
140 Available **here**.
141 **Section 224** and **section102(1)**.
142 See discussion in **8.3.1**.
143 **Section 129(3)**.
144 **Section 270(6D)** and discussion in **3**.

# Annexure A – Relevant sections of the Tax Administration Act

## Chapter 1 – Definitions

### Section 1 – Definitions

In this Act, unless the context indicates otherwise, a term which is assigned a meaning in another tax Act has the meaning so assigned, and the following terms have the following meaning—

"**customs and excise legislation**" means the Customs and Excise Act, 1964 (Act No. 91 of 1964), the Customs Duty Act, 2014 (Act No. 30 of 2014), or the Customs Control Act, 2014 (Act No. 31 of 2014);

"**effective date**" is the date described in section 187(3), (4) and (5) of this Act, or the date from when interest is otherwise calculated under a tax Act;

"**prescribed rate**" has the meaning assigned in section 189(3);

"**self-assessment**" means a determination of the amount of tax payable under a tax Act by a taxpayer and—

(*a*) submitting a return which incorporates the determination of the tax; or

(*b*) if no return is required, making a payment of the tax;

"**tax**", for purposes of administration under this Act, includes a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act;

"**tax Act**" means this Act or an Act, or portion of an Act, referred to in section 4 of the SARS Act, excluding customs and excise legislation;

## Chapter 2 – General Administration Provisions
## Part A – In General

### Section 4

(3) In the event of any inconsistency between this Act and another tax Act, the other Act prevails.

## Chapter 5 – Information Gathering
## Part A – General Rules for Inspection, Verification, Audit and Criminal Investigation

### Section 42 – Keeping taxpayer informed

(2) Upon conclusion of the audit or a criminal investigation, and where—

(*a*) the audit or investigation was inconclusive, SARS must inform the taxpayer accordingly within 21 business days; or

(*b*) the audit identified potential adjustments of a material nature, SARS must within 21 business days, or the further period that may be required based on the complexities of the audit, provide the taxpayer with a document containing the outcome of the audit, including the grounds for the proposed assessment or decision referred to in section 104(2).

(3) Upon receipt of the document described in subsection (2)(*b*), the taxpayer must within 21 business days of delivery of the document, or the further period requested by the taxpayer that may be allowed by SARS based on the complexities of the audit, respond in writing to the facts and conclusions set out in the document.

## Chapter 8 – Assessments

### Section 95 – Estimation of assessments

(1) SARS may make an original, additional, reduced or jeopardy assessment based in whole or in part on an estimate if the taxpayer—

(*a*) fails to submit a return as required; or

(*b*) submits a return or information that is incorrect or inadequate.

(2) SARS must make the estimate based on information readily available to it.

(3) If the taxpayer is unable to submit an accurate return, a senior SARS official may agree in writing with the taxpayer as to the amount of tax chargeable and issue an assessment accordingly, which assessment is not subject to objection or appeal.

### Section 96 – Notice of assessment

(2) In addition to the information provided in terms of subsection (1) SARS must give the person assessed—

(*a*) in the case of an assessment described in section 95 or an assessment that is not fully based on a return submitted by the taxpayer, a statement of the grounds for the assessment; and

(*b*) in the case of a jeopardy assessment, the grounds for believing that the tax would otherwise be in jeopardy.

## Chapter 9 – Dispute Resolution
## Part A – General

### Section 102 – Burden of proof

(1) A taxpayer bears the burden of proving—

(*a*) that an amount, transaction, event or item is exempt or otherwise not taxable;

(*b*) that an amount or item is deductible or may be setoff;

(*c*) the rate of tax applicable to a transaction, event, item or class of taxpayer;

(*d*) that an amount qualifies as a reduction of tax payable;

(*e*) that a valuation is correct; or

(*f*) whether a 'decision' that is subject to objection and appeal under a tax Act, is incorrect.

(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.

## Part D – Tax Court

### Section 129 – Decision by tax court

(3) In the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the tax court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or increase the understatement penalty.

## Chapter 12 – Interest

### Section 187 – General interest rules

(1) If a tax debt or refund payable by SARS is not paid in full by the effective date, interest accrues, and is payable, on the amount of the outstanding balance of the tax debt or refund—

(*a*) at the rate provided under section 189; and

(*b*) for the period provided under section 188.

(2) Interest payable under a tax Act is calculated on—

(*a*) the daily balance owing; or

(*b*) the daily balance owing and compounded monthly, which method of determining interest will apply to a tax type from the date the Commissioner prescribes it by public notice.

(3) The effective date for purposes of the calculation of interest in relation to—

(*a*) tax other than income tax or estate duty for any tax period, is the date by which tax for the tax period is due and payable under a tax Act;

(*b*) income tax for any year of assessment, is the date falling seven months after the last day of that year in the case of a taxpayer that has a year of assessment ending on the last day of February, and six months in any other case;

(*c*) estate duty for any period, is the earlier of the date of assessment or 12 months after the date of death;

(*d*) a fixed amount penalty referred to in section 210, is the date of assessment of the penalty, and in relation to an increment of the penalty under section 211(2), the date of the increment.

(*e*) a percentage based penalty referred to in section 214, is the date by which tax for the tax period should have been paid;

(*f*) an understatement penalty, is the effective date for the tax understated;

(*g*) an outstanding tax debt referred to in section 190(5), is the date of payment of a refund which is not properly payable under a tax Act.

(4) The effective date in relation to an additional assessment or reduced assessment is the effective date in relation to the tax payable under the original assessment.

(5) The effective date in relation to a jeopardy assessment is the date for payment specified in the jeopardy assessment.

(6) If a senior SARS official is satisfied that interest payable by a taxpayer under subsection (1) is payable as a result of circumstances beyond the taxpayer's control, the official may, unless prohibited by a tax Act, direct that so much of the interest as is attributable to the circumstances is not payable by the taxpayer.

(7) The circumstances referred to in subsection (6) are limited to—

(*a*) a natural or human-made disaster;

(*b*) a civil disturbance or disruption in services; or

(*c*) a serious illness or accident.

(8) SARS may not make a direction that interest is not payable under subsection (6) after the expiry of three years, in the case of an assessment by SARS, or five years, in the case of self-assessment, from the date of assessment of the tax in respect of which the interest accrued.

### Section 188 – Period over which interest accrues

(1) Unless otherwise provided in a tax Act, interest payable under section 187 is imposed for the period from the effective date of the tax to the date the tax is paid.

(2) Interest payable in respect of the—

(*a*) first payment of provisional tax, is imposed from the effective date for the first payment of provisional tax until the earlier of the date on which the payment is made or the effective date for the second payment of provisional tax; and

(*b*) second payment of provisional tax, is imposed from the effective date for the second payment of provisional tax until the earlier of the date on which the payment is made or the effective date for income tax for the relevant year of assessment.

(3) Unless otherwise provided under a tax Act—

(*a*) interest on an amount refundable under section 190 is calculated from the later of the effective date or the date that the excess was received by SARS to the date the refunded tax is paid; and

(*b*) for this purpose, if a refund is offset against a liability of the taxpayer under section 191, the date on which the offset is effected is considered to be the date of payment of the refund.

### Section 189 – Rate at which interest is charged

(1) The rate at which interest is payable under section 187 is the prescribed rate.

(2) In the case of interest payable with respect to refunds on assessment of provisional tax and employees' tax paid for the relevant year of assessment, the rate payable by SARS is four percentage points below the prescribed rate.

(3) The prescribed rate is the interest rate that the Minister may from time to time fix by notice in the Gazette under section 80(1)(*b*) of the Public Finance Management Act, 1999 (Act No. 1 of 1999).

(4) If the Minister fixes a different interest rate referred to in subsection (3) the new rate comes into operation on the first day of the second month following the month in which the new rate becomes effective for purposes of the Public Finance Management Act, 1999.

(5) If interest is payable under this Chapter and the rate at which the interest is payable has with effect from any date been altered, and the interest is payable in respect of any period or portion thereof which commenced before the said date, the interest to be determined in respect of—

(*a*) the period or portion thereof which ended immediately before the said date; or

(*b*) the portion of the period which was completed before the said date, must be calculated as if the rate had not been altered.

## Chapter 15 – Administrative Non-Compliance Penalties
## Part B – Fixed Amount Penalties

### Section 208 – Definitions

In this Chapter, unless the context indicates otherwise, the following terms, if in single quotation marks, have the following meanings—

'**administrative noncompliance penalty**' or '**penalty**' means a "penalty" imposed by SARS in accordance with this Chapter or a tax Act other than this Act, and excludes an understatement penalty referred to in Chapter 16

### Section 210 – Non-compliance subject to penalty

(1) If SARS is satisfied that noncompliance by a person referred to in subsection (2) exists, SARS must impose the appropriate 'penalty' in accordance with the Table in section 211.

(2) Noncompliance is failure to comply with an obligation that is imposed by or under a tax Act and is listed in a public notice issued by the Commissioner, other than—

(*a*) the failure to pay tax subject to a percentage based penalty under Part C;

(*b*) non-compliance in respect of which an understatement penalty under Chapter 16 has been imposed; or

(*c*) the failure to disclose information subject to a reportable arrangement penalty under section 212.

## Part C – Percentage Based Penalty

### Section 213 – Imposition of percentage based penalty

(1) If SARS is satisfied that an amount of tax was not paid as and when required under a tax Act, SARS must, in addition to any other 'penalty' or interest for which a person may be liable, impose a 'penalty' equal to the percentage of the amount of unpaid tax as prescribed in the tax Act.

## Chapter 16 – Understatement Penalty
## Part A – Imposition of Understatement Penalty

### Section 221 – Definitions

In this Chapter, unless the context indicates otherwise, the following terms, if in single quotation marks, have the following meanings—

'**impermissible avoidance arrangement**' means an arrangement in respect of which Part IIA of Chapter III of the Income Tax Act is applied and includes, for purposes of this Chapter, any transaction, operation, scheme or agreement in respect of which section 73 of the Value-Added Tax Act or any other general anti-avoidance provision under a tax Act is applied;

'**repeat case**' means a second or further case of any of the behaviours listed under items (i) to (vi) of the understatement penalty percentage table reflected in section 223 within five years of the previous case;

'**substantial understatement**' means a case where the prejudice to SARS or the fiscus exceeds the greater of five per cent of the amount of 'tax' properly chargeable or refundable under a tax Act for the relevant tax period, or R1 000 000;

'**tax**' means tax as defined in section 1, excluding a penalty and interest;

'tax position' 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; and

'understatement' means 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;

(*d*) if no return is required, the failure to pay the correct amount of 'tax'; or

(*e*) an 'impermissible avoidance arrangement'.

## Section 222 – Understatement penalty

(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.

(2) The understatement penalty is the amount resulting from applying the highest applicable understatement penalty percentage in accordance with the table in section 223 to each shortfall determined under subsections (3) and (4) in relation to each understatement in a return.

(3) The shortfall is the sum of—

(*a*) the difference between the amount of 'tax' properly chargeable for the tax period and the amount of 'tax' that would have been chargeable for the tax period if the 'understatement' were accepted;

(*b*) the difference between the amount properly refundable for the tax period and the amount that would have been refundable if the 'understatement' were accepted; and

(*c*) the difference between the amount of an assessed loss or any other benefit to the taxpayer properly carried forward from the tax period to a succeeding tax period and the amount that would have been carried forward if the 'understatement' were accepted, multiplied by the tax rate determined under subsection (5).

(4) If there is a difference under both paragraphs (*a*) and (*b*) of subsection (3), the shortfall must be reduced by the amount of any duplication between the paragraphs.

(5) The tax rate applicable to the shortfall determined under subsections (3) and (4) is the maximum tax rate applicable to the taxpayer, ignoring an assessed loss or any other benefit brought forward from a preceding tax period to the tax period.

## Section 223 – Understatement penalty percentage table

(1) The understatement penalty percentage table is as follows:

| **1**<br><br>**Item** | **2**<br><br>**Behaviour** | **3**<br><br>**Standard case** | **4**<br><br>**If obstructive, or if it is a repeat case** | **5**<br><br>**Voluntary disclosure after notification of audit or investigation** | **6**<br><br>**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% |

| 1<br><br>Item | 2<br><br>Behaviour | 3<br><br>Standard case | 4<br><br>If obstructive, or if it is a repeat case | 5<br><br>Voluntary disclosure after notification of audit or investigation | 6<br><br>Voluntary disclosure before notification of audit or investigation |
|---|---|---|---|---|---|
| (iv) | ‘Impermissible avoidance arrangement’ | 75% | 100% | 35% | 0% |
| (v) | Gross negligence | 100% | 125% | 50% | 5% |
| (vi) | Intentional tax evasion | 150% | 200% | 75% | 10% |

(2) An understatement penalty for which provision is made under this Chapter is also chargeable in cases where—

(*a*) an assessment based on an estimation under section 95 is made; or

(*b*) an assessment agreed upon with the taxpayer under section 95(3) is issued.

(3) 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 of the substance over form doctrine or the 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.

## Section 224 – Objection and appeal against imposition of understatement penalty

The imposition of an understatement penalty under section 222 or a decision by SARS not to remit an understatement penalty under section 223(3), is subject to objection and appeal under Chapter 9.

## Part B – Voluntary Disclosure Programme

### Section 229 – Voluntary disclosure relief

Despite the provisions of a tax Act, SARS must, pursuant to the making of a valid voluntary disclosure by the applicant and the conclusion of the voluntary disclosure agreement under section 230—

(*a*) not pursue criminal prosecution for a tax offence arising from the 'default';

(*b*) grant the relief in respect of any understatement penalty to the extent referred to in column 5 or 6 of the understatement penalty percentage table in section 223; and

(*c*) grant 100 per cent relief in respect of an administrative noncompliance penalty that was or may be imposed under Chapter 15 or a penalty imposed under a tax Act, excluding a penalty imposed under that Chapter or in terms of a tax Act for the late submission of a return.

## Chapter 20 – Transitional Provisions

### Section 270 – Application of Act to prior or continuing action

(1) Subject to this Chapter, this Act applies to an act, omission or proceeding taken, occurring or instituted before the commencement date of this Act, but without prejudice to the action taken or proceedings conducted before the commencement date of the comparable provisions of this Act.

(2) The following actions or proceedings taken or instituted under the provisions of a tax Act repealed by this Act but not completed by the commencement date of the comparable provisions of this Act, must be continued and concluded under the provisions of this Act as if taken or instituted under this Act—

(*c*) an inspection, verification, request for information, audit, criminal investigation, inquiry or search and seizure;

(6) Additional tax, penalty or interest may be imposed or levied as if the repeal of the legislation in Schedule 1 had not been effected and may be assessed and recovered under this Act, if—

(*a*) additional tax, penalty or interest which but for the repeal would have been capable of being imposed, levied, assessed or recovered by the commencement date of this Act, has not been imposed, levied, assessed or recovered by the commencement date of this Act; or

(*b*) an understatement penalty, administrative noncompliance penalty or interest under this Act cannot be imposed, levied, assessed or recovered in respect of an understatement as defined in section 221, noncompliance or failure to pay that occurred before the commencement date of this Act.

(6A) For the purposes of subsection (6), 'capable of being imposed' means that the verification, audit or investigation necessary to determine the additional tax, penalty or interest had been completed before the commencement date of this Act.

(6B) If a return was due by the commencement date of this Act, the requirement under section 223(3)(*b*)(i) is regarded as having been met for the purposes of remittance of a substantial understatement penalty.

(6C) A person who made a valid voluntary disclosure before the commencement date of this Act, qualifies for the relief referred to in section 229(*b*) if the audit or investigation of the person's affairs has commenced before but only concluded after commencement date of this Act and the requirements of Part B of Chapter 16 have been met.

(6D) If an understatement penalty is imposed as a result of an understatement, as defined in section 221, made in a return submitted before the commencement date of this Act, a taxpayer may object against the penalty under Chapter 9 (whether or not the taxpayer has previously objected against the assessment imposing the penalty) and if the return was required under—

(*a*) the Income Tax Act, excluding returns required under the Fourth Schedule to that Act, a senior SARS official must, in considering the objection, reduce the penalty in whole or in part if satisfied that there were extenuating circumstances; or

(*b*) the Value-Added Tax Act or the Fourth Schedule to the Income Tax Act, a senior SARS official must reduce the penalty in whole if the penalty was imposed under circumstances other than the circumstances referred to in item (vi) of the understatement penalty table in section 223(1).

(6E) Until the date on which the whole of Chapter 12 and of Schedule 1 to this Act come into operation—

(*a*) the accrual and payment of interest on an understatement penalty imposed under section 222 must be calculated in the manner that interest upon additional tax is calculated in terms of the interest provisions of the relevant tax Act; and

(*b*) the effective date referred to in section 187(3)(*f*) for tax understated before 1 October 2012 must be regarded as the commencement date of this Act.

(6F) From the date on which the whole of Chapter 12 and of Schedule 1 to this Act come into operation, the accrual and payment of interest on an understatement penalty imposed under section 222 must be calculated in the manner prescribed by Chapter 12 in respect of an understatement penalty imposed after such date.

(7) Interest arising before the commencement date of this Act must be—

(*a*) calculated in accordance with the relevant tax Act until the commencement date; and

(*b*) regarded as interest payable under this Act from the commencement date of the comparable provisions of this Act.

### Section 272 – Short title and commencement

(1) This Act is called the Tax Administration Act, 2011, and comes into operation on a date to be determined by the President by proclamation in the Gazette.

(2) The President may determine different dates for different provisions of this Act to come into operation.

## Annexure B – Interest accrual provisions of the taxation Acts

| Tax type | Section | Effective date for interest | Interest rate | Remittance or other relief |
|---|---|---|---|---|
| **Income Tax Act** | | | | |
| Withholding tax – sale of immovable property by non-resident seller and penalties | Section 35A(9)(*a*) read with subsection (4) and section 89(2) | 15 days, where the purchaser is a resident, or 29 days, where the purchaser is not a resident, after the date that the amount is withheld | Prescribed rate | Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest |
| Dividends tax and penalties | Section 64K(6) read with subsection (1) and section 89(2) | The day after the last day of the month following the month in which the dividend is paid | Prescribed rate | Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest |
| Income tax and penalties | Section 89(2) | The day after the date of payment prescribed in either –<br>• the notice of assessment; or<br>• the Income Tax Act | Prescribed rate | Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest |
| Employees' tax and penalties | Section 89*bis*(2) read with subsection (3) and paragraph 2(1) of the Fourth Schedule | • 8 days after –<br>o the end of the month during which the tax was deducted or withheld;<br>o the date on which a person ceases to be an employer; or<br>• the day after a further period approved by the Commissioner | Prescribed rate | Commissioner may, having regard to circumstances of case, direct otherwise |

| Tax type | Section | Effective date for interest | Interest rate | Remittance or other relief |
|---|---|---|---|---|
| Provisional tax and penalties | Section 89*bis*(2) read with subsection (3) and paragraphs 21 and 23 of the Fourth Schedule | The day after –<br>• 6 months from the first day of the year of assessment; and<br>• the last day of the year of assessment | Prescribed rate | Commissioner may, having regard to circumstances of case, direct otherwise |
| Provisional tax and penalties after increase of estimate | Section 89*bis*(2) read with paragraph 25(1) of the Fourth Schedule | The day after the date of payment prescribed in the notice of assessment | Prescribed rate | Commissioner may, having regard to circumstances of case, direct otherwise |
| Underpayment of and penalties for understatement of provisional tax | Section 89*quat* | • If the year of assessment ends on the last day of February, 1 October<br>• If the year of assessment ends on another day, the day after 6 months from the last day of the year of assessment | Prescribed rate | Commissioner may remit interest, in whole or in part under certain circumstances |
| Turnover tax of micro businesses and penalties | Paragraph 11 of the Sixth Schedule read with section 89(2) | The day after –<br>• 6 months from the first day of the year of assessment; and<br>• the last day of the year of assessment | Prescribed rate | Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest |
| **Value-Added Tax Act** | | | | |
| Value-added tax | Section 39(1)(*a*)(ii) read with sections 28(1) and 39(7)(*a*) | The first day of the month following the month in which payment should have been made | Prescribed rate | Commissioner may remit interest, in whole or in part under certain circumstances |

| Tax type | Section | Effective date for interest | Interest rate | Remittance or other relief |
|---|---|---|---|---|
| Tax on goods supplied in the course of an enterprise | Section 39(2)(*b*) read with sections 29(1) and 39(7)(*a*) | The first day of the month following the month in which the period of 30 days from the date that the sale was made expires | Prescribed rate | Commissioner may remit interest, in whole or in part under certain circumstances |
| Tax on the importation of goods | Section 39(4) read with section 39(7)(*a*) | The later of the first day of the month following the month in which –<br>• the goods are entered for home consumption under the Customs and Excise Act[145]; or<br>• the customs duty is payable or would have been payable under the Customs and Excise Act | Prescribed rate | Commissioner may remit interest, in whole or in part under certain circumstances |
| Excise duty and environmental levy | Section 39(5) read with section 39(7)(*a*) | The first day of the month following the month in which the liability for payment arises for excise duty or environmental levy under the Customs and Excise Act | Prescribed rate | Commissioner may remit interest, in whole or in part under certain circumstances |
| Additional tax | Section 39(6A) read with section 39(7)(*a*) | The first day of the month following the month in which payment should have been made | Prescribed rate | Commissioner may remit interest, in whole or in part under certain circumstances |
| **Transfer Duty Act** | | | | |
| Transfer duty | Section 4(1A) and 4(3) read with section 3 | The day after 6 months from the date of acquisition | 10% per annum | Commissioner may, under certain circumstances, extend the time within which the duty is payable without interest |

[145] Customs and Excise Act 91 of 1964.

| Tax type | Section | Effective date for interest | Interest rate | Remittance of other relief |
|---|---|---|---|---|
| **Estate Duty Act** | | | | |
| Estate duty | Section 10 | • 31 days after the date of payment prescribed in the notice of assessment; or<br>• if no assessment has been made within 12 months from the date of death, the day after such 12 months period | 6% per annum | Commissioner may, under certain circumstances, extend the time within which the duty is payable without interest |
| **Skills Development Levies Act** | | | | |
| Skills development levy and penalties | Section 11 read with sections 6, 7, and 12(3) and (4) | • 8 days after the end of the month in respect of which the levy is payable<br>• In case of micro businesses, 8 days after –<br>o 6 months from the first day of the year of assessment; and<br>o the end of the year of assessment | Prescribed rate | N/A |
| **Unemployment Insurance Contributions Act** | | | | |
| Unemployment insurance contribution | Section 12 read with<br>sections 8 and 9 | • 8 days after the end of the month in respect of which the contribution is payable<br>• In case of micro businesses, 8 days after –<br>o 6 months from the first day of the year of assessment; and<br>o the end of the year of assessment | Prescribed rate | N/A |
| Additional penalties | Section 13(2) read with subsection (3) and section 11 | The day after the date of payment prescribed in the notice of assessment | Prescribed rate | N/A |

| Tax type | Section | Effective date for interest | Interest rate | Remittance or other relief |
|---|---|---|---|---|
| **Diamond Export Levy (Administration) Act** | | | | |
| Diamond export levy | Section 15(2) and (3) read with section 1 and 4(2) | 31 days after –<br>• in the case of a natural person, 31 August and the last day of February; and<br>• in the case of any other person –<br>o 6 months from the first day of the financial year; and<br>o the end of the financial year | Prescribed rate | N/A |
| **Securities Transfer Tax Administration Act** | | | | |
| Securities transfer tax | Section 5 read with section 3 | • In the case of listed securities, the 15th day of the month following the month in which the security is transferred<br>• In the case of unlisted securities, the first day of the third month following the month in which the security is transferred | Prescribed rate | N/A |
| **Mineral and Petroleum Resources Royalty (Administration) Act** | | | | |
| Mineral and petroleum resources royalties | Section 16(2) read with sections 5(1), (2), 5A and 6 as well as **Chapter 12** of the TA Act | • In the case of a first payment, the day after 6 months from the first day of the year of assessment<br>• In the case of a second payment, the day after the last day of the year or assessment<br>• In the case of a SARS assessment, the day after the period specified in the notice of assessment<br>• In the case of an excess payment, the day after 6 months from the last day of the year of assessment | Prescribed rate | Interest can be remitted in the same way as the understatement penalty. See discussion in **10** above |