A COMPARATIVE ANALYSIS OF THE NEW BEHAVIOURS AND TERMS INTRODUCED IN THE UNDERSTATEMENT PENALTY TABLE IN SECTION 223 OF THE TAX ADMINISTRATION ACT

Submitted in (partial) fulfilment of the requirements for the degree of

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by

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ABSTRACT

The Tax Administration Act became effective on the 1 October 2012 and in Chapter 16 introduced the understatement penalty regime which replaced section 76 of the Income Tax Act. The understatement penalty is calculated by applying a percentage in terms of the table included in section 223 of the Tax Administration Act to the shortfall in tax giving rise to the imposition of the penalty. There are five behaviours reflected in the understatement penalty table in section 223, namely, "substantial understatement", "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence" and "intentional tax evasion". "Substantial understatement" is the only behaviour defined in the Tax Administration Act. Section 222(1) of the Tax Administration Act requires SARS to impose the penalty reflected in the table in the event of an "understatement", unless the "understatement" results from a "*bona fide* inadvertent error". The term "*bona fide* inadvertent error" is not defined in the Tax Administration Act; neither is the term "obstructive". The Memorandum on the Objects of the Tax Administration Laws Amendment Bill confirmed that guidance would be developed in this regard for the use of taxpayers and SARS officials. This guidance has not yet been released. Media reports express the view that the lack of definition of the behaviours is problematic for both SARS and taxpayers as the table is new and there is still room for interpretation and understanding of the meaning of each of the behaviours.

The primary goal of this study was is to obtain a better understanding of the meaning of the new behaviours and terms introduced in the understatement penalty table. In addressing this main goal, the penalty tables and behaviours in legislation in New Zealand were compared to South Africa's understatement penalty. The similarities and differences between the understatement penalty imposed in terms of Chapter 16 of the Tax Administration Act and the additional tax previously imposed in terms of section 76 of the Income Tax Act were also discussed to determine whether this would be of assistance in enabling a better understanding of the meaning of the behaviours and terms in section 223. Guidance on the interpretation of the various behaviours and terms was developed and a definition was proposed for the meaning of "*bona fide* inadvertent error" and "obstructive" to assist in the objective and consistent application of the understatement penalty table in relation to each shortfall identified.

The proposed definition for "*bona fide* inadvertent error" is as follows: "An honest mistake made or simple oversight, which the taxpayer was not aware of, despite taking reasonable care and displaying a prudent attitude while making a genuine attempt to comply with all applicable tax obligations." The definition for "obstructive" is proposed as: "Deliberately interfering with, causing difficulties (impeding) or delays in, or preventing the progress of a SARS audit or review."

KEYWORDS: *Bona fide* inadvertent error; Gross negligence; Intentional tax evasion; Obstructive; Penalty behaviour characteristics; Reasonable care; Reasonable grounds; Tax Administration Act; Understatement penalty.

Declaration

I declare that the Dissertation/Thesis entitled, A Comparative Analysis of the New Behaviours and Terms Introduced in the Understatement Penalty Table in Section 223 of the Tax Administration Act, which I hereby submit for the degree, Master's Degree Commerce (Taxation) at Rhodes University, is my own work. I also declare that this thesis/dissertation has not previously been submitted by me for a degree at this or any other tertiary institution and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

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Kim Doolan

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CHAPTER 1
Introduction

1.1 Introduction and background

The Tax Administration Act, 28 of 2011 (the Tax Administration Act) became effective on the 1 October 2012 and introduced the understatement penalty regime which replaced section 76 of the Income Tax Act, 58 of 1962 (the Income Tax Act). Section 76(1) of the Income Tax Act made provision for a penalty equal to twice the tax chargeable on the omission or understatement of taxable income. In terms of section 76(2)(a) the Commissioner for the South African Revenue Service (SARS) had the power to remit the additional tax imposed in terms of section 76(1), or any part thereof, as he may deem fit, provided that there was no intent to evade taxation and if there was intent to evade taxation, he must be satisfied that there were "extenuating circumstances". Goldswain (2001b: 133 - 134), in his article entitled: *The general meaning of "extenuating circumstances" for the purposes of section 76(2)(a) of the Income Tax Act*, confirmed that some of the "extenuating circumstances" that have influenced the level of the penalty imposed in terms of section 76 were: conduct, character, attitude, behaviour, negligence and carelessness. It is noteworthy that these "extenuating circumstances" also appear in the understatement penalty table set out in section 223 of the Tax Administration Act.

Chapter 16 of the Tax Administration Act deals with the imposition of an understatement penalty. The understatement penalty is calculated by applying a percentage in terms of the following table included in section 223 of the Tax Administration Act to the shortfall in tax giving rise to the imposition of the penalty:

Table 1.1: Understatement Penalty Percentage Table (Section 223 of the Tax Administration Act, 2011)

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

Section 222(1) of the Tax Administration Act requires SARS to impose the penalty reflected in the table in the event of an “understatement”, unless the “understatement” results from a *bona fide* inadvertent error. The term “*bona fide* inadvertent error” is not defined in the Tax Administration Act, nor is the term “obstructive”. The Memorandum on the Objects of the Tax Administration Laws Amendment Bill (SARS, 2013: 40) confirms that, due to the broad range of possible errors, a proposal to define the term “*bona fide* inadvertent error” has the potential to inadvertently exclude deserving cases and include undeserving cases. It goes on to confirm that SARS will, however, develop guidance in this regard for the use of taxpayers and SARS officials. This guidance has not yet been released.

The Tax Administration Act defines “understatement” in section 221 as any prejudice to SARS or the *fiscus* as a result of a default in rendering a return, an omission from a return, an incorrect statement in a return, or if no return is required, the failure to pay the correct amount of "tax". SARS has no discretion to reduce the percentage where it has been determined that a taxpayer falls within a particular behavioural category (Louw: 2013). SARS bears the onus in terms of section 102(2) of the Tax Administration Act of proving "the facts on which SARS based the imposition of an understatement penalty . . .".

The percentage penalty levied as a result of an understatement is determined based on the behaviour of the taxpayer which gave rise to the "understatement". There are five behaviours reflected in the table, namely, "substantial understatement", "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence" and "intentional tax evasion". Numerous authors (Gad & Solomon: 2012; Vanek: 2012; and Khaki: 2012) express the view that the lack of definition of the behaviours is problematic for both SARS and taxpayers as the table is new and there is still room for interpretation and understanding of the meaning of each of the behaviours.

There are similarities between the penalty provisions in the now repealed section 76 of the Income Tax Act and Chapter 16 of the Tax Administration Act, which will make a comparison of the two sets of provisions and their impact on a defaulting taxpayer relevant.

As the application of the new penalty provisions in relation to the type of taxpayer behaviour have not been subject to interpretation by the courts in South Africa, an analysis of similar provisions in New Zealand may be of assistance. The tax office of New Zealand has a penalty system which has been in operation for longer than that of South Africa, with behaviours or penalty categories that are similar to the behaviours detailed in the table in South Africa. This makes a comparison between the countries useful.

The New Zealand Inland Revenue Department (Inland Revenue) has issued Interpretation Statements, namely Interpretation Statements IS0053 issued in October 2005, IS0055 issued in October 2005, IS0060 issued in August 2004, IS0061 issued in December 2005 and IS0062 issued in November 2006, which provide a detailed interpretative explanation of the shortfall penalty system included in legislation in New Zealand. The shortfall penalty behaviours have also been subject to interpretation by the New Zealand courts. The Inland Revenue published an explanation of shortfall penalties entitled: *What are shortfall penalties?* on 4 September 2013 confirming that a shortfall penalty is applied as a percentage of a tax shortfall (deficit or understatement of tax), resulting from certain actions on the part of the taxpayer. The law divides these actions into five categories of fault or breach, with a specified penalty for each category. The breaches can be summarised as follows: "lack of reasonable care", "unacceptable tax position", "gross carelessness", "abusive tax position" and "evasion".

1.2 Goals of the research

The primary goal of this research is to obtain a better understanding of the meaning of the new behaviours and terms introduced in the table in section 223 of the Tax Administration Act, namely, "substantial understatement", "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence", "intentional tax evasion", "obstructive" and in section 222, the term "*bona fide* inadvertent error". This goal will be addressed as follows:

1) to provide a comprehensive comparison between the understatement penalty imposed in terms of Chapter 16 of the Tax Administration Act and the additional tax previously imposed in terms of section 76 of the Income Tax Act to determine whether the repealed legislation may be of assistance in understanding the meaning and application of the new behaviours and terms;
2) to explain in detail and compare the new behaviours and terms with the penalty tables and behaviours in legislation in New Zealand, which deals extensively with the meaning of "reasonable care", "gross carelessness" and "evasion", to enable a better understanding of the meaning of the behaviours and terms; and
3) to propose a definition for the meaning of "*bona fide* inadvertent error" and "obstructive", and develop guidance on the interpretation of the various behaviour categories.

1.3 Overview of the methodological approach

An interpretative research approach will be adopted for the present research as it seeks to understand and describe (Babbie & Mouton: 2009). The research methodology to be applied can be described as a doctrinal research methodology. This methodology provides a systematic exposition of the rules governing a particular legal category, analyses the relationships between the rules, explains areas of difficulty and is based purely on documentary data (McKerchar: 2014).

The documentary data to be used for the research consists of:

- South African legislation pertaining to additional tax and the understatement penalty, specifically the repealed section 76 of the Income Tax Act and chapter 16 of the Tax Administration Act;
- legislation, tax rulings and guidelines relating to the determination, imposition and calculation of penalties and the specific behaviours listed on the penalty tables or systems in South Africa and New Zealand;
- relevant case law; and
- writings of experts in the field of taxation.

The research is conducted in the form of an extended argument, supported by documentary evidence. The validity and reliability of the research and the conclusions will be ensured by:

- adhering to the rules of the statutory interpretation, as established in terms of statute and common law;
- placing greater evidential weight on legislation, case law which creates precedent or which is of persuasive value (primary data) and the writings of acknowledged experts in the field;
- discussing opposing viewpoints and concluding, based on a preponderance of credible evidence; and
- the rigour of the arguments.

All the documentary data is in the public domain. There are therefore no ethical issues concerning their use. Interviews will not be conducted and opinions will only be considered in their written form.

1.4 Thesis structure

The remaining chapters of this thesis are structured as follows. Chapter 2 introduces a discussion of the legislation relating to the understatement penalty imposed in Chapter 16 of the Tax Administration Act and the new behaviours and terms introduced in the understatement penalty table in section 223 and provides a comprehensive comparison between the understatement penalty imposed in terms of Chapter 16 of the Tax

Administration Act and the additional tax previously imposed in terms of the repealed section 76 of the Income Tax Act. Chapter 3 analyses the penalty system in operation in New Zealand and compares the penalty system to the understatement penalty system currently in operation in South Africa. Chapter 4, based on an analysis of "extenuating circumstances" referred to in section 76(2)(a) of the Income Tax Act and the penalty system in operation in New Zealand, proposes a definition for the meaning of "*bona fide* inadvertent error" referred to in section 222 of the Tax Administration Act and guidance on the interpretation of the various behaviour categories introduced in the table in section 223 of the Tax Administration Act, namely "reasonable care not taken in completing return", "no reasonable grounds for the tax position taken", "gross negligence", "intentional tax evasion" and "obstructive" is developed. Chapter 5 concludes the thesis with a summary of its goals and the findings of the research in relation to these goals.

CHAPTER 2
Comparison of Chapter 16 of the Tax Administration Act and the now repealed section 76 of the Income Tax Act

2.1 Introduction

The primary goal of this research is to obtain a better understanding of the meaning of the new behaviours and terms introduced in the table in section 223 of the Tax Administration Act, namely, “substantial understatement”, “reasonable care not taken in completing return”, “no reasonable grounds for tax position taken”, “gross negligence”, “intentional tax evasion”, “obstructive” and “*bona fide* inadvertent error”.

This chapter introduces a discussion of the legislation relating to the understatement penalty imposed under Chapter 16 of the Tax Administration Act and the new behaviours and terms introduced in the understatement penalty table in section 223. It will be demonstrated that the lack of definition in the Tax Administration Act and the delay in the issuance of the comprehensive guidance by the South African Revenue Service (SARS) has resulted in uncertainty regarding the new understatement penalty regime, which could create a risk of subjectivity and inconsistent application of the understatement penalty table by SARS officials.

In addition, this chapter seeks to provide a comprehensive comparison between the understatement penalty imposed in terms of Chapter 16 of the Tax Administration Act and the additional tax previously imposed in terms of section 76 of the Income Tax Act to determine whether the repealed legislation may be of assistance in understanding the meaning and application of the new behaviours and terms, as well as in developing guidance for the use of SARS officials. Of particular interest is the “extenuating circumstances” referred to in section 76(2)(a) of the Income Tax Act and specifically whether the legislation, court decisions and guidance already in existence can be inferred to any of the behaviours and terms detailed in the understatement penalty table in section 223 of the Tax Administration Act.

2.2 Chapter 16 of the Tax Administration Act

Part A of Chapter 16 of the Tax Administration Act comprises sections 221 to 224 and deals with the imposition of an understatement penalty.

Section 221 of the Tax Administration Act sets out the definitions of the terms in the chapter namely, "repeat case", "substantial understatement", "tax", "tax position" and "understatement". These definitions are as follows:

A "repeat case" is defined as: "A second or further case of any of the behaviours listed under items (i) to (v) of the understatement penalty percentage table reflected in section 223 within five years of the previous case."

A "substantial understatement" is defined as: "A case where the prejudice to SARS or the *fiscus* exceeds the greater of five percent of the amount of 'tax' properly chargeable or refundable under a tax Act for the relevant tax period or R1 million."

"Tax" means: "Tax as defined in section 1, excluding penalties and interest." "Tax" as defined in section 1 for the purposes of the Tax Administration Act: "…includes a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act."

A "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."

Section 222(1) of the Tax Administration Act provides that an understatement penalty is chargeable in the event of an understatement. An "understatement" is defined (also in section 221) as: "Any prejudice to SARS or the *fiscus* as a result of –

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

SARS has issued guidance in the form of the SARS Short Guide to the Tax Administration Act (SARS: 2013) (the SARS Short Guide), the purpose of which is to provide assistance to taxpayers in understanding their obligations and entitlements under the Tax Administration Act. The SARS Short Guide is not a binding general ruling, interpretation note, practice note or other official publication as referred to in the Tax Administration Act, and therefore does not constitute law, but is useful for guidance purposes.

2.2.1 The shortfall

The SARS Short Guide (SARS, 2013: 78) confirms that: "An understatement penalty may only be imposed if the *fiscus* is prejudiced by the taxpayer's conduct in reporting and that the *fiscus* will be prejudiced if there is a shortfall." The shortfall on which the applicable percentage from the understatement penalty table is applied is defined in section 222(3) of the Tax Administration Act as: "…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 charged 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)."

Section 222(5) states that: "The tax rate is the maximum rate of tax applicable to the taxpayer, ignoring an assessed loss or any other benefit brought forward from a preceding tax period to the tax period."

If an understatement results in a difference under both (a) and (b) above, section 222(4) states that "…the shortfall must be reduced by the amount of any duplication between the paragraphs."

2.2.2 The understatement penalty

In terms of section 222(2) of the Tax Administration Act the understatement penalty is the amount resulting from applying the applicable understatement penalty percentage in accordance with the understatement penalty table to each shortfall determined in relation to each understatement in a return.

2.2.3 The understatement penalty table

The understatement penalty table is set out in section 223 of the Tax Administration Act. The SARS Short Guide (SARS, 2013: 79) states that, once an applicable behaviour is identified, SARS must consider the conduct of the taxpayer and determine whether the taxpayer made a voluntary disclosure before or after being notified of an audit, the taxpayer was obstructive when engaging with SARS officials, or it is a repeat case. If the case is not defined by any of the above, it is a standard case. The rate of the penalty escalates with increasing culpability and obstructiveness.

2.2.4 Remittance, objection and appeal

"Substantial understatement" is the only behaviour where specific rules exist that permit the remission of the penalty imposed. These rules are reflected in section 223(3) of the Tax Administration Act and permit the penalty imposed to be remitted if "…SARS is satisfied that the taxpayer:

(a) made full disclosure of the arrangement 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 the 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 the 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."

These are extremely narrow grounds upon which a penalty may be remitted. Taxpayers not in the possession of an opinion by a registered tax practitioner would not qualify for remission, even if full disclosure of the arrangement is made before or on the date the relevant return is due.

Section 224 of the Tax Administration Act states that 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.

2.3 Introduction of the new behaviours and terms

2.3.1 Substantial understatement

The SARS Short Guide (SARS, 2013: 79) confirms that, if no other behaviour defines the facts of a case, then an understatement penalty will be triggered if there is a "substantial understatement". "Substantial understatement" is the only behaviour defined in the Tax Administration Act and is also the only behaviour where specific rules exist that permit the remission of the penalty imposed.

At present, if the taxpayer's behaviour at the time of the default is considered to be "substantial understatement", an understatement penalty of 0 percent is levied should the taxpayer make voluntary disclosure of the "understatement" before notification of an audit or investigation, 5 percent should the taxpayer make voluntary disclosure of the "understatement" after notification of an audit or investigation, 10 percent should it be a standard case and 20 percent should the SARS official deem the taxpayer to be "obstructive" or if the taxpayer is a repeat offender.

As stated above, a "substantial understatement" is defined as a case where the prejudice to SARS or the *fiscus* exceeds the greater of five percent of the amount of tax properly chargeable or refundable under a tax Act for the relevant tax period or R1 million. Van Zyl (2014: 913) submits that, to be classified as "substantial", the "shortfall" in tax paid must exceed the greater of the two limits as stated in the definition, and since this involves mere mathematical calculations, it will be quite easy for SARS to discharge the burden of proof in this regard.

It is submitted that since "substantial understatement" is based on the size of an "understatement" as opposed to the lack of or existence of a specific behaviour, the issuing of guidelines and/or an international comparison to obtain a better understanding of the term will not provide further guidance. The meaning has been clearly defined in the Tax Administration Act.

2.3.2 Reasonable care not taken in completing return

The SARS Short Guide (SARS, 2013: 80) states that, as "reasonable care" is not defined, the ordinary meaning must apply. A taxpayer must take reasonable care in keeping records and providing complete and accurate information to SARS. Reasonable care means that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the circumstances of the taxpayer would take to fulfil his or her tax obligations. It means, for example, that a taxpayer must try his or her best to lodge a correct tax return. The reasonable care standard does not mean perfection, but refers to the effort required commensurate with the reasonable person in the taxpayer's circumstances.

At present, if the taxpayer's behaviour at the time of the default is considered to be "reasonable care not taken in completing return", an understatement penalty of 0 percent is levied should a taxpayer make voluntary disclosure of the "understatement" before notification of an audit or investigation, 15 percent should a taxpayer make voluntary disclosure of the "understatement" after notification of an audit or investigation, 25 percent should it be a standard case, and 50 percent should the SARS official deem the taxpayer to be "obstructive" or the taxpayer is a repeat offender.

Van der Walt (2013) poses the question: how much effort should actually go into the completion of a tax return before a taxpayer can be said to have met the "reasonable care" yardstick? Van der Walt (2013) also points out that the SARS Short Guide gives limited content as to what exactly SARS expects of a taxpayer and merely restates the well-known "man on the Clapham bus" test. Van Zyl (2014: 914) submits that van der Walt has correctly pointed out that the guideline merely restates the well-known "man on the Clapham bus" test and confirms that this refers to a hypothetical reasonable person, used by the courts in English law where it is necessary to decide whether a party has acted as a reasonable person would, for example, in a civil action for negligence. The man on the Clapham bus is a reasonably well educated and intelligent but nondescript person, against whom the defendant's conduct can be measured.

It is clear that the SARS Short Guide (SARS, 2013: 80) gives limited content to what is expected of a taxpayer in order to have met the "reasonable care" taken standard set by the understatement penalty table.

2.3.3 No reasonable grounds for tax position taken

The definition of "tax position" needs to be considered when interpreting the behaviour "no reasonable grounds for the tax position taken". A "tax position", as stated above, means an assumption underlying one or more aspects of a tax return, including whether an item or amount, transaction, event or item is taxable, an amount or item is deductible or may be set-off, a lower rate of tax than the maximum applicable to that class of taxpayer, transaction, event or item applies or an amount qualifies as a reduction of tax payable.

The SARS Short Guide (SARS, 2013: 80) confirms that, where an underpayment of tax occurs due to a taxpayer's interpretation of the application of a tax Act, an understatement penalty is payable if the taxpayer does not have a reasonably arguable position. A taxpayer's interpretation of the application of the law is reasonably arguable if, having regard to the relevant authorities, for example an income tax law, a court decision or a general ruling, it would be concluded that what is being argued by the taxpayer is at least as likely as not, correct. Should a shortfall arise because of a substantive disagreement concerning the application of a taxation provision, this understatement penalty will be imposed if the taxpayer's position is not based on reasonable grounds. The purpose is not to levy a penalty when SARS disagrees with a position adopted by a taxpayer but to attach a penalty where a taxpayer assumes a position unreasonably. As there is an inherent risk in assuming a tax position, taxpayers are expected to adopt a sensible approach in the process of adopting a tax position and also to have considered the integrity of the tax position taken.

At present, if the taxpayer's behaviour at the time of the default is considered to be "no reasonable grounds for the tax position taken", an understatement penalty of 0 percent is levied should a taxpayer make voluntary disclosure of the "understatement" before notification of an audit or investigation, 25 percent should a taxpayer make voluntary disclosure of the "understatement" after notification of an audit or investigation, 50 percent should it be a standard case, and 75 percent should the SARS official deem the taxpayer to be "obstructive" or the taxpayer is a repeat offender.

Van Zyl (2014: 916) expresses the opinion that it seems that the burden is on SARS to prove, objectively and without taking the personal circumstances of the taxpayer into account, that the taxpayer did not have a reasonable or rational argument regarding the interpretation or application of a tax Act. This may seem to be an easy task, but it remains to be seen what SARS will have to do in order to (in effect) disprove that what is being argued by the taxpayer is at least as likely as not correct.

It is submitted that the SARS Short Guide (SARS, 2013: 80) does not provide an adequate explanation of what a SARS official is expected to prove or take into account in determining whether the taxpayer did not have a reasonably arguable position in the interpretation of the application of the Tax Administration Act.

2.3.4 Gross negligence

The SARS Short Guide (SARS, 2013: 80) confirms that, "gross negligence" essentially means doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences. The test for gross negligence is objective and is based on what a reasonable person would foresee as being conduct which creates a high risk of a tax shortfall occurring. Gross negligence involves recklessness but, unlike evasion, does not require an element of *mens rea,* meaning wrongful intent or "guilty mind", or intent to breach a tax obligation.

At present, if the taxpayer's behaviour at the time of the default is considered to be "gross negligence", an understatement penalty of 5 percent is levied should a taxpayer make voluntary disclosure of the "understatement" before notification of an audit or investigation, 50 percent should a taxpayer make voluntary disclosure of the "understatement" after notification of an audit or investigation, 100 percent should it be a standard case, and 125 percent should the SARS official deem the taxpayer to be "obstructive" or the taxpayer is a repeat offender.

Van Zyl (2014: 917) is concerned that, taking the SARS Short Guide (SARS, 2013: 80) definition of "gross negligence" into account, the "reasonable person" referred to in this regard is a reasonable person in the position of the taxpayer. The risk exists of inconsistent application by SARS officials due to a lack of comprehensive guidelines and should be addressed expediently, especially in light of the high percentage penalty imposed for this type of behaviour.

It is clear that there is insufficient information in the SARS Short Guide (SARS, 2013: 80) to enable a SARS official to understand exactly what is required to prove that that the taxpayer acted with "gross negligence", as well as what processes or built in controls put in place by a taxpayer could prevent SARS from imposing the penalty for "gross negligence".

2.3.5 Intentional tax evasion

The SARS Short Guide (SARS, 2013: 81) states that: "The most severe penalty is reserved for cases where a taxpayer has acted with the intention to evade tax. To evade tax includes actions that are intended to reduce or extinguish the amount that should be paid, or which inflate the amount of a refund that is correctly refundable to the taxpayer. Intentional tax evasion can exist where a taxpayer makes a false statement in a return, and can also exist where a person does not file a return. The most important factor is that the taxpayer must have acted with intent to evade tax. Intention is a wilful act that exists when a person's conduct is meant to disobey or wholly disregard a known legal obligation, and knowledge of illegality is crucial. Whether SARS acts on or accepts a false declaration is irrelevant. If SARS does not accept the declaration, but audits the taxpayer and determines the correct tax position, the original intent to evade tax is not excused. Since the application of tax law to a particular taxpayer may be complex, it may be that a genuine misunderstanding of the practical application of a taxing provision does not indicate intentional tax evasion. If the taxing provision is uncertain, for instance if there are conflicting judgements on the issue, and the taxpayer applies a reasonable interpretation, it is doubtful that intent to evade could be established and that the more appropriate behavioural category would be whether the taxpayer had taken a tax position on unreasonable grounds or, at worse, that the taxpayer has been grossly negligent. This is an area that is also influenced by the nature of the actions that underlie an understatement and circumstances of the taxpayer."

At present, if the taxpayer's behaviour at the time of the default is considered to be "intentional tax evasion", an understatement penalty of 10 percent is levied should a taxpayer make voluntary disclosure of the "understatement" before notification of an audit or investigation, 75 percent should a taxpayer make voluntary disclosure of the "understatement" after notification of an audit or investigation, 150 percent should it be a standard case, and 200 percent should the SARS official deem the taxpayer to be "obstructive" or the taxpayer is a repeat offender.

The SARS Short Guide (SARS, 2013: 81) acknowledges that, intention may, at times, be difficult to distinguish from an act that is grossly negligent. It is questioned whether the SARS Short Guide (SARS, 2013: 81) has provided adequate guidance to enable a SARS official to correctly and consistently prove that that the taxpayer has acted with "intentional tax evasion".

2.3.6 Obstructive

The SARS Short Guide (SARS, 2013: 79) confirms that SARS must determine whether the taxpayer was "obstructive" when engaging with the SARS official. If SARS determines the taxpayer to be "obstructive", the penalty percentage could increase by 50 percent, depending on the behaviour identified.

Determining whether a taxpayer was "obstructive" is a subjective decision based on the SARS official's dealings and feelings with regard to the taxpayer. It can be argued that the lack of guidelines could result in inconsistent application by SARS officials.

2.3.7 *Bona fide* inadvertent error

Section 222(1) of the Tax Administration Act was revised to take account that no understatement penalty is payable if the "understatement" results from a "b*ona fide* inadvertent error". The statement "*bona fide* inadvertent error" has not been defined in the Tax Administration Act nor does the SARS Short Guide (SARS, 2013) offer any guidance on the term. The Memorandum on the Objects of the Tax Administration Laws Amendment Bill

(SARS, 2013: 40) (the Final Memorandum) confirms that SARS will develop guidance in this regard. This guidance has not yet been released.

The Draft Explanatory Memorandum on the Objects of the Tax Administration Laws Amendment Bill (SARS, 2013: 13) states that in order to determine whether an understatement was caused by a "*bona fide* inadvertent error", SARS will have regard to the circumstances in which the error was made, but also other factors, including the taxpayer's knowledge, education, experience and skill, the size or quantum, the nature and frequency of the error, whether similar errors were made previously. In respect of errors relating to the interpretation of tax laws, SARS will have regard to the complexity of the provisions, whether the taxpayer tried to understand the provisions, including consulting the relevant explanatory memoranda or making reasonable enquiries and whether the taxpayer relied on information (correct or misleading) which came from a reputable source and a reasonable person in the same circumstances would find the information complex.

Haupt (2014: 994) expresses the opinion that this places the bar too high and, as a result this interpretation did not find its way into the Final Memorandum (SARS, 2013: 40), which confirms that, due to the broad range of possible errors, a proposal to define the term "*bona fide* inadvertent error" has the potential to inadvertently exclude deserving cases and include undeserving cases.

Van Zyl (2014: 906) states that, in light of the mandatory nature of the understatement penalty, it is of the utmost importance to understand what the "*bona fide* inadvertent error" exception means. The lack of comprehensive guidelines regarding the process to identify and rule out a "*bona fide* inadvertent error" may prove to be to the detriment of taxpayers due to possible inconsistent application and even possible abuse of this new exception. If comprehensive guidelines regarding the process to identify and rule out a "*bona fide* inadvertent error" are not issued and applied consistently and properly by SARS, the "*bona fide* inadvertent error" exclusion might prove to be of little value.

Van Zyl and Haupt have attempted to define the term "*bona fide* inadvertent error" as follows: Van Zyl (2014: 910) explains that, the Free Dictionary by Farlex, 2014 confirms "*bona fide*" is a Latin phrase that means "in good faith", and thus means sincere or genuine. Haupt (2015: 1025) confirms that, the correct meaning of the term can be found in the *Collins*

English Dictionary which defines "inadvertent" as "failing to act carefully or considerately; inattentive, resulting from heedless action; unintentional". Clarity is required to prevent inconsistent application or abuse, as confirmed by Van Zyl.

2.4 The problem with the current level of understanding of the understatement penalty provisions

The application of the new penalty provisions in relation to the type of taxpayer behaviour has not yet been subject to interpretation by the courts in South Africa. Numerous authors (Gad & Solomon: 2012; Vanek: 2012; and Khaki: 2012) express the view that the ambit of the various categories of behaviour in the table linking the penalty to the type of behaviour is not clear and the lack of definition of the behaviours is problematic for both SARS and taxpayers as the table is new and there is still room for interpretation and understanding of the meaning of each of the behaviours. These authors also found that the lack of definition of the types of behaviour result in the penalties raised in respect of the behaviours being subjective and dependant on the person assessing the return.

The understatement penalty table allows SARS to impose penalties of up to 200 percent. In light of these high penalty percentages, it is necessary to understand what hurdles SARS must overcome first before it can slot a taxpayer into these categories in the understatement penalty table (Van Der Walt: 2013).

The restructuring of the penalties was intended to make matters clearer for the taxpayer and to place less reliance on the discretion of an individual SARS employee. There are still some uncertain areas with respect to the table of behaviours and relevant penalties. Guidance may be found in the SARS Short Guide (SARS, 2013) but it seems that in practice this process is still dependent on the individual SARS employee making the assessment. It is therefore still a subjective decision due to the nature of the behaviours described (Khaki: 2012).

The new penalty regime can be severe and taxpayers and SARS are already arguing about into which categories of understatement a particular offence falls (Surtees: 2014).

Van Zyl (2014: 919) claimed that the understatement penalty regime is a very sharp new "sword" due to its mandatory nature and the current lack of guidance from SARS. Van Zyl

(2014: 920) confirms that a lot of uncertainty still clouds the application of the new understatement penalty regime and submits that by honouring its undertaking to issue guidance SARS will contribute positively to ensure that all of its officers apply the same principles consistently in ruling out a "*bona fide* inadvertent error" and in determining the correct understatement penalty in terms of the understatement penalty table.

The commentary provided by the South African Institute of Tax Practitioners (SAIT) dated 5 August 2013 on the draft Tax Administration Laws Amendment Bill, 2013 recommended that the term "*bona fide* inadvertent error" should be defined in the Tax Administration Act or the examples mentioned in the Explanatory Memorandum should be incorporated into the Tax Administration Act. The SAIT also suggested that a matrix (decision-tree) be compiled and be distributed to SARS officials, taxpayers and tax practitioners to ensure consistency of decisions taken when the discretion of the Commissioner is exercised in determining an understatement penalty and to remove the differences in interpretations.

It appears that the current level of understanding of the meaning of the new terms and behaviours discussed above and application of the understatement penalty table is not sufficient. Without guidance, the understatement penalty table is exposed to subjectivity and inconsistent application by SARS officials. This has the potential to create negative perceptions about the fairness of the tax system and expose taxpayers to unnecessary costs.

The SARS Short Guide (SARS, 2013: 78) confirms that the previous open-ended discretion to impose "additional tax" of up to 200 percent imposed in terms of section 76 of the Income Tax Act has been replaced with the understatement penalty framework that is aimed at ensuring consistent treatment of taxpayers in comparable circumstances. The penalty will be determined by locating each case within a table that assigns a percentage to objective criteria. It is submitted that at present, the aim of the understatement penalty framework cannot be achieved.

2.5 Comparison with the now repealed section 76 of the Income Tax Act

2.5.1 When to impose and the discretion to impose the penalties

In terms of section 222(1) of the Tax Administration Act, an "understatement" is defined (in section 221) as: "…any prejudice to SARS or the *fiscus* as a result of –

(a) a default in rendering a return;
(b) an omission from a return;
(c) an incorrect statement in a return; or
(d) if no return is required, the failure to pay the correct amount of "tax"."

Section 76(1) of the Income Tax Act provided that: "A taxpayer shall be required to pay in addition to the tax chargeable in respect of his taxable income –

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

The provisions relating to when to impose a penalty are similar under both the Tax Administration Act and the Income Tax Act in that, section 76(1)(a) of the Income Tax Act and section 221 of the Tax Administration Act both refer to a default in rendering a return, section 76(1)(b) of the Income Tax Act and section 221 of the Tax Administration Act both refer to an omission from a return and section 76(1)(c) of the Income Tax Act Income Tax Act and section 221 of the Tax Administration Act both refer to an incorrect statement in a return. The two sections differ in that section 221 of the Tax Administration Act provides for the situation where no return is required and section 76 of the Income Tax Act does not.

The Tax Administration Act does not define an "omission" from a return referred to in section 221. This is in contrast to section 76 of the Income Tax Act where subsections 5, 6 and 7 set out the circumstances under which a taxpayer was deemed to omit an amount from his return for the purposes of section 76(1)(b). The section provided as follows:

“(5) Any taxpayer who in determining their taxable income, deducts, sets off, disregards or excludes any impermissible amount under the provisions of the Income Tax Act, or shows any amount as an expenditure or loss which he has in fact not expended or lost, shall be deemed to have omitted the amount from his return.

(6) Any taxpayer who wilfully fails to disclose in any return made by him any facts which should be disclosed and the disclosure of which would result in the taxation of the taxpayer’s taxable income on an amount which is higher than the amount declared on the return, shall be deemed to have omitted the difference between the two amounts from his return.

(7) If in any year of assessment in which the determination of the taxable income of the taxpayer does not result in an assessed loss, he is entitled to the set-off of a balance of assessed loss from the previous year of assessment and such balance is less than it would have been had it been calculated on the basis of the returns rendered by him, he shall for the purposes of this section be deemed to have omitted from his return for the first-mentioned year of assessment an amount equal to the difference between the amount at which such balance is finally determined and the amount at which it would have been determined on the said basis.”

It is suggested that the imposition of an understatement penalty under the Tax Administration Act and additional tax under the Income Tax Act are both mandatory penalties. This is made clear by the use of the words “must pay” in section 221 of the Tax Administration Act and “shall be required” in section 76(1) of the Income Tax Act. There is a clear discrepancy with regard to SARS’ discretion to remit the penalty imposed under the two Acts. Haupt (2012: 720) confirms that: “Section 76 of the Income Tax Act gave the Commissioner the power to remit any portion of the additional tax, with the proviso that he could not remit if he was satisfied that the taxpayer intended to evade tax, unless he was satisfied that there were “extenuating circumstances”.” The inconsistencies between the remission of the penalties are discussed in more detail under paragraph 2.5.7 below.

2.5.2 How the penalties are calculated

The understatement penalty is the amount resulting from applying the applicable understatement penalty percentage in accordance with the understatement penalty table to each “shortfall” determined in relation to each “understatement” in a return. This is confirmed in section 222(2) of the Tax Administration Act. The SARS Short Guide (SARS, 2013: 79) states that, once an applicable behaviour is identified, SARS must consider the conduct of the taxpayer and determine whether the taxpayer made a voluntary disclosure before or after being notified of an audit, the taxpayer was obstructive when engaging with SARS officials, it is a repeat case or if the case is not defined by any of the above, it is a standard case. The rate of the penalty escalates with increasing culpability and obstructiveness.

Section 76(1) of the Income Tax Act stated that the additional tax imposed will be equal to twice the taxes chargeable on his taxable income for that year of assessment. Effectively, a straightforward penalty of 200 percent was imposed.

2.5.3 Onus of proof

According to the now repealed section 82 of the Income Tax Act, the burden of proof that any amount is exempt from or not liable to any tax chargeable, subject to any deduction, abatement or set-off or to be disregarded or excluded in terms of the Eighth Schedule shall be upon the person claiming such exemption, non-liability, deduction, abatement or set-off, or that such amount must be disregarded or excluded, and upon the hearing of any appeal from any decision of the Commissioner, the decision shall not be reversed or altered unless it is shown by the appellant that the decision is wrong. The taxpayer had to prove the existence of mitigating and extenuating circumstances and motivate the reduction of the 200 percent maximum penalty under section 76 of the Income Tax Act.

Section 102(2) of the Tax Administration Act, on the other hand, confirms that 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.

2.5.4 Dispute process

Section 224 of the Tax Administration Act provides that the imposition of an understatement penalty imposed under section 222 or a decision by SARS not to remit an understatement penalty under section 223(3) is subject to objection and appeal. Similarly, section 76(2)(b) of the Income Tax Act stated that the decision of the Commissioner not to remit part or the whole of the additional tax imposed was subject to objection and appeal by the taxpayer.

There is a discrepancy with regard to section 76(2)(c) of the Income Tax Act, which envisaged the Commissioner and the taxpayer reaching an agreement on the amount of additional tax to be paid either before or after an assessment was issued and if an agreement was reached, the amount agreed upon was not subject to any objection and appeal. There is no similar provision for this in the Tax Administration Act.

2.5.5 Penalties on estimated assessments

According to section 76(3) of the Income Tax Act, in cases where the taxpayer's taxable income or any part thereof was estimated by the Commissioner in terms of section 78 of the Income Tax Act or determined from accounts rendered by the taxpayer, additional tax was calculated as discussed above under sections 76(1)(a) – (c). Similarly, section 223(2) of the Tax Administration Act provides that an understatement penalty is chargeable where an assessment is based on an estimate under section 95 or an assessment agreed upon with the taxpayer under section 95(3).

2.5.6 Penalties on assessed losses

Silke (2008: 912) stated that the liability for additional tax for assessed losses under the Income Tax Act does not extend beyond the first year of assessment in which the taxable income is determined. For example, if the taxable income in the first year of assessment, including the omitted income of a previous year, does not give rise to any payment of tax, no additional tax is payable. This was confirmed by section 76(7) of the Income Tax Act which stated that where a taxpayer had in the past overstated the assessed loss to which he or she was actually entitled, additional tax was calculated on the difference between the balance of the assessed loss as properly determined and the larger overstated assessed loss in a year of assessment in which the determination of the taxable income does not result in an assessed loss.

By contrast, a "shortfall" as defined by the Tax Administration Act specifically includes 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).

This is an area of concern for both taxpayers and tax practitioners. Van Manen (2014) argues that taxpayers who find themselves in assessed loss positions have regularly been taken aback by SARS levying the penalties where timing errors have occurred. While an uncorrected error made by a taxpayer still in an assessed loss position will result in an understatement in a future year of assessment, by definition, an understatement cannot occur in the year of assessment. SARS, however, levies penalties on shortfalls resulting from the difference between the balance of an assessed loss corrected for an error and an assessed loss affected by an error.

2.5.7 Remission of the penalty

"Substantial understatement" is the only behaviour where specific rules exist that permit the remission of the penalty imposed. In terms of section 223(3), the penalty may be remitted if SARS is satisfied that the taxpayer:

(a) made full disclosure of the arrangement 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 the 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 the 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.

The SARS Short Guide (SARS, 2013: 80) confirms that the purpose of the remission is to recognise where a taxpayer took particular care before preparing a return. It is argued that the present power of SARS to remit the understatement penalties is very limited. By contrast, section 76(2)(a) of the Income Tax Act granted the Commissioner the power to remit the additional tax imposed in terms of section 76(1) of the Income Tax Act, or any part thereof, as he may deem fit, provided that there was no intent to evade taxation and if there was intent to evade taxation, he must be satisfied that there were "extenuating circumstances". These "extenuating circumstances" were to be provided by the taxpayer. The Tax Administration Act does not envisage extenuating circumstances.

2.5.7.1 Extenuating circumstances

Goldswain (2001b: 133), in his article entitled: *The general meaning of "extenuating circumstances" for the purposes of section 76(2)(a) of the Income Tax Act*, explains that the general meaning of the phrase "extenuating circumstances" is broader than that used in criminal law and incorporates the often-used phrase "mitigating circumstance". It even extends to circumstances that arise subsequent to the default act or omission. The state of mind of the defaulting taxpayer at the time that the act or omission was committed, and even subsequently, is vital. It should be established from the taxpayer's *ipse dixit* (subjective test) and be weighted and tested against the probabilities and inferences drawn from the established facts (objective factors). Goldswain (2001b: 133) is of the opinion that the extent of the penalty will normally not be determined by a single factor and that, as a general proposition, the greater the number of prevailing "extenuating circumstances" that can be identified in in favour of the taxpayer, the larger the remission of the penalty will be. It is submitted that this supports the SAIT (SAIT, 2013) proposition that a matrix (decision-tree) should be compiled, which should take into account all the surrounding facts and circumstances of the taxpayer before a decision is taken in determining the understatement penalty to be imposed.

Goldswain (2001b: 133 – 134) compiled a list of what the courts regard as "extenuating circumstances", which emerged from the cases analysed in his articles. Some of the "extenuating circumstances" which have influenced the level of the penalty imposed in terms of section 76 of the Income Tax Act which could assist in the development of guidance for the new behaviours and terms introduced in Chapter 16 of the Tax Administration Act are:

- reliance on tax advisor, bookkeeper, accountant or member of staff;
- personal circumstances: lifestyle, financial means;
- ignorance of the law;
- illiteracy, naivety;
- conduct, character, attitude, behaviour;
- negligence, carelessness; and
- age.

In addition, in the South African case of *Grundling v the State* (20616/14) [2015] ZASCA 129, the Supreme Court of Appeal confirmed that in their view, both the Regional Magistrates Court and the Gauteng Division of the High Court did not accord sufficient weight to the appellant's mitigating circumstances when sentencing was decided. The mitigating and aggravating factors presented by the appellant and the counsel for the State may be of assistance in understanding the meaning and application of the new behaviours and terms in Chapter 16 of the Tax Administration Act.

2.5.7.1.1 Using a tax agent

Goldswain (2001a: 151 - 152) in his article entitled: *Reliance on professional and non-professional advisors or staff as a defence to the imposition of penalties in income tax matters*, explains that based on an analysis of the relevant case law, the reliance on advisors, be it an accountant, bookkeeper or even a member of staff, can be taken into account as either a complete defence against the imposition of penalties or be regarded as an "extenuating circumstance" for the purposes of remission of penalties, provided that the taxpayer has submitted complete and honest information to the advisor, has not set out on a course of tax evasion, is not an astute businessman who has the ability to determine that the information submitted by the advisor was incorrect and the return submitted by the advisor was not purely based on figures produced by the taxpayer and without review.

At present, the SARS Short Guide (SARS, 2013: 80) specifically confirms that if the taxpayer uses an adviser to complete a return and the advisor does not exercise reasonable care, the taxpayer is liable to pay an understatement penalty. It is submitted that this is a severe approach and should be removed from the SARS Short Guide.

It is proposed that the SARS Short Guide (SARS, 2013: 80) should be updated as follows to reflect Goldswain's (2001a: 151 - 152) findings discussed above: "Where the taxpayer makes use of an advisor and provides incomplete or inaccurate information to the advisor, or does not detect an error made by the advisor which a reasonable person in their circumstances would have detected, or had reason to believe the advice provided was not correct, an understatement penalty should be considered."

2.5.7.1.2 Personal circumstances

The personal circumstances of a taxpayer such as education, literacy, low intelligence and naiveté, financial means, ability to pay, loss of employment, hardship, insolvency and reliance on the taxpayer by dependants, age, infirmity, sickness, general poor health, anxiety and sanity, gender, lifestyle, intoxication, drugs, influence of others and provocation, previous good character and loss of respect of the community, and the death, insolvency or liquidation of the taxpayer were discussed by Goldswain (2003b: 70 – 78) in his article entitled: *The personal circumstances of the taxpayer as a defence or as a plea of "extenuating circumstances" for the purposes of remission of penalties in income tax matters.* It was concluded that generally, any adverse personal circumstance that the taxpayer may plead in a case that involves the imposition and remission of penalties in terms of section 76 of the Act can constitute "extenuating circumstances", provided that there is some evidence that the disability of the mind or age is an operative cause of the failure to comply with the taxation laws. This would be difficult to demonstrate if the surrounding evidence establishes that the accused otherwise functioned well in the business world. This agrees with the mitigating factors presented by the appellant in the case of *Grundling v the State* (20616/14) [2015] ZASCA 129, which included the facts that the appellant was a 65 year old former teacher who was a productive member of society with an untainted professional career, a first offender capable of rehabilitation and the wife of a dominating and aggressive husband who was the primary perpetrator. In addition, it was confirmed that the appellant should not be made to bear the brunt of the punishment in the absence of the primary perpetrator (the appellant's husband had died) and was not in the position to be able to pay a suitable fine.

The SARS Short Guide (2013: 80) does not confirm which circumstances of the taxpayer should be taken into account in the determination of a reasonable person in the taxpayer's same circumstances.

It is proposed that the SARS Short Guide (SARS, 2013: 80) be updated to reflect Goldswain's (2003b: 70 - 78) findings discussed above: "All personal circumstances of the taxpayer such as education, literacy, low intelligence and naiveté, loss of employment, hardship, insolvency and reliance on the taxpayer by dependants, age, infirmity, sickness, general poor health, anxiety and sanity, gender, lifestyle, intoxication, drugs, influence of others and provocation, previous good character, and death, insolvency or liquidation, must be taken into account when determining the behaviour of a reasonable person in the taxpayer's same circumstances. Due consideration should be given to whether or not the personal circumstances hampered the taxpayer in the exercising of good business acumen and whether there is any evidence to suggest that any possible infirmity, sickness, disability or anxiety from which the taxpayer may suffer was an operative cause in the failure to comply with the provisions of the Income Tax Act or Tax Administration Act."

2.5.7.1.3 Conduct and other miscellaneous defences

Goldswain (2002: 83 - 84) in his article entitled: *The conduct of the taxpayer – can the conduct of the taxpayer affect the level of the penalty or sanction imposed in income tax matters,* examined the conduct of the taxpayer before, during and after committing a tax offence and established that:

- Where a taxpayer systematically commits income tax fraud or even "innocently" omits income over a number of years, the taxpayer will be treated in a far more serious light than someone who only occasionally attempts to evade the payment of taxes.
- A professional or director of a company or businessman who evades taxes with a sophisticated, premeditated and business-like approach is held to be more culpable than an inexperienced taxpayer who uses an impulsive and unsophisticated approach. The fact that the appellant played a crucial role in the commission of the scheme by intentionally signing documentation completed by her late husband to obtain refunds to which they were not entitled and in the creation of fictitious invoices relating to non-existent transactions were seen as aggravating factors in the case of *Grundling v the State.*
- The magnitude of the evasion has a decided effect on the extent of the penalty imposed. The larger the evasion, the more severe the penalty. This agrees with the decision in *Grundling v the State,* where the considerable value of the false Value-Added Tax (VAT) refunds from which the appellant benefitted was presented as an aggravating factor.
- The use to which the evaded taxes are put can constitute extenuating circumstances. If the evaded taxes were used to provide support needed by a taxpayer's family rather than for "high" living, "extenuating circumstances" could be found to be present in the former case. In the case of *Grundling v the State*, the fact that there was no

evidence to indicate to what extent the appellant benefited personally from the scheme or to suggest that the appellant concealed any assets that may have been acquired with the money from the scheme was presented as a mitigating circumstance.

- There have been instances in which the assistance given to the revenue authorities during an investigation, a plea of "guilty" at the first opportunity and the speed with which the tax liability is settled indicated remorse by the taxpayer and were regarded as "extenuating circumstances". This is opposed to lies, obstruction, false trails of evidence, contesting a case without any real hope of succeeding or unnecessarily prolonging the trial of a relatively simple case which will not be seen as "extenuating circumstances". Showing remorse by pleading guilty and genuinely appearing to have the intention of not wanting to transgress the law again was presented as a mitigating factor in the case of *Grundling v the State* and the fact that a considerable amount of the money lost through the appellant's scheme was not recovered by the *fiscus* was presented as an aggravating factor.

Other miscellaneous defences which may be raised as an "extenuating circumstance" were examined by Goldswain (2003a: 63) in his article entitled: *Special or unusual defences or "extenuating circumstances" that may be pleaded for the purposes of remission of penalties in income tax matters*, where it was established that, in the appropriate circumstances, ignorance of the law, a *bona fide* belief that what was submitted to SARS was correct, following the wrong advice, where an honest attempt has been made to reconstruct the financial records that were destroyed, the offence is of a trifling nature and the physical impossibility of complying with the law, can either be regarded as a complete defence or, at the very least, can constitute "extenuating circumstances".

It is submitted that the above findings can be used to assist in compiling a matrix (decision-tree) that can be distributed to SARS officials, taxpayers and tax practitioners to ensure consistency of decisions taken when the discretion of the Commissioner is exercised in determining whether an understatement penalty is applicable, particularly with regard to the behaviours "reasonable care not taken" and "intentional tax evasion".

2.6 Conclusion

Van Zyl (2014) suggests that a comprehensive standardised list of factors to be taken into account, and questions to be asked by SARS officials before imposing an understatement penalty, will assist its officials to minimise the influence of bias or subjectivity when applying the understatement penalty table. Based on her review of the new "*bona fide* inadvertent error" exclusion and the burden of proof, Van Zyl is of the opinion that it is imperative that comprehensive guidelines be issued expediently in order to prevent inconsistent application by SARS officials and to clarify the alleged automatic penalty position. This is consistent with the commentary provided by the SAIT (SAIT, 2013).

In addition, the evidence gathered suggests that there is not enough guidance at present to enable SARS officials to consistently apply the behaviours detailed on the understatement penalty table in section 223 of the Tax Administration Act to the "shortfall" in relation to each "understatement" identified.

Section 76(1) of the Income Tax Act is distinctly similar to the definition of understatement in section 221 of the Tax Administration Act and was of assistance in understanding the meaning and application of the new behaviours and terms in Chapter 16 of the Tax Administration Act. It is submitted that section 76(5), (6) and (7) can be of assistance in understanding the meaning of the term "omission" referred to in section 221 of the Tax Administration Act. In addition, the conduct that triggers the imposition of additional tax or understatement penalty is similar in both the Income Tax Act and the Tax Administration Act.

It is suggested that the imposition of an understatement penalty under the Tax Administration Act and additional tax under the Income Tax Act are both mandatory penalties. The penalties imposed are also subject to objection and appeal and can be imposed on estimated assessments under both the Income Tax Act and the Tax Administration Act.

The comparison revealed four inconsistencies worth noting between the previous penalty legislation in section 76 of the Income Tax Act and the current penalty legislation in Chapter 16 of the Tax Administration Act:

- Firstly, under the Income Tax Act provisions, the taxpayer had the responsibility to provide reasons as to why additional tax should not be imposed. Currently, SARS bears the burden of proving the facts on which understatement penalty is imposed.
- Secondly, the treatment of the penalties imposed on reducing an assessed loss when applying the two Acts is not consistent. Additional tax imposed under the Income Tax Act was only calculated on the reduction of an assessed loss in the year in which the reduction resulted in taxable income. An understatement penalty imposed under the Tax Administration Act is calculated on the reduction of an assessed loss in the year that the assessed loss is reduced, even if the reduction does not result in taxable income. This is a contentious issue which may need to be clarified in the Tax Administration Act.
- Thirdly, the calculations of the two penalties differ. Previously, under the Income Tax Act, a straightforward additional tax of 200 percent was imposed. Currently, the penalty is determined by locating each "understatement" within the understatement penalty table in Chapter 16 of the Tax Administration Act that assigns a percentage to different criteria, where a SARS official has to identify the behaviour of the taxpayer.
- Lastly, the two penalty provisions differ with regard to the discretion given to the Commissioner to remit the penalties. Under the previous penalty regime in section 76 of the Income Tax Act, the Commissioner was provided the discretion to remit the penalty imposed based on the mitigating and extenuating circumstances presented by the taxpayer. Under the Tax Administration Act, the Commissioner may only remit the penalty if there is a substantial understatement and this is subject to the requirements of section 223(3) of the Tax Administration Act being met.

It is submitted that the discussion of the "extenuating circumstances" which have influenced the level of the penalty imposed in terms of section 76(1) of the Income Tax Act will assist in the development of guidance for the new behaviours and terms introduced in Chapter 16 of the Tax Administration Act. This discussion provides the foundation upon which Chapter 4 is based, which will develop guidance on the interpretation of the various behaviour categories.

In the next chapter, the penalty system currently in operation in South Africa will be compared with the penalty system in operation in New Zealand to determine whether there are any provisions that will assist in obtaining a better understanding of the new behaviours and terms introduced in Chapter 16 of the Tax Administration Act. This may be of assistance in determining whether there are any potential omissions from the Tax Administration Act.

CHAPTER 3
Guidance from the penalty system in New Zealand and other Jurisdictions

3.1 Introduction

In the previous chapter it was argued that the application of the new behaviours and terms introduced in the understatement penalty table reflected in section 223 of the Tax Administration Act may give rise to problems of interpretation and may not ensure that all taxpayers are treated consistently when a SARS official applies the table to the "shortfall" calculated in relation to each "understatement" identified.

In addition, the discussion in Chapter 2 highlighted the similarities as well as the dissimilarities between the understatement penalty imposed in terms of Chapter 16 of the Tax Administration Act and the additional tax previously imposed in terms of section 76 of the Income Tax Act. It was demonstrated that the guidance surrounding the repealed legislation, particularly with regard to determining whether or not a penalty imposed in terms of section 76 of the Income Tax Act could be remitted in full or in part, will be of assistance in understanding the meaning and application of the behaviours and terms introduced in the table reflected in section 223 of the Tax Administration Act.

The penalty system currently in operation in South Africa will be compared with the penalty system in operation in New Zealand to determine whether there are any provisions or case law decisions that will assist in providing a better understanding of the new behaviours and terms introduced in Chapter 16 of the Tax Administration Act. The dissimilarities of the penalty systems in operation in each country will also be discussed. This may be of assistance in determining whether there are any potential omissions from the penalty provisions in the Tax Administration Act.

The primary goal of this research is to obtain a better understanding of the meaning new behaviours and terms introduced in the table in section 223 of the Tax Administration Act, namely, "substantial understatement", "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence", "intentional tax evasion", "obstructive", to propose a definition for the meaning of "*bona fide* inadvertent error" and develop guidance on the interpretation of the various behaviour categories.

It will be demonstrated that the penalty system in operation in New Zealand is substantially similar to the penalty system in operation in South Africa, which makes a comparison of the countries useful in assisting with the development of guidance on the interpretation of the various behaviour categories. A definition for the meaning of "*bona fide* inadvertent error" and "obstructive" will also be proposed based on arguments raised below.

3.2 The penalty provisions in New Zealand

Section 141 of Part 9 of the Tax Administration Act, 1994 (the New Zealand Tax Administration Act) deals with penalties relating to tax shortfalls, referred to as the shortfall penalty.

Part 1 of the New Zealand Tax Administration Act confirms that: "A shortfall penalty means a penalty imposed under any of sections 141AA to 141K for taking an incorrect tax position or for doing or failing to do anything specified or described in those sections." The Inland Revenue (2013) has issued on-line guidance on penalties and interest and shortfall penalties entitled: *What are shortfall penalties?*, which states that the shortfall penalty is applied as a percentage of the tax shortfall (a deficit or understatement of tax) resulting from certain actions on the part of a taxpayer. This is similar to the South African definition of understatement penalty in section 222(2) of the Tax Administration Act, which refers to the understatement penalty being the amount resulting from applying the applicable understatement penalty percentage in accordance with the understatement penalty table to each shortfall determined in relation to each understatement in a return.

Part 1 of the New Zealand Tax Administration Act explains that: "A tax shortfall for a return period means the difference between the tax effect of a taxpayer's tax position for the return period and the correct tax position for that period, when the taxpayer's tax position results in too little tax paid or payable by the taxpayer or another person or overstates a tax benefit, credit, or advantage of any type or description whatever, by or benefiting (as the case may be) the taxpayer or another person." This is comparable with the South African definition of shortfall in section 222(3) of the Tax Administration Act, which refers to the difference between the amount of tax that was chargeable (payment) or refundable (credit) and the amount that would have been chargeable or refundable had it not been for the "understatement".

It is noted that the South African definition of shortfall does not deal with the concept of too little tax paid or payable by another person. It only deals with the taxpayer's tax position. This difference is discussed in the New Zealand Tax Information Bulletin, Volume 18 No. 11 issued in December 2006 (Inland Revenue, 2006: 21). If a taxpayer enables or attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law, the taxpayer is liable to pay the Commissioner an amount equal to the shortfall penalty that would have been imposed if the other person's tax position had been the taxpayer's tax position. This means that two penalties could potentially be imposed in this situation. One penalty could be imposed on the person for whom the refund or payment was sought, and a second penalty could be imposed on the enabling taxpayer. An additional difference noted between the New Zealand and South African penalty provisions is that where the shortfall penalty results from failure to make or account for deductions or withholding taxes, or from applying those to a purpose other than payment to the Commissioner, the Commissioner is empowered (under section 141F of the New Zealand Tax Administration Act) to apportion the shortfall penalty between the company taxpayer and its officers involved.

Part 1 of the New Zealand Tax Administration Act states that: "A taxpayer's tax position means a tax position taken by a taxpayer in or in respect of a tax return, an income statement or a due date." This is similar to the South African definition of tax position in section 221 of the Tax Administration Act, which confirms that a "tax position" means an assumption underlying one or more aspects of a tax return, including whether an item or amount, transaction, event or item is taxable, an amount or item is deductible or may be set-off, a lower rate of tax applies than the maximum applicable to that class of taxpayer, transaction, event or item, or an amount qualifies as a reduction of tax payable.

Section 141EB of the New Zealand Tax Administration Act makes provision for promoter penalties. It is submitted that the penalty contained in section 212 of the Tax Administration Act for failing to report a "reportable arrangement" is the equivalent provision in South Africa. Two fundamental differences are noted:

- The promoter of an arrangement in New Zealand is liable for a promoter penalty if a taxpayer becomes a party to the arrangement and a shortfall penalty for an abusive tax position is imposed on the taxpayer as a result of the arrangement and the arrangement is offered, sold, issued or promoted to 10 or more persons in a tax year. The South African legislation does not provide for a minimum number of persons to whom the arrangement must be offered, sold, issued or promoted for the reportable arrangement penalty to apply.
- The amount of the promoter penalty in New Zealand is the greater of nil and the sum of the tax shortfalls resulting from taking an abusive tax position on the arrangement. In South Africa, section 212 of the Tax Administration Act imposes a fixed monthly penalty of R50 000 per month (for up to 12 months) for the participant and R100 000 per month (for up to 12 months) for the promoter of the arrangement. The penalty is doubled if the amount of the anticipated "tax benefit" for the participant by reason of the arrangement exceeds R5 000 000, and is tripled if the benefit exceeds R10 000 000.

Section 141FB of the New Zealand Tax Administration Act confirms that a shortfall penalty imposed may be reduced to 50 percent of the amount that would be payable by the taxpayer, provided that the taxpayer is not convicted of an offence that is a disqualifying offence, or liable for another shortfall penalty that is a disqualifying penalty, for the purposes of this subsection. The guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 32) confirms that the taxpayer must not have been liable for a tax shortfall penalty relating to the same tax type within the previous two year or four year period, depending on the tax type. A penalty imposed in respect of one tax type does not mean that the reduction is not available for the other tax types. This differs from the legislation in South African in section 221 of the Tax Administration Act, which confirms that a repeat case applies to a five year period and includes all tax types.

Sections 141G, 141H and 141I of the New Zealand Tax Administration Act also provide for a reduction in the shortfall penalty imposed. A shortfall penalty may be reduced for voluntary disclosure of the tax shortfall, disclosure of the unacceptable tax position and for temporary shortfalls. This is consistent with South Africa where the understatement penalty legislation has built voluntary disclosure before and after the audit into the understatement penalty table.

There is, however, no provision for temporary shortfalls in South Africa. Section 141H of the New Zealand Tax Administration Act confirms that the shortfall penalty payable by the taxpayer may be reduced if the taxpayer makes adequate disclosure of the taxpayer's position at the time the tax position is taken. There is also no provision for this in the South African penalty legislation.

It is interesting to note that section 141B(2) of the New Zealand Tax Administration Act sets out thresholds which a tax shortfall must exceed to qualify for a penalty for an unacceptable tax position. The tax shortfall must exceed both $20 000 and the lesser of $250 000 and one percent of the taxpayer's total tax liability for the relevant return period. The South African penalty legislation has not provided for this.

Section IG 10 of the New Zealand Income Tax Act, 1994 imposes an additional penalty worth noting, which is not provided for in the South African penalty legislation. A taxpayer in a loss situation can elect to use the losses to pay for shortfall penalties imposed by the New Zealand Inland Revenue.

Section 141JAA of the New Zealand Tax Administration Act states that the shortfall penalty for not taking reasonable care and for taking an unacceptable tax position may not be more than $50 000 in certain situations. The guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 34) confirms that the cap equates to the maximum criminal penalty imposed. The guidance issued by Inland Revenue, Interpretation Statement IS0055 (Inland Revenue, 2005: 43) explains that the reason for the introduction of the monetary cap, is to ensure that the penalty for such breach is not out of step with other monetary penalties imposed under the New Zealand Tax Administration Act and a cap is also likely to reduce compliance and administrative costs as taxpayers will have less incentive to dispute the imposition of a penalty they consider is unfair. There is no provision for this in South Africa.

Section 141 of the New Zealand Tax Administration Act explains that a separate tax shortfall calculation is required for each return period, tax type and tax position taken by the taxpayer. This is consistent with South Africa where section 222 of the Tax Administration Act confirms that the applicable understatement penalty percentage imposed in accordance with the understatement penalty table is applied to each shortfall determined in relation to each understatement in a return.

In New Zealand, Inland Revenue (2008) has issued on-line guidance for imposing penalties on partnerships and trusts entitled: *Unacceptable Tax Position*, where it is stated that to establish whether a tax shortfall incurred by a partnership is over the threshold for charging a penalty, the partnership is treated as a single entity. Shortfalls relating to the partnership activities are added together and the total is compared with the threshold. A tax shortfall arising from a trust is assessed as trustee income and the trustee incurs any penalties. This is because the trust is a separate legal entity and the trustee is liable for tax on any income that is not beneficiary income. There is no specific guidance or legislation in South African for imposing penalties on partnerships or trusts.

New Zealand Inland Revenue (2013) has issued on-line guidance on penalties and interest and shortfall penalties entitled: *What are shortfall penalties?*, which confirms that there are five categories of tax shortfall penalties: "lack of reasonable care", "unacceptable tax position", "gross carelessness", "abusive tax position" and "evasion".

The New Zealand shortfall penalties can be reflected in tabular form as follows:

Table 3.1: New Zealand Penalty Table (Inland Revenue on-line guidance entitled: *What are shortfall penalties?* 2013)

If the breach is	then the standard penalty (% of tax shortfall) is
lack of reasonable care	20%
unacceptable tax position	20%
gross carelessness	40%
abusive tax position	100%
evasion	150%

3.2.1 Lack of reasonable care

Inland Revenue (2008) has issued on-line guidance on penalties and interest and shortfall penalties entitled: *Not taking reasonable care,* which explains that not taking reasonable care generally means that the same level of care must be taken that a reasonable person in the same circumstances would take. It is submitted that this behaviour category agrees with the concept of "reasonable care not taken in completing the return" in the understatement penalty table, which the SARS Short Guide (SARS, 2013: 80) has clarified as meaning that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the circumstances of the taxpayer would take to fulfil his or her tax obligations. There is also agreement in both countries with regard to the fact that reasonable care standard does not mean perfection and that the entity's circumstances, including knowledge, education and skill should be taken into account (Inland Revenue (2008) on-line guidance on penalties and interest and shortfall penalties entitled: *Not taking reasonable care* and SARS Short Guide (SARS, 2013: 80)).

It will be demonstrated that the penalty provisions in New Zealand and South Africa are similar with regard to no penalty being charged, provided that it can be shown that reasonable care was taken or a genuine attempt to comply was made and that "reasonable care taken" as referred to in the guidance issued in New Zealand is the equivalent of South Africa's "*bona fide* inadvertent error". The behaviour categories "reasonable care not taken" and "*bona fide* inadvertent error" will therefore be discussed together and referred to as "reasonable care".

New Zealand Inland Revenue (2007) has published a standard practice statement entitled: *SPS 07/03: Requests to amend assessments (May 07)* (Inland Revenue, 2007) which refers to the exercise of the Commissioner's discretion under section 113 of the New Zealand Tax Administration Act to amend assessments to ensure their correctness when they contain genuine errors.

Inland Revenue (2006) has published an additional standard practice statement entitled: *SPS 06/01 Discretion to cancel or not assess shortfall penalties for taking an unacceptable tax position (April 2006)* (Inland Revenue, 2006) which refers to a "clear mistake or simple oversight" as an acceptable reason to cancel penalties for an unacceptable tax position. Standard Practice Statement SPS 06/01 published in New Zealand by Inland Revenue (Inland Revenue, 2006) has since been withdrawn, but it appears that the guidance might be relevant and of assistance in understanding the term "*bona fide* inadvertent error" in the South African Tax Administration Act, which could amount to a clear mistake or simple oversight.

There is no concept in the New Zealand penalty legislation which directly coincides with the concept of "*bona fide* inadvertent error" in the Tax Administration Act. It is submitted that an analysis of the various concepts as set out in the guidance above will assist in understanding "*bona fide* inadvertent error", which could amount to a genuine error or a clear mistake or simple oversight.

The discussion of reasonable care in the present chapter attempts to provide clarity on the following:

- what constitutes a "*bona fide* inadvertent error";
- what is a reasonable person in the same circumstances and how this is established;
- how to test for negligence and whether the common law principles established by the courts to determine whether there has been a breach of the standard of care expected of a reasonable person can be used for determining "reasonable care not taken in completing a return" in terms of taxation law;
- how the reasonable care standard is applied to different classes of taxpayers, for example business persons, individual taxpayers and tax specialists; and
- how the reasonable care standard is applied in certain situations, for example when SARS advice was obtained, the area of the law is complex or in relation to human error.

3.2.1.1 Bona fide inadvertent error

Chapter 2 revealed that Van Zyl (2014: 910) explained the term "*bona fide* inadvertent error" as meaning an error which is sincere or genuine. The Merriam-Webster dictionary (2015) defines "genuine" as: actual, real, or true, not false or fake, sincere and honest. It follows therefore that a taxpayer making an actual, real or true attempt to submit a correct declaration to the revenue authorities has made a genuine attempt.

Standard practice statement SPS 07/03 published in New Zealand by Inland Revenue (Inland Revenue, 2007: 4) confirms the principles which are relevant to determining whether an error is a "genuine error". A discussion of these principles for the understanding of the meaning of the term "*bona fide* inadvertent error" is therefore relevant. The principles which may be of assistance in South Africa are as follows:

- all relevant factors relating to the error must be ascertained, for example, the reason for the error and the length of time that has passed since the error was made;
- the facts and tax laws relating to the genuine error must be clear and unambiguous;

- the error must not relate to disputed statutory interpretation, that is, it must not be as a result of a disagreement about the meaning of the law;
- incorrect tax positions arising from arithmetical, transportation and other types of obvious errors must be clear and easily verified; and
- if changes need to be made to other tax returns as a result of the adjustment, they should also be treated as genuine errors.

Practice Statement Law Administration PS LA 2012/5 (ATO, 2015: 8) and Practice Statement Law Administration PS LA 2011/30 (ATO, 2014: 4 - 5) issued by the Australian Tax Office (ATO) are of interest and relevant to this discussion as the meaning of the term "genuine" is discussed. The guidance confirms two key indicators that show that an entity is genuinely attempting to comply with its tax obligations, namely:

- reasonable attempts are made to effectively manage the risks associated with the tax position and this approach is displayed in the reporting to ATO; and
- a reasonable investigative approach is displayed to the steps and risks associated with the tax position taken appropriate to the personal circumstances of the taxpayer; the degree of the investigation must reflect the risk, complexity of tax affairs and the level of sophistication and resources of the entity.

Practice Statement Law Administration PS LA 2011/30 issued by the Australian Government (ATO, 2014: 4 - 5) lists examples of what could be seen as investigative behaviour. It is recommended that the South African equivalent could be built into the SARS Short Guide as follows:

- obtaining confirmation of the accountant or provider's tax practitioner number, licence details or whether they are registered with a recognised professional body;
- determining whether there is a product disclosure statement;
- obtaining independent advice from an advisor who has no connection with the seller or the arrangement;
- assessing or evaluating the material or information gathered;
- determining whether there are any appropriate SARS guides or interpretation notes;
- approaching the nearest SARS office for guidance;
- applying for an advance ruling from SARS; and
- ensuring that the advice received is followed appropriately.

It is submitted that where a reasonable person in the same circumstances of the taxpayer would have had apprehensions regarding the outcome of the investigations conducted or advice provided, or that inadequate investigations were carried out, the taxpayer has not made a genuine attempt to comply with their tax obligations.

New Zealand has issued Standard Practice Statement SPS 07/03 published by Inland Revenue (Inland Revenue, 2007: 5), which confirms that the onus is on the taxpayer to provide all relevant information to enable the merits of the request to be considered by Inland Revenue to determine whether the error is a genuine error. It is recommended that the South African penalty provisions should also confirm that the onus of proof in relation to whether an error is a "*bona fide* inadvertent error" should be on the taxpayer and not on the SARS official.

Standard Practice Statement SPS 07/03 published in New Zealand by Inland Revenue (Inland Revenue, 2007: 6) details the information which is expected to be provided in writing by the taxpayer in support of the request to amend the assessment for "genuine errors". It is submitted that before determining whether an error is a "*bona fide* inadvertent error", the taxpayer should provide the SARS official with the following information:

- a description of the understatement including the background circumstances and the reason for the occurrence;
- the nature of the understatement, including the relevant tax laws;
- reasons as to why the understatement was not identified at the time of submission;
- where relevant, details of any incorrect advice given directly to the taxpayer by SARS or a tax practitioner or accountant together with confirmation on how the taxpayer relied on that advice; and
- the action/s required and confirmation of the implementation date to ensure that the understatement is not repeated going forward.

In the New Zealand guidance, Standard Practice Statement SPS 06/01 published by Inland Revenue (Inland Revenue, 2006: 2), it is confirmed that one of the criteria used by the Commissioner in determining whether to cancel or decide not to assess a shortfall penalty assessed for taking an unacceptable tax position is that it was "a clear mistake or simple oversight" which caused the taxpayer to take the unacceptable tax position. The Free-dictionary (2015) defines "mistake" as: an error or fault resulting from defective judgment, deficient knowledge, or carelessness, a misconception or misunderstanding, to understand wrongly; misinterpret or to recognize or identify incorrectly. The Merriam-Webster dictionary (2015) defines "oversight" as: an inadvertent omission or error. A discussion of the guidance issued in New Zealand relating to the term "clear mistake or simple oversight" is therefore relevant for the understanding of the meaning of the term "*bona fide* inadvertent error".

Standard Practice Statement SPS 06/01 published in New Zealand by Inland Revenue (Inland Revenue, 2006: 6) confirms that in order for the error to be classified as "a clear mistake or simple oversight", the mistake or oversight must be an inadvertent one and the existence of the mistake should be plain and obvious on review. The reason for the mistake must be clearly identifiable and understood and the process of explaining the mistake and how it led to the tax shortfall should be an uncomplicated process. If the taxpayer knew of the mistake or oversight, the tax position would not have been taken.

Standard Practice Statement SPS 06/01 published in New Zealand by Inland Revenue (Inland Revenue, 2006: 6 - 7) provides the following situations as examples of when the term "a clear mistake or simple oversight" can be applied:

- in situations when a particular outcome is intended, but that outcome later turns out not to be achieved as a result of a miscalculation, misunderstanding or unintentional omission;
- to a mistake in the calculation or recording of numbers in a return;
- to overlooking or completely misunderstanding a statutory obligation; and
- timing differences which relate to multiple tax types, tax periods, or in some cases other taxpayers.

Standard Practice Statement SPS 06/01 published in New Zealand by Inland Revenue (Inland Revenue, 2006: 7) confirms that, generally, the following situations are examples of when the term "a clear mistake or simple oversight" cannot be applied:

- where the taxpayer did not know about the law, the reason for this being that taxpayers have a duty to be aware of their obligations;
- where the taxpayer knows the law but chooses to ignore it; and
- where the taxpayer repeatedly makes similar mistakes.

It is submitted that the above examples can be built into the SARS Short Guide (SARS, 2013).

From the above it is proposed that the SARS Short Guide be amended to include the definition for "bona fide inadvertent error" as follows: "An honest mistake made or simple oversight, which the taxpayer was not aware of, despite taking reasonable care and displaying a prudent attitude while making a genuine attempt to comply with all applicable tax obligations."

It is also proposed that the following guidelines on the various terms used in the proposed definition are incorporated into the SARS Short Guide (or in an Interpretation Note) to assist the SARS officials in understanding the proposed definition and in determining whether the understatement identified should be classified as a "*bona fide* inadvertent error".

- An honest mistake is a genuine, true or sincere error or fault resulting from defective judgment, deficient knowledge, carelessness, a misinterpretation or misunderstanding.
- A simple oversight is an inadvertent omission or error, the existence of which is plain and obvious on review and the reasons for which are clearly identifiable and understood. The process of explaining the mistake and how it leads to the tax shortfall should not be a complicated process.
- Taking reasonable care means that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the same circumstances as that of the taxpayer would take to fulfil his or her tax obligations, taking the taxpayer's personal circumstances into account, to ensure that the submission to SARS is free of any possible understatements.
- Making a genuine attempt means making a sincere and honest attempt. A taxpayer who displays an investigative approach to the steps and risks associated with the tax position and effectively manages these risks should be considered to have made a genuine attempt. Whether an investigative approach was in fact displayed should be considered on a case by case basis. It is also expected that the degree of the investigation must reflect the risk. A riskier transaction with greater financial implications will be expected to have been subject to greater efforts to investigate the correct tax position.

3.2.1.2 Reasonable person in the same circumstances

Reasonable care is not defined in either of the South African or New Zealand penalty provisions and acquires its meaning from the dictionary definition or ordinary meaning (Inland Revenue, Interpretation Statement IS0053 (2005: 8), SARS Short Guide (SARS, 2013: 80)). The guidance issued by Inland Revenue, Interpretation Statement IS0053 (2005: 8) uses the dictionary definition of the word "care" and "reasonable" to explain that "reasonable care" in the context of section 141A of the New Zealand Tax Administration Act suggests giving appropriately serious attention to the imposed obligations. The Oxford Dictionary (2015) defines "reasonable" as having sound judgement; fair and sensible. The Oxford Dictionary (2015) defines "care" as serious attention or consideration applied to do something correctly or to avoid damage or risk.

It is proposed that the SARS Short Guide (SARS, 2013: 80) explanation of "reasonable care not taken" which currently reads as follows: "A taxpayer must take reasonable care in keeping records and in providing complete and accurate information to SARS", should be expanded to include the following: "In this regard, the ordinary meaning of 'reasonable care' in the context of making a statement to the Commissioner means an approach that accords appropriately serious attention to complying with the obligations imposed under a taxation law to avoid risk."

In the New Zealand case of *Case W4* (2003) 21 NZTC 11,034, it was confirmed that the test for reasonable care is whether a taxpayer of ordinary skill and prudence would have foreseen as a reasonable probability or likelihood the prospect that an act, or failure to act, would cause a tax shortfall, having regard to all the circumstances. An important consideration in respect of determining whether or not reasonable care was taken was also discussed in the Australian case of *Hart v Federal Commissioner of Taxation* (2003) 131 FCR 203; [2003] FCAFC 105; 2003 ATC 4665; (2003) 53 ATR 371. In this case it was confirmed that in the ordinary case, the mere fact that a tax return includes a deduction which is not allowable is not itself sufficient to expose the taxpayer to a penalty. Negligence must be established. It follows that there is no presumption that the existence of a shortfall amount caused by a false or misleading statement necessarily or automatically points to failure to take reasonable care.

It is recommended that the SARS Short Guide (SARS, 2013: 80) be updated to include the following: "It is important to provide evidence to support the conclusion that the actions which resulted in the tax shortfall fall short of what would be reasonably expected in the circumstances. Negligence must be established. A shortfall amount does not automatically indicate a failure to take reasonable care."

In New Zealand, the principles formulated by the courts to determine whether there has been a breach of the standard of care expected of a reasonable person in common law have been used to provide guidance on the meaning of the expression "reasonable care" and to assist in the decision-making process regarding whether there is a liability for an administrative penalty for a failure to take reasonable care. The guidance issued by Inland Revenue Interpretation Statement IS0053 (Inland Revenue, 2005: 8) confirms that lack of reasonable care has long since been one of the constituents of tort negligence.

Inland Revenue Interpretation Statement IS0053 (Inland Revenue, 2005: 23) states that in tort law, there are three factors to be considered which may indicate the level of care necessary to fulfil tax obligations, namely the probability of injury (which in the tax context would be the likelihood of a tax shortfall), the gravity of the risk (which in the tax context would be the quantum of the shortfall) and the burden of precautionary measures (which in the tax context would be the difficulty in preventing a tax shortfall).

The guidance issued by Inland Revenue Interpretation Statement IS0053 (Inland Revenue, 2005: 25) confirms that in respect of the likelihood of a tax shortfall, the test is whether a reasonable person, in the circumstances of that taxpayer, would have foreseen the likelihood of a tax shortfall. The test is not whether the taxpayer concerned foresaw the tax shortfall. In addition, Tax Information Bulletin Volume 17, No. 9 issued by Inland Revenue (Inland Revenue, 2005: 17) states that the actions that a reasonable person would have taken to prevent the risk foreseen must also be considered.

The New Zealand guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 28) considers that a taxpayer who takes reasonable care will, if necessary, seek help, although a wage or salary earner may generally satisfy the reasonable care test by carefully following the tax guide and it is considered that taxpayers with more complex tax affairs will follow appropriate guidance issued by the Inland Revenue Department and will consult Inland Revenue or a tax advisor where they are uncertain as to the tax treatment of an issue.

It is proposed that the SARS Short Guide (SARS, 2013: 80) be updated to include the following: "Reasonable care means that a taxpayer is required to take the degree of care that a reasonable person in the circumstances of the taxpayer would take to fulfil his or her tax obligations, where a reasonable person would have reasonably foreseen the consequences of the actions and taken steps to avoid such consequences. Where the conduct of the taxpayer does not comply with this standard, it would be seen as reasonable care not taken."

Tax Information Bulletin Volume 17, No. 9 issued by Inland Revenue (Inland Revenue, 2005: 17 - 18) confirms that in respect of the quantum of the tax shortfall, materiality may be relevant in determining whether a taxpayer has taken reasonable care. A tax shortfall may be considered material where the shortfall is a substantial amount in comparison to the taxpayer's tax liability or assessable income.

In respect of the difficulty in preventing a tax shortfall, the New Zealand case of *Froom v Butcher* [1975] 3 All ER 520, confirmed that a reasonable man takes notice of the standards that are authoritative, sensible, accepted, or persuasive. In addition, the New Zealand case of *Graham v Co-operative Wholesale Society Ltd* [1957] 1 WLR 511, confirmed that a person will be expected to keep abreast of such standards (standards which are authoritative, sensible, accepted or persuasive) and that it is reasonable to do so.

In the case of *Duchess of Argyll v Beuselinck* [1972] 2 Lloyds rep 172, it was confirmed that the use of hindsight is not relevant in determining whether or not a person has been negligent. The SARS Short Guide (SARS, 2013: 80) does not make it clear that the increased knowledge or experience of hindsight after the event should not form part of the components of what is reasonable in all the circumstances and that the matter should be judged in prospect and not in retrospect. It is proposed that the SARS Short Guide (SARS, 2013: 80) be updated to include the following: "Perfection or the use of increased knowledge or experience based on hindsight after the event should form no part of the enquiry relating to what is reasonable in all the circumstances".

It is submitted that a SARS official should attempt to apply the common law principles and personal circumstances tests to a category of taxpayer, rather than to that of the individual taxpayer concerned. This will ensure that the reasonable care standard is applied fairly and consistently as confirmed in Tax Information Bulletin, Volume 8, No. 7 issued by the New Zealand Inland Revenue (Inland Revenue, 1996: 11).

It is submitted that the categories of natural persons to be built into the SARS Short Guide (SARS, 2013:80) should be:

- Normal salary and wage earners. This will include all taxpayers whose income is subject to employees' tax (Pay-As-You- Earn (PAYE)). Taxpayers in this category will generally satisfy the reasonable care test by carefully following the tax guides and guidance available on the SARS website and consulting SARS where they are uncertain as to the tax treatment of an issue. Due consideration must be given to the particular person's abilities and circumstances.
- Business taxpayers. This will include all provisional taxpayers, commission earners, taxpayers who receive rental income and taxpayers who receive any other non-salary or wage income, for example director's remuneration or simple share or capital gains tax transactions. In addition to the above, taxpayers in this category will generally satisfy the reasonable care test by consulting a tax advisor where they are uncertain as to the tax treatment of an issue.
- High net worth individuals. As confirmed by SARS spokesperson Adrian Lackay, the definition for high net worth individuals includes taxpayers with an annual income of R7 million or more, taxpayers who make use of trusts or offshore accounts and taxpayers with complex share or capital gains tax transactions. In addition to the above, a taxpayer in this category will generally satisfy the reasonable care test by having appointed a tax advisor, as well as displaying an investigative approach where the degree of the investigation reflects the size of the risk and the risks identified are effectively managed.

3.2.1.3 Persons other than natural persons

Goldswain (2003a: 63) in his article entitled: *Special or unusual defences or "extenuating circumstances" that may be pleaded for the purposes of remission of penalties in income tax matters,* held that a corporate taxpayer should be treated in the same manner as an individual taxpayer and be afforded the same opportunities for demonstrating that reasonable care was in fact taken.

In New Zealand, Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 23), considers that the circumstances that may be taken into account to determine whether a business taxpayer has taken reasonable care includes the size and nature of the business, the internal controls in place, the business' record-keeping practices and any system failures. Due consideration should be given to the reason for the system failure. In addition, the guidance in place in New Zealand, Interpretation Statement IS0053 (Inland Revenue, 2005: 28), confirms that a taxpayer who takes reasonable care will utilise adequate systems appropriate for the size of the business and the number and complexity of the transactions.

The question arises as to what happens in a situation where a staff member made the mistake which gave rise to the shortfall identified. The New Zealand guidance confirms that entities are responsible for the acts of their employees, provided that the acts are within the acts authorised for that employee (New Zealand guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 21)). It follows that if an employee fails to meet the reasonable care standard, the employer is liable for the failure.

From the guidance issued in New Zealand by Inland Revenue Interpretation Statement IS0053 (Inland Revenue, 2005:22) the following list establishing when an employer is considered to have taken reasonable care as a result of the action or inaction of an employee emerges:

- The use of an employee that a reasonable person would know or suspect of being incapable of correctly filing the tax return can expose the taxpayer to a shortfall penalty for not taking reasonable care. This would apply regardless of whether the task is delegated by the taxpayer or by another employee of the taxpayer.
- The lack of care would also encompass situations where employees provide assistance or information to be used in taking a tax position, or perform other relevant functions concerned with taking a tax position. Taxpayers are equally liable for the actions of these employees, as they are for the actions of the staff member who actually prepares the tax return.
- The penalty can apply regardless of whether the employee completing the return took reasonable care, given their age, health and background. The penalty is applied to the taxpayer, not the employee.

It is submitted that the categories for persons other than natural persons to be built into the SARS Short Guide (SARS, 2013:80) should be:

- Micro business, share block schemes and bodies corporate. This will include entities with a gross income equal to or less than R1 million and total assets equal to or less than R5 million. An entity in this category will generally satisfy the reasonable care test by having basic book keeping practices in place.
- Small companies. This will include entities with a gross income equal to or less than R20 million and total assets equal to or less than R10 million. An entity in this category will generally satisfy the reasonable care test by implementing adequate record keeping systems appropriate for the size of the business and the number and complexity of the transactions to ensure it complies with tax obligations. In addition, having an appointed auditor or tax advisor, ensuring staff are well trained and displaying an investigative approach, where the degree of the investigation reflects the size of the risk and the risks identified are effectively managed, will reflect that the entity has acted with reasonable care.
- Medium to large businesses. This will include all entities with a gross income of R20 million or more and total assets of R10 million or more. In addition to the above, an entity in this category will generally satisfy the reasonable care test by implementing appropriate internal controls and monitoring these internal control activities.

3.2.1.4 Application of the reasonable care standard to various types of taxpayers and situations

3.2.1.4.1 Using a tax agent

A professional person with specialist tax knowledge will be subject to a higher standard of care that reflects the level of knowledge and experience of a reasonable person in their circumstances (New Zealand guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 19)). In contrast, it is confirmed that the objective standard of reasonableness that applies is commensurately lower for an inexperienced person or new entrant into the tax system who has little tax knowledge of the guidance in place (New Zealand guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 10)).

It is proposed that the SARS Short Guide (SARS, 2013: 80) be updated to include the following: "It is important to note that professional persons with specialist tax knowledge will be subject to a higher standard of care that reflects the level of knowledge and experience a reasonable person in their circumstances will possess".

In New Zealand, in Interpretation Statement IS0053 (Inland Revenue, 2005: 27 - 28), Inland Revenue is of view that if taxpayers have relied on the advice of tax agents, they will usually be considered to have taken reasonable care. However, this is not a blanket rule and a penalty may still be chargeable in the following circumstances:

- inadequate information was provided when seeking advice;
- failure to give reasonable instructions to a tax agent;
- unreasonable reliance on a tax agent or on wrong advice (when the taxpayer had reason to believe that the advice was not correct); or
- similar tax shortfalls have occurred in the previous four years.

This agrees with the facts and circumstances to be taken into account when determining whether the use of a tax agent discharges the obligation to take reasonable care discussed by Goldswain (2001a: 151 - 152) in his article entitled: *Reliance on professional and non-professional advisors or staff as a defence to the imposition of penalties in income tax matters*, referred to in Chapter 2.

3.2.1.4.2 Relying on information provided by a third party

The on-line guidance issued by Inland Revenue in New Zealand on penalties and interest entitled: *Not taking reasonable care,* states that a taxpayer is unlikely to have breached the reasonable care standard if information has been relied upon that, although misleading, came from reputable sources, or a reasonable person in the same circumstances would be likely to find the relevant information extremely complex or specialised.

Based on the above guidance, it is proposed that the SARS Short Guide (SARS, 2013: 80) be updated to include the following: "If the shortfall identified is as a result of the taxpayer relying on information provided by a reputable third party, for example, from a financial institution, or a reasonable person in the same circumstances as the taxpayer would be likely to find the information relied upon extremely complex or specialised, the taxpayer is unlikely to have breached the reasonable care standard".

3.2.1.4.3 Arithmetical errors and repetition of errors

In New Zealand, Inland Revenue (2008) confirms in the on-line guidance issued on penalties and interest and shortfall penalties entitled: *Not taking reasonable care*, that in determining whether reasonable care has been taken regarding arithmetical errors, Inland Revenue considers the procedures which were in place to detect arithmetical errors, the size, nature and frequency of the errors and the circumstances in which the errors were made. However, generally, an arithmetical error does not necessarily indicate a lack of reasonable care.

The guidance in New Zealand confirms that the factors indicating that a taxpayer may not have taken reasonable care include repeated errors where the taxpayer has been advised or is otherwise aware that mistakes have previously been made (New Zealand guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 26)).

Based on the above analysis it is proposed that the SARS Short Guide (SARS, 2013:80) be updated to include the following: "With regard to arithmetical errors, the nature of the error and the circumstances under which it was made must be considered. Once this has been established, the following must be determined:

- whether there are any procedures in place to detect arithmetical errors;
- the magnitude of the error;
- the frequency of the error; and
- whether the error identified has previously been brought to the attention of the taxpayer."

3.2.1.4.4 Relying on a revenue official

The New Zealand guidance issued by Inland Revenue, Interpretation Statement IS0053 (Inland Revenue, 2005: 29) confirms that if a taxpayer seeks advice from Inland Revenue disclosing all relevant facts and follows that advice, this would be taking reasonable care, unless there was some reason for the taxpayer to question that advice on the basis of the taxpayer's own knowledge.

It is submitted that the same practice should be adopted in South Africa and that the SARS Short Guide (SARS, 2013:80) be updated in this regard. If taxpayers have reasonable proof that they have disclosed all relevant facts to the SARS official, followed the advice of a

SARS official and interpreted the advice correctly, the understatement identified should be treated as a "*bona fide* inadvertent error", depending on the personal circumstances of the taxpayer.

3.2.1.4.5 Complexity of the law

In New Zealand, Inland Revenue (2008) has issued on-line guidance on penalties and interest and shortfall penalties entitled: *Not taking reasonable care*, which confirms that a taxpayer is expected to have taken reasonable care in interpreting the law. If there is any uncertainty regarding the interpretation, a tax agent or Inland Revenue should be approached. For questions of interpretation of law, Inland Revenue has confirmed that reasonable care depends on the efforts made to resolve the question, the type of advice received and the certainty of the law.

The guidance in New Zealand issued by Inland Revenue, Interpretation Statement IS0055 (Inland Revenue, 2005: 2) specifically confirms that an unacceptable interpretation of law can give rise to an unacceptable tax position.

From the above discussion, it is proposed that the SARS Short Guide (SARS, 2013:80) be updated to include the following: "With regard to interpreting the law, firstly, the class of taxpayer should be considered and thereafter the certainty of the law. Once this has been established, it must be determined whether reasonable efforts have been made to obtain the correct advice and resolve the question. Due consideration should be given to whether a penalty for 'no reasonable grounds for tax position taken' is applicable."

3.2.2 Unacceptable tax position

Section 141B(1) of the New Zealand Tax Administration Act confirms that a taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct. This concept overlaps with the concept of "no reasonable grounds for tax position taken" in the Tax Administration Act, which the SARS Short Guide (SARS, 2013: 80) has explained as meaning that a taxpayer's interpretation of the application of the law is reasonably arguable if, having regard to the relevant authorities, for example income tax legislation, a court decision or a general ruling, it would be concluded that what is being argued by the taxpayer is at least as likely as not, correct.

The discussion of “no reasonable grounds for the tax position taken” attempts to provide clarity on the following:

- the nature of the test;
- the timing of the tax position taken;
- the meaning of relevant authorities;
- how to determine what is being argued by the taxpayer is at least as likely as not, correct; and
- whether an understatement penalty for “no reasonable grounds for the tax position taken” can be applied to mistakes.

3.2.2.1 Objective test

The SARS Short Guide (SARS, 2013: 80) does not confirm that the test for “no reasonable grounds for the tax position taken” is an objective test. This is not in line with the guidance in place in New Zealand. Section 141B of the New Zealand Tax Administration Act confirms that a taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct.

It is submitted that the SARS Short Guide (SARS, 2013: 80) should be extended to include the statement that: “The test for ‘no reasonable grounds for the tax position taken’ is an objective test.”

3.2.2.2 Timing of the tax position

Section 141B of the New Zealand Tax Administration Act confirms that the timing of determining whether the tax position taken is acceptable or not acceptable is at the time the taxpayer takes the tax position.

It is proposed that the SARS Short Guide (SARS, 2013: 80) explanation of “no reasonable grounds for the tax position taken” which currently reads as follows: “A taxpayer’s interpretation of the application of the law is reasonably arguable if, having regard to the relevant authorities”, be expanded to include the following: “at the time the tax position is taken.”

3.2.2.3 Errors of fact or mistake

In New Zealand, Inland Revenue (2008) specifically confirms in the on-line guidance issued on penalties and interest and shortfall penalties entitled: *Unacceptable tax position*, that a taxpayer does not take an unacceptable tax position merely by making a mistake in the calculation or recording of numbers in a return. The guidance in New Zealand issued by Inland Revenue, Interpretation Statement IS0055 (Inland Revenue, 2005: 37) confirms that an error of judgement that results in an unacceptable tax position is, effectively, a tax position taken by choice, albeit that it is an incorrect choice. An error of judgement is considered to be a deliberate choice. It follows therefore that taking a tax position does not refer to mistakes. It does however refer to an error of judgement.

It is submitted that the SARS Short Guide (SARS, 2013: 80) should be extended to include the statement that: "A penalty for 'no reasonable grounds for the tax position taken' cannot be imposed for a mistake in the calculation or recording of numbers in a return. Instead, it may be necessary to consider whether the entity has taken reasonable care. However, an error of judgement is considered to be a deliberate choice and a penalty for 'no reasonable grounds for the tax position taken' may be applicable."

3.2.2.4 Meaning of relevant authorities

It is submitted that the reference to having regard to the relevant authorities and providing the examples of income tax law, a court decision or a general ruling, in the SARS Short Guide (SARS, 2013: 80) is not sufficient. The New Zealand guidance does not make reference to the term "relevant authorities" referred to in the SARS Short Guide (SARS, 2013: 80). Subsection 284-75(2) of the Australian Taxation Administration Act, 1953 makes reference to treating a relevant tax law as applying to a matter (or identical matters) in a particular way that, when having regard to the relevant authorities, is not reasonably arguable. Additional guidance has been issued recognising exactly what is meant by relevant authorities, how to weigh the relevant authorities against each other and what to do in the situation where there is no relevant authority. This makes a discussion of legislation and guidance in place pertaining to "relevant authorities" in Australia useful.

The Australian guidance issued by the ATO, Miscellaneous Tax Ruling MT 2008/2 (ATO, 2015: 9 - 10) explains that a taxation law, any material not forming part of the Act which is capable of assisting in the ascertainment of the meaning of the provision such as explanatory memoranda and second reading speeches, a decision of a court, the Administrative Appeals Tribunal or a Taxation Board of Review and a public ruling are relevant authorities in determining whether an entity has a reasonably arguable position and that the relevant authorities will be weighed according to their:

- persuasiveness (an authority that has extensive reasoning, relating relevant law and facts, would be more persuasive than one that simply states a conclusion);
- relevance (an authority that has some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is inapplicable to the tax treatment at issue); and
- source (a High Court decision on all fours with the tax treatment in question will be accorded more weight than a Federal Court decision, which in turn would be accorded more weight than a decision of the Tax Court).

The Australian guidance issued by the ATO, Miscellaneous Tax Ruling MT 2008/2 (ATO, 2015: 10 - 11) confirms that the absence of authority for a particular position, other than the legislation itself, will not be detrimental to an entity seeking to establish a reasonably arguable position. What is required in such cases is that the entity has a well-reasoned construction of the applicable statutory provision which it could be concluded was about as likely as not the correct interpretation. In addition, an entity having an opinion expressed by an accountant, lawyer or other adviser is not in itself a relevant authority. The Commissioner will consider the authorities referred to in any opinion submitted by a taxpayer.

It is submitted that the above explanation of "relevant authorities" will assist in expanding the current explanation of "no reasonable grounds for the tax position taken" in the SARS Short Guide (SARS, 2013: 80).

3.2.2.5 Meaning of at least as likely as not, correct

Section 141B of the New Zealand Tax Administration Act makes reference to failing to meet the standard of being about as likely as not to be correct. This is in line with the guidance already in place in the SARS Short Guide (SARS, 2013: 80), which refers to concluding that what is being argued by the taxpayer is at least as likely as not, correct. However, it is submitted that the SARS Short Guide (SARS, 2013: 80) does not provide enough detail on understanding what is meant by the statement "at least as likely as not, correct".

In New Zealand, the words "as likely as not" were considered to indicate an even balance of 50/50 in *Case U47* (2000) 19 NZTC 9,410, where the judge held that there would need to be an about equal chance of an interpretation being as likely to be correct as it is incorrect. The judge concluded that where one of two interpretations does not have about a 50 percent chance of being correct, in the view of the Court the taxpayer will have failed to meet the required standard. The judge continued that the word "about" makes the test less stringent and provides some latitude in applying the test.

It is proposed that the SARS Short Guide (SARS, 2013: 80) explanation of "no reasonable grounds for the tax position taken" be updated to include the following: "At least as likely as not, correct in the context of 'no reasonable grounds for the tax position taken' is interpreted to mean about a 50 percent chance of being correct in the view of the Court."

3.2.2.6 Use of a tax advisor

The New Zealand guidance issued by Inland Revenue, Interpretation Statement IS0055 (Inland Revenue, 2005: 27) confirms that if a taxpayer has followed the advice of a tax adviser in preparing a tax return, or the tax advisor has prepared the tax return, the taxpayer will be taken to have adopted the interpretation of the advisor. The involvement of an agent or advisor does not derogate from the taxpayer's overall responsibility for the tax position taken. The taxpayer is deemed to have taken the tax position.

The SARS Short Guide (SARS, 2013: 80) specifically states under the explanation of "reasonable care not taken in completing the return" that if the taxpayer uses an adviser to complete a return and the practitioner does not exercise reasonable care, the taxpayer is liable to pay an understatement penalty. It is questioned why this was not specifically stated under the explanation of "no reasonable grounds for the tax position taken" as well.

3.2.3 Gross carelessness

Section 141C(3) of the New Zealand Tax Administration Act defines "gross carelessness" as follows: "for the purposes of this Part, gross carelessness means doing or not doing something in a way that, in all circumstances, suggests or implies complete or a high level disregard for the consequences". Inland Revenue (2006) has issued on-line guidance on penalties and interest and shortfall penalties entitled: *Gross carelessness*, confirms that whether the taxpayer was unaware of being grossly careless or intended to be so is not relevant. The guidance issued in New Zealand by Inland Revenue, Interpretation Statement IS0060 (Inland Revenue, 2006: 9) confirms that gross carelessness is conduct which creates a high risk of a tax shortfall occurring where the requisite risk is foreseeable by a reasonable person in the circumstances. This concept is similar to the concept of "gross negligence" in the understatement penalty table, which the SARS Short Guide (SARS, 2013: 80) has explained as doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences.

The SARS Short Guide (SARS, 2013: 80) confirms that gross negligence involves recklessness but does not provide clarity on what conduct would constitute recklessness. The SARS Short guide (SARS, 2013: 80) also explains the difference between a finding of "gross negligence" and "intentional tax evasion", but does not explain the difference between a finding of "reasonable care not taken" and "gross negligence".

The discussion of "gross negligence" attempts to provide clarity on the following:

- what is meant by recklessness as referred to in the SARS Short Guide (SARS, 2013: 80); and
- the extent to which or by what degree the conduct should fall below that required of a reasonable person to trigger a finding of "gross negligence".

3.2.3.1 Recklessness for the purposes of "gross negligence" and the difference between "gross negligence" and "reasonable care not taken"

In order to fully understand recklessness and to what extent or by what degree the conduct of the entity should fall below that required by a reasonable person to warrant a finding of "gross negligence", guidance is found from the case law in New Zealand, which in turn can be used to construct an example to be included in the SARS Short Guide (SARS, 2013:80).

It is submitted that there is a fine dividing line between "gross negligence" and "reasonable care not taken" and that the test for "gross negligence" is essentially the same as that of "reasonable care not taken". However, it would need to be determined what constitutes a "high" risk, or a "high" level of disregard for the consequences, as opposed to a risk resulting from a lack of reasonable care as confirmed in the guidance issued in New Zealand by Inland Revenue, Interpretation Statement IS0060 (Inland Revenue, 2006: 9).

Interpretation Statement IS0062 (Inland Revenue, 2006: 17 - 18) confirms that the concept of objective recklessness is relevant to determining gross carelessness. That is, the taxpayer is genuinely unaware that the conduct has created a high risk of a tax shortfall, but the risk and its consequences would have been foreseen by a reasonable person in the circumstances, then this will give rise to a shortfall penalty for gross negligence. In *Case W4*, Barber DJ considered case law on the concept of "recklessness". Citing *R v Caldwell* [1982] AC 341; [1981] 1 All ER 961, Barber DJ held that, a person who fails to give any thought to the consequences of his or her behaviour or to an obvious or serious risk, or recognises the existence of the risk and nevertheless decides to ignore it, has acted recklessly.

The Inland Revenue official imposed a penalty in *Case W4* due to the following:

- the taxpayer did not have an adequate system in place to ensure that the output tax was returned;
- input tax was correctly claimed and the taxpayer should then have been aware of the need to return the output tax when the item was sold;
- the taxpayer had a long experience in GST (Goods and Services Tax) matters; and
- there was previous assistance and warnings by Inland Revenue.

The guidance issued in New Zealand by Inland Revenue, Interpretation Statement IS0060 (Inland Revenue, 2006: 10 - 11) confirms that from the above analysis of the facts in *Case W4*, but bearing in mind the principle that whether or not gross carelessness is present is dependent upon the circumstances in each case, it is relevant to consider the following characteristics in determining whether a reasonable person would have foreseen that his or her conduct created a high risk of a tax shortfall occurring, i.e. whether the taxpayer had been grossly careless:

- a large tax shortfall (whether resulting from a single transaction or from a number of similar transactions);
- a significant transaction, or transactions of a similar nature when viewed together, when compared to the taxpayer's business or taxable activity;
- indifference to an obvious risk of a possible tax shortfall occurring;
- a relatively short period of time between the purchase and sale of an item, where the purchase triggered a tax effect that the taxpayer recognised;

- the taxpayer being experienced in the relevant tax laws; and
- a failure by the taxpayer to heed previous warnings or to take on board suggestions of tax advisors (whether by the Inland Revenue Department or other professional people) which were aimed at reducing the likelihood of errors occurring.

The guidance issued in New Zealand by Inland Revenue, Interpretation Statement IS0060 (Inland Revenue, 2006: 11) states that where few or none of the above characteristics are present, the less likely it will be that the taxpayer has been grossly careless. However, the taxpayer may nevertheless not have taken reasonable care.

It is submitted that under the South African legislation, a failure by the taxpayer to heed previous warnings from SARS could also result in the taxpayer incurring an increased penalty for a "repeat case".

It is proposed that the following example be included in the SARS Short Guide (SARS, 2013:80) to assist in determining whether an understatement penalty should be imposed for "gross negligence":

> *The taxpayer owned a company which was involved in land development and speculative building transactions. The taxpayer did not make use of a book keeper or accountant and completed and submitted the company's VAT201 returns to SARS himself, as he believed that the SARS e-filing system had simplified the process enough for him to be able to correctly submit the VAT returns without assistance. He had been submitting the company's VAT201 returns for a number of years with no major findings by SARS. In the past two years, the company had grown substantially. The taxpayer continued to keep manual records and was of the opinion that purchasing an accounting programme was a waste of money. The VAT201 return was selected for verification by SARS and it was found that the taxpayer had entered into an agreement to sell a property which had been purchased approximately 3 months previously and did not declare output tax on the sale of the property. The taxpayer claimed that he was not aware that the output tax needed to be declared*

on the sale. The SARS official determined that on the purchase of the property, the taxpayer had correctly claimed the input VAT.

This example illustrates "gross negligence" as opposed to "reasonable care not taken". The taxpayer's refusal to purchase an accounting programme, even though his business had grown substantially, reflects an indifference to an obvious risk of a possible tax shortfall occurring. There was a relatively short period of time between the purchase and sale of the property and the taxpayer recognised the tax effect of the purchase correctly. The taxpayer has been submitting VAT returns for a number of years and should therefore have experience in the relevant tax laws.

From the guidance issued and case law in New Zealand, it is also proposed that the following be included in the SARS Short Guide (SARS, 2013: 80) to assist in determining whether an understatement penalty should be imposed for "reasonable care not taken": If at any stage it is clear that a *high degree* of negligence is displayed, the conduct falls *significantly* short of the standard of care expected of a reasonable person in the same position or circumstances of the entity, there is a real risk which the taxpayer showed indifference to by not taking steps to reduce the risk, or the tax shortfall is large or significant when compared to the taxpayer's business or taxable activity, consider "gross negligence".

3.2.4 Abusive tax position and evasion

A taxpayer is liable to pay a shortfall penalty if the taxpayer takes an abusive tax position. This is confirmed in section 141D(2) of the New Zealand Tax Administration Act. Section 141D(7)(b) goes on to state that, for the purposes of this Part and section 177C, an abusive tax position means a tax position that, viewed objectively, the taxpayer takes in respect or as a consequence of an arrangement that is entered into with the dominant purpose of avoiding tax, whether directly or indirectly, or with a dominant purpose of avoiding tax (where the tax position does not relate to an arrangement), whether indirectly or directly.

Section 141E of the New Zealand Tax Administration Act imposes a shortfall penalty for "evasion or a similar act". The remaining paragraphs of section 141E(1) set out various acts or omissions which constitute a "similar act" to evasion. It is submitted that the SARS Short Guide (SARS, 2013: 81) should be updated to include the phrase "or similar act" and that a list of possible breaches is established. The New Zealand Inland Revenue has issued

Interpretation Statement IS0062 (Inland Revenue, 2006: 1) which confirms that the remaining paragraphs of section 141E(1) all require that the act or omission occurs “knowingly” and that evasion occurs when a taxpayer deliberately breaches a tax obligation.

It is submitted that there is no equivalent in South Africa for an “abusive tax position” as is included in the New Zealand penalty provisions. However, the concepts discussed in the guidance issued by Inland Revenue, Interpretation Statement IS0061 (Inland Revenue, 2005), may be of assistance in understanding and determining the steps to follow in determining whether “intentional tax evasion” is applicable in South Africa. The concept of evasion in New Zealand is similar to “intentional tax evasion” in the understatement penalty table, which the SARS Short Guide (SARS, 2013: 81) has explained as meaning a wilful act that exists when a person’s conduct is meant to disobey or wholly disregard a known legal obligation, and knowledge of illegality is crucial.

It is submitted that the SARS Short Guide (SARS, 2013: 80) has made the difference between “gross negligence” and “intentional tax evasion” clear by confirming that gross negligence involves recklessness but, unlike evasion, does not require an element of *mens rea*, meaning wrongful intent or “guilty mind”, or intent to breach a tax obligation. Interpretation Statement IS0062 issued by Inland Revenue in New Zealand (Inland Revenue, 2006: 11) confirms that the intention or *mens rea* element of evasion will be satisfied if the taxpayer knew that the act or omission was in breach of a tax obligation.

The discussion of “intentional tax evasion” attempts to provide clarity on the following:

- whether recklessness is sufficient for a finding of “intentional tax evasion”
- how to prove the existence of “*mens rea*”, “known legal obligation”, “acted with intent to evade tax” and “knowledge of illegality”;
- establish what actions and circumstances of the taxpayer should be taken into account when a SARS official is in the process of determining whether a penalty for “intentional tax evasion” is applicable; and
- propose possible breaches which could be seen as a “similar act” to evasion.

3.2.4.1 Recklessness sufficient for "intentional tax evasion" and testing for recklessness

It could be argued that the taxpayer is merely acting recklessly and not with "intentional tax evasion". Interpretation Statement IS0062 (Inland Revenue, 2006: 17 - 18) confirms that the concept of subjective recklessness, that is, where the taxpayer knew or strongly suspects that the conduct will result in a breach of a tax obligation and proceeds regardless, is sufficient *mens rea* for evasion.

The New Zealand Interpretation Statement IS0062 issued by Inland Revenue (Inland Revenue, 2006: 14 - 15) confirms that the weight of authority indicates that recklessness is to be tested subjectively for the purposes of the evasion penalty. In the case of *S v Sigwahla* 1967 (4) SA 566 (A), the judge held that subjective foresight, like any other factual issue, may be proved by inference. Wikipedia (2015: 55) confirms that the inference must be the only one that can be drawn from the proved facts. In the case of *R v Horn* 1958 (3) SA 457 (A), the Appellate Division decided that the realisation of the possibility of the consequences is sufficient for criminal intention.

In the case of *S v Beukes* 1988 (1) SA 511 (A), the judge confirmed that normally recklessness would only be satisfied where the accused foresaw a consequence as a reasonable possibility and as an accused would seldom admit this element, the court had to draw an inference regarding an accused's state of mind from facts indicating, objectively assessed, that a reasonable possibility would ensue. From the mere fact that he acted, it could be inferred that he had reconciled himself to the result.

It is proposed that the SARS Short Guide (SARS, 2013: 80) explanation of "intentional tax evasion" be expanded to include the following: "Subjective recklessness is sufficient *mens rea* for evasion. Recklessness is satisfied where the taxpayer strongly suspects that the actions will result in a breach of a tax obligation and proceeds regardless."

3.2.4.2 Inference and balance of probabilities

Case W4, a New Zealand case, confirms that the following must be present for a finding of intentional tax evasion:

- there must be actual knowledge that the tax position taken is false;

- there must be an understanding of the effect of the relevant legislation and how it operates;
- a deliberate choice must then be made to ignore the relevant legislation;
- dishonesty is a necessary feature; and
- the taxpayer must have endeavoured or intended to avoid the payment of tax and have known that the act or omission was in breach of a tax obligation.

Interpretation Statement IS0062 issued by New Zealand Inland Revenue (Inland Revenue, 2006: 20) states that the concept of "knowingly" is discussed in *Case W3* (2003) 21 NZTC 11,014 and is a subjective test which requires knowledge of the doing of the act (or of the omission) that amounts to a breach.

It follows therefore that where taxpayers are aware of the tax obligation and have deliberately or knowingly planned their actions to achieve a dishonest result, an understatement penalty for "intentional tax evasion" may be applicable.

In New Zealand, Interpretation Statement IS0062 issued by Inland Revenue (Inland Revenue, 2006: 18) confirms the standard for proving evasion is that of the balance of probabilities. This means that the Commissioner must prove that it is more likely than not that the taxpayer had the requisite "*mens rea*" for evasion. The guide is useful in that it confirms that, although the test for evasion is a subjective test, it can be tested objectively through an analysis of the surrounding circumstances and conduct of the taxpayer. This is also supported in case law. In *Case H90* (1986) 8 NZTC 619 at 624, the judge confirmed that intent can be inferred by reference to such factors as the taxpayer's background and business experience. Evasion includes an element of intent and actual knowledge can be established by direct evidence or by inference.

Intentional disregard of the law can therefore be found through direct evidence and can also be inferred from the facts and surrounding circumstances, including the conduct of the entity and its tax agent. It is submitted that the SARS Short Guide (SARS, 2013: 81) should be updated to include the following: "If there is no direct evidence of the taxpayer's intention, intention may be inferred from the surrounding circumstances (the taxpayer must be presumed to intend the natural consequences of his own act) and can also be determined based on a balance of probabilities. Background, business experience and conduct are to be taken into account when considering evidence inferred from the surrounding circumstances. The natural consequence of the act must also be determined and documented."

New Zealand Inland Revenue has issued Interpretation Statement IS0062 (Inland Revenue, 2006: 9 - 10), which confirms a number of criteria to be taken into account in determining whether to impose a shortfall penalty for evasion that may assist a SARS official in determining whether a penalty for "intentional tax evasion" is applicable, namely:

- whether the taxpayer has been previously prosecuted and/or been subject to shortfall penalties for evasion;
- the reason given by the taxpayer for his/her behaviour;
- the degree of the culpability of the taxpayer;
- the likelihood of future compliance;
- the degree of cooperation received from the taxpayer;
- the effect on promoting voluntary compliance; and
- the duty to protect the integrity of the tax system.

It is submitted that the above should be compulsory background information built into the SARS Short Guide which the SARS official should establish, before following the guidelines to determine whether a penalty for "intentional tax evasion" is applicable.

3.2.4.3 Dominant purpose

The guidance issued in New Zealand by Inland Revenue, Interpretation Statement IS0061 (Inland Revenue, 2005) is useful in that it provides guidance on how to determine the taxpayer's dominant purpose. It is submitted that the actual intention of the taxpayer is a critical element and if it can be proved that the taxpayer's dominant purpose was to evade taxes, a SARS official would not need to prove "intentional tax evasion" based on the balance of probabilities and an analysis of the surrounding circumstances and conduct of the taxpayer.

Interpretation Statement IS0061 (Inland Revenue, 2005: 8) confirms that according to the dictionary meaning of the words, and Richardson J's judgment in the Court of Appeal case *CIR v National Distributors Ltd* [1989] 3 NZLR 661, it is considered that the "dominant purpose" is the most important or influential reason of the taxpayer at the relevant time.

Interpretation Statement IS0061 issued in New Zealand by Inland Revenue (Inland Revenue, 2005:10 - 11) confirms that the factors which may indicate a dominant purpose of avoiding tax are as follows:

- Artificiality and contrivance suggest questioning whether the transactions have been designed to appear to comply with the legislation. Consideration should be given to the commercial reality of the arrangement. The importance of the commercial purpose of the transaction as compared to the tax benefit that the relevant taxpayer obtained must be examined.
- Circularity of funding, which refers to funding going around in a circle, usually through a tax haven, resulting in income being tax exempt and the related expenditure tax deductible, may be considered as an indicator of a tax avoiding arrangement.
- Concealment of information and non-availability of evidence may occur through the use of a tax haven. By going through a tax haven, disclosure protection may result due to the particular tax haven's secrecy laws. These laws usually do not allow information to be released to tax authorities, thereby providing an obstacle to the gathering of information to establish whether the transaction or arrangement is artificial or contrived.
- Spurious interpretation of tax laws covers situations where a tax position taken has no or very little basis at law or the interpretation made or position taken is frivolous.

It is submitted that the SARS Short Guide (SARS, 2013: 81) should be updated to include the following: "The taxpayer's dominant purpose (the most important or influential reason for the taxpayer at the time of taking the tax position which gave rise to the shortfall identified) must be determined. In determining the taxpayer's dominant purpose, due consideration should be given to the commercial purpose of the transaction, whether transactions have been designed to appear to comply with legislation, whether a tax avoiding arrangement has been entered into, information has been concealed or is not available and whether the tax position taken is frivolous or has no or very little basis at law."

3.2.4.4 Similar act

The remaining paragraphs of section 141E(1) of the New Zealand Tax Administration Act set out various acts or omissions which constitute a "similar act" to evasion. It is submitted that the acts or omissions described in section 141E(1) are not specific and will be time consuming for a SARS official to prove based on inference or the balance of probabilities.

HM Revenue and Customs (HMRC) has constructed specific examples of the acts or omissions that may result in a penalty being imposed for deliberate inaccuracies in the United Kingdom. It is submitted that the development of specific possible breaches which could be seen as a "similar act" to evasion to be built into the SARS Short Guide (SARS, 2013) will prevent taxpayers and SARS from arguing about the categories of understatement into which a particular offence falls. The taxpayers will be aware of the consequences of their actions beforehand. This makes a discussion of the specific examples taken from the on-line guidance issued by HMRC (undated), CH 81150, entitled: *Deliberate and not concealed inaccuracy* and CH81160: *Deliberate and concealed inaccuracy* relevant. It is submitted that the SARS Short Guide (SARS, 2013: 81) should be updated with the following actions that could lead to an understatement penalty being imposed for "intentional tax evasion":

- systematically paying wages without accounting for employees' tax;
- knowingly failing to record all sales, especially where there is a pattern to the under-recording, such as omitting all transactions with a particular customer or at a particular time of the week, month or year;
- deliberately describing transactions inaccurately or in a way likely to mislead;
- submitting a VAT return to SARS that includes an amount of net VAT due that is too low because the person does not have the cash at that time to pay the full amount, and later informing SARS of the true figure when the funds to pay are available;
- claiming a deduction for personal expenses of such a size or frequency that the inaccuracy must have been known;
- deliberately not making any attempt to ensure that money withdrawn for personal use from an incorporated business is treated correctly for tax purposes;
- deliberately omitting a known asset, rather than making enquiries about its value, on the basis that the asset can be included in a corrective account later;
- creating false invoices to support inaccurate figures in the return;
- backdating or postdating contracts or invoices;
- creating false minutes of meetings or minutes of fictitious meetings;
- destroying books and records so that they are not available;
- systematically diverting takings into undisclosed bank accounts and covering the traces;

- invoice routing, for example the purported sale or purchase of goods through a tax haven company (with no activity undertaken by that company even though contracts exist showing the contrary) and leaving profits untaxed in that company;
- creating sales records that deliberately understate the value of the goods sold;
- describing expenditure in the business records in such a way as to make it appear to be business related when it is in fact private; and
- altering genuine purchase invoices to inflate their value.

It is suggested that additional examples can be developed over time as more recurring situations or scenarios of "intentional tax evasion" arise.

3.2.5 Obstructive behaviour

Inland Revenue (2008) has issued on-line guidance on penalties and interest entitled: *How penalties can be reduced or increased,* which confirms that that obstructive behaviour may result in the shortfall penalty being increased by 25 percent. This is similar to the concept of "obstructive" in the understatement penalty table in South Africa, as the understatement penalty imposed can be increased by an additional 10 – 50 percent, depending on the behaviour identified.

The discussion of obstructive in the present chapter attempts to provide clarity on the following:

- the meaning of obstructive;
- what can be seen as obstructive behaviour; and
- the standard of proof required.

3.2.5.1 Meaning of obstructive

There is no definition of "obstructive" in the Tax Administration Act. It therefore follows that the ordinary meaning must apply. The free dictionary by Farlex (2015) defines "obstructive" as meaning: to impede, retard, or interfere with. The Oxford Dictionary (2015) confirms that "obstructive" means: to hinder, causing or tending to cause deliberate difficulties and delays.

From the dictionary definitions of "obstructive" (Farlex, 2015 & Oxford Dictionary, 2015), it follows that a taxpayer deliberately interfering with, causing difficulties (impeding) or delays in or preventing the progress of a SARS review or audit could be regarded as being "obstructive".

In addition to there being no definition of "obstructive" in the Tax Administration Act, there is also not yet any case law relating to the definition of "obstructive" in South Africa. However, there is case law in New Zealand which may be of assistance in understanding the ordinary meaning of "obstructive".

The following guidance can be obtained from the case law in New Zealand:

- In the case of *Ulrich v Police* (1989) 4 CRNZ 144, it was confirmed that: "the ordinary meaning of 'obstruct' is to impede or to make more difficult..." Accordingly, obstruction occurs when the action or actions make it more difficult for the Commissioner or officer to carry out their lawful duties. Obstruction does not require physical action. The court also found that "there is no reason why words alone, provided they are uttered in circumstances under which they can be believed, cannot amount to obstruction."
- The case of *Goldsmith v Police* (1993) 10 CRNZ 106 confirmed that: "The conduct must be obstructive and without justification or lawful excuse."

In New Zealand, Tax Information Bulletin Volume 8, No. 7 issued by Inland Revenue (Inland Revenue, 1996: 24) confirms that: "deliberate repeated failure or deferral by the taxpayer to supply information and respond adequately to reasonable requests for information without an acceptable reason, including giving information that is false, misleading or not relevant, refusing reasonable access to business premises, destroying relevant records and lying at an interview, can be viewed as steps taken to prevent or obstruct the investigation. Obstruction is not a single action of a passive nature, exercising legal rights, contesting an assessment or a difference of opinion."

The above cases and guidance make it clear that the following factors should be present before a penalty can be imposed for obstruction:

- the conduct must be obstructive;

- it must be without justification or lawful excuse; and
- the steps taken to hinder the investigation must be active as opposed to passive.

It is proposed that the SARS Short Guide should be updated to include a definition of obstructive in the context of Chapter 16 of the Tax Administration Act as follows: "Deliberately interfering with, causing difficulties (impeding) or delays in or preventing the progress of a SARS audit or review."

Three inconsistencies were noted between the South African guidance relating to "obstructive" and the guidance and case law in New Zealand:

- Firstly, in the the New Zealand case of *Police v Hardaker* [1959], the court held that once a *prima facie* case of obstruction is made out against a defendant, the onus lies on the defendant to satisfy the court that their conduct was with lawful justification or excuse. It is submitted that this may be an omission from the Tax Administration Act. Section 102(2) of the Tax Administration Act places the onus on the SARS official to prove the facts upon which the imposition of the understatement penalty is based.
- Secondly, the New Zealand Inland Revenue issued Tax Information Bulletin Volume 8, No. 7 (Inland Revenue, 1996: 24), which confirms that the standard of proof for obstruction for shortfall penalties is on the "balance of probabilities". The SARS Short Guide (SARS, 2013) is silent on the standard of proof required in South Africa.
- Lastly, the guidance in issue in New Zealand (Tax Information Bulletin Volume 8, No. 7 issued by Inland Revenue (Inland Revenue, 1996: 25)) confirms that a penalty for obstruction cannot be applied to agents and third parties. It must be the taxpayer who obstructs the Commissioner in order for the penalty to apply. The South African penalty legislation does not specify that the Commissioner for SARS must be dealing with the taxpayer in order for an increased penalty for obstruction to apply.

It is submitted that the increase in the penalty rate in South Africa from a "standard case" to that of an obstructive or "repeat case" is high when compared to that of New Zealand (25 percent). It is proposed that the penalty rate should be increased by 20 percent for obstruction and that the increase in penalty rate based on the behaviour identified be removed. The reason for this is that the level of obstruction does not increase, depending on whether the behaviour was identified as "reasonable care not taken" or "gross negligence".

Obstruction cannot escalate from being more than what it is. In addition, it is proposed that the SARS Short Guide should specifically confirm that an increased penalty for obstruction can only be imposed if it is the taxpayer who obstructs the SARS official.

3.3 Conclusion

The terms used in the penalty systems in South Africa and New Zealand can be compared as follows:

Table 3.2: Comparison of the terms used in South Africa and New Zealand (own construct)

South Africa	New Zealand
Understatement	Taxpayer's tax position
Repeat case	None
Tax	Tax
Tax position	Tax position
Shortfall	Tax shortfall
Understatement penalty	Shortfall penalty
Behaviour	Seriousness of breach
Substantial understatement	None
Reasonable care not taken in completing return	Lack of reasonable care
No reasonable grounds for tax position taken	Unacceptable tax position
Gross negligence	Gross carelessness
Intentional tax evasion	Evasion
Obstructive	Obstructing the investigator
Bona fide inadvertent error	Genuine error, clear mistake and simple oversight

A better understanding of the meaning new behaviours and terms introduced in the understatement penalty table in section 223 of the Tax Administration Act, namely, "substantial understatement", "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence", "intentional tax evasion", "obstructive" and "*bona fide* inadvertent error" can therefore be established.

It is clear that both countries' penalty provisions are consistent in that the reasonable care standard does not mean perfection, that the reasonable care standard refers to a reasonable and genuine attempt to comply with obligations imposed under a tax law and that the entity's circumstances should be taken into account. Through an analysis of the case law relating to the concept of "reasonable care" in New Zealand, it was recommended that the SARS Short Guide (SARS, 2013: 80) explanation of "reasonable care" be expanded, which will assist the users of the SARS Short Guide to better understand and implement the concept of "reasonable care not taken in completing return".

It was determined that the "reasonable care" test is an objective test, which takes subjective factors into account. It was shown that the test for "reasonable care" corresponds with the test to determine whether there has been a breach of the standard of care expected of a reasonable person under the law of negligence or negligence in tort referred to in common law and that the following four particulars should be taken into account when determining whether reasonable care was shown:

- it must be determined whether a reasonable person in the same circumstances and with a similar background as that of the taxpayer would have acted differently under the same circumstances, taking the taxpayer's personal circumstances such as knowledge, education, experience and skill into account;
- due consideration should be given to the fact that reasonable care does not mean the highest possible level of care or perfection;
- it must be determined whether a reasonable person in the same circumstances and with a similar background as that of the taxpayer, taking the taxpayer's personal circumstances into account, would have foreseen the likelihood of a shortfall or the risk that the tax position taken is incorrect; and
- it must be determined whether a reasonable person in the same circumstances and with a similar background as that of the taxpayer, again taking the taxpayer's personal circumstances into account, would have taken precautionary measures in preventing the shortfall.

It was demonstrated that the "reasonable care" standard cannot be applied as a blanket rule across all types and classes of taxpayers. Every case should be evaluated on its own merits taking all possible personal circumstances and background information into account and that companies should be treated in the same manner as an individual taxpayer and be afforded the same opportunities for demonstrating that reasonable care was taken.

It was shown that using an accountant or tax practitioner, relying on third party data or a SARS official, arithmetical errors and repetition of errors does not in itself mean that, in the case of both individuals and other entities, the taxpayer has discharged the obligation to take reasonable care. It must still be demonstrated that the taxpayer could not have known or be reasonably expected to know that the information submitted to SARS or the tax position taken is incorrect.

Despite there being no concept in New Zealand's penalty legislation which directly coincides with the concept *"bona fide* inadvertent error" in South Africa, as discussed above, New Zealand has guidance which is relevant and of assistance in understanding the term "*bona fide* inadvertent error" in the Tax Administration Act. A definition for the meaning of "*bona fide* inadvertent error" and the principles to be put in place in determining whether the understatement identified should be treated as a "*bona fide* inadvertent error" was proposed using the principles applied in New Zealand for determining whether the taxpayer is genuinely attempting to comply with their tax obligations and whether the understatement identified is a genuine error, or a clear mistake, or simple oversight.

A penalty for taking a tax position which is not reasonable can only be applied if, having regard to the relevant authorities, what is being argued by the taxpayer is at least as likely as not, correct. The terms would appear to bear the same meaning in South Africa and New Zealand. The tax position must have been assumed unreasonably for the penalty to be applied. In the discussion of "no reasonable grounds for the tax position taken" it was determined that the nature of the test is an objective test, which takes into account the relevant legislation and facts at the time the tax position was taken by the taxpayer. It was concluded that a mistake cannot attract a penalty for "no reasonable grounds for the tax position taken". The meaning of "relevant authorities" referred to in the SARS Short Guide (SARS, 2013: 80), that would support the taxpayer's decision, was expanded to make it clear what is meant by the term, how to weigh the relevant authorities against each other and what to do in a situation where there are no relevant authorities. In addition, the meaning of "at least as likely as not, correct" referred to in the SARS Short Guide (SARS, 2013: 80) was interpreted as meaning about a fifty percent chance of being correct in view of the Court.

South Africa and New Zealand's guidelines refer to a complete or high level of disregard of the risk, when referring to a grossly negligent taxpayer. Whether the taxpayer was aware of being grossly careless or intended to be so is not relevant. It follows that the test for gross negligence appears to be an objective test in both countries, where the intention of the taxpayer does not appear to be relevant. It was shown that "gross negligence" refers to a complete or high level of disregard of the risk and that the actions result in a high risk of a shortfall occurring, which is to be tested for objectively. It was determined that the test for "gross negligence" is essentially the same as that for "reasonable care not taken in completing a return", however it is the extent or degree to which the taxpayer's conduct falls below that of a reasonable person in the same circumstances and with the same background as that of the taxpayer that determines a finding of "gross negligence", rather than that of "reasonable care not taken in completing return". In order to fully understand to what extent or by what degree the conduct of the taxpayer should fall below that required by a reasonable person to warrant a finding of "gross negligence", an analysis of the relevant case law in New Zealand was undertaken. The analysis of case law in New Zealand was also used to construct an example to be used to expand the SARS Short Guide. In addition, the concept of recklessness was discussed, as well as what conduct of the taxpayer would constitute recklessness. It was concluded that recklessness can constitute "gross negligence".

There must be knowledge of the illegality of the tax position taken and an understanding of the relevant legislation and how it operates, for a finding of "intentional tax evasion" to apply in South Africa and New Zealand. In order to fully understand "intentional tax evasion" and how to determine whether an element of intention is present, an analysis of the case law in New Zealand was presented. It was demonstrated that in order to prove that the taxpayer acted with "intentional tax evasion", the SARS official must have sufficient direct evidence or evidence inferred from the surrounding circumstances which supports the finding that the taxpayer had knowledge of the illegality of the tax position taken, the taxpayer had an understanding of the legislation and how it operates, the taxpayer's dominant purpose or intention was to evade tax and if there is no direct evidence supporting the above conclusions, the finding can be inferred from the surrounding circumstances and can also be determined based on a balance of probabilities. It was concluded that recklessness is also sufficient for a finding of "intentional tax evasion". In addition, possible breaches which could be seen as a "similar act" to evasion were developed.

South Africa and New Zealand's penalty systems provide for an increased penalty percentage for obstructing or not co-operating with the investigation or investigator. It was determined that, as there is no definition of "obstructive" in the Tax Administration Act, the ordinary meaning must apply. Through an analysis of the guidance and case law in New Zealand, clarity was provided on what can specifically be seen as obstructive behaviour when determining whether the taxpayer was "obstructive" in their engagement with the SARS official. The following could be seen as "obstructive" behaviour: repeated and deliberate failure to provide information requested timeously, verbal or documented false trails of information, misleading relevant material, destruction of records or refusing reasonable access to the business premises.

The taxpayer's right to object, appeal or dispute the penalties imposed, not remitted or not reduced by the revenue offices is consistent in both countries. As a general rule, the taxpayers in both countries have the right to object, appeal or dispute the penalty.

The differences between the penalty system in operation in New Zealand may be potential omissions from the Tax Administration Act. These possible omissions or differences are as follows:

- New Zealand has specific penalty rules that specify the person liable for penalties identified in companies, trusts and partnerships. By contrast, South Africa does not have specific penalty rules for companies, trusts and partnerships.
- If there is tax evasion, two penalties could potentially be imposed in New Zealand, firstly on the person for whom the refund or payment was sought and secondly on the enabling taxpayer. The New Zealand legislation provides for the penalty for intentional tax evasion to be apportioned between the taxpayer and the officers involved. The South African penalty legislation does not make provision for the transferring of penalties onto the person responsible for the shortfall or for the remission of the understatement penalty, if the shortfall is not as a direct result of the taxpayer's actions.
- There is no consistency with regard to the remission of penalties. The Commissioner in New Zealand is authorised to reduce all penalties for disclosure as well as reduce all penalties by up to 50 percent, subject to certain conditions. In South Africa, the

Commissioner can only remit the penalty imposed for substantial understatement. However, a lower penalty percentage is built into the understatement penalty table for voluntary disclosure before and after the audit.

- New Zealand has a threshold in place for the equivalent behaviour of "no reasonable grounds for the tax position taken" in South Africa. There is no such threshold in South Africa.
- The South African penalty legislation does not make provision for the reduction of penalties for temporary shortfalls as specified in the New Zealand legislation.
- The South African penalty legislation for failing to report a "reportable arrangement" does not provide for a minimum number of persons to whom the arrangement must be offered, sold, issued or promoted for the reportable arrangement penalty to apply. In addition, section 212 of the Tax Administration Act provides for a fixed monthly penalty as opposed to New Zealand where the penalty is the greater of nil and the sum of the tax shortfalls.

New Zealand has three penalty provisions worth mentioning which are not provided for in the South African penalty legislation:

- Firstly, the shortfall penalty payable by the taxpayer may be reduced if the taxpayer makes adequate disclosure of the "tax position" at the time that the tax position is taken.
- Secondly, there is a cap of $50 000 on the penalty amount for an unacceptable tax position.
- Lastly, a taxpayer in New Zealand may elect to use a net loss to pay a shortfall penalty assessed in respect of an income tax liability.

It has been demonstrated that the penalty system in operation in New Zealand is substantially similar to the penalty system in operation in South Africa. A comparison of the countries was therefore useful. A discussion of the relevant case law, tax rulings and guidelines relating to the specific behaviours listed on the penalty table or system in New Zealand was of assistance and can be incorporated into the guidance to be developed for the use of SARS officials to assist with the interpretation of the various behaviour categories introduced in the table in section 223 of the Tax Administration Act. Where relevant, provisions in other jurisdictions were referred to. This submission, as well as the foundation already laid in

Chapter 2, provides the basis for Chapter 4, which will essentially address one of the main goals of the research, to develop guidance on the interpretation of the various behaviour categories.

CHAPTER 4
Guidance on the interpretation of the various behaviours and terms

4.1 Introduction

The discussion in Chapter 2 demonstrated that the guidance regarding the repealed legislation, particularly with regard to determining whether or not a penalty imposed in terms of section 76 of the Income Tax Act could be remitted in full or in part, is of assistance in understanding the meaning and application of the behaviours and terms referred to in Chapter 16 of the Tax Administration Act. The discussion in Chapter 3 concluded that the penalty system in operation in New Zealand is similar to the penalty system in operation in South Africa, which made a comparison of the countries useful.

This chapter addresses the main goal of the research, which is to develop guidance on the interpretation of the various behaviour categories introduced in the table in section 223 of the Tax Administration Act, namely, "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence", "intentional tax evasion", "obstructive" and "*bona fide* inadvertent error". This will be accomplished by building on the foundation laid in Chapters 2 and 3.

The flowcharts reflected in this chapter and the proposed adjustments to be made to the SARS Short Guide (SARS, 2013) discussed in Chapters 2 and 3 are consolidated in a Master Decision-making Flow Chart in Appendix A. It is proposed that the guidelines, factsheets and flowcharts developed should be incorporated into the existing SARS Short Guide (SARS, 2013).

4.2 Guidance on the interpretation of "reasonable care not taken" and "*bona fide* inadvertent error"

From the discussion in Chapters 2 and 3, the guidelines for "reasonable care not taken" and "*bona fide* inadvertent error" can be constructed. "Extenuating circumstance" has been replaced with the term "reasonable care not taken", "reasonable care" and "*bona fide* inadvertent error", where applicable.

Tables 4.1.1 – 4.7 below reflect the flowcharts based on the guidelines. It is proposed that:

- Table 4.1.1 is completed by a SARS official to obtain as much background on the taxpayer as possible before determining whether reasonable care has been taken by a natural person (table 4.1.2 to replace points 1 – 4 on table 4.1.1 if the taxpayer is a person other than a natural person).
- Tables 4.2 – 4.7 are followed by a SARS official to assist in determining whether reasonable care has been taken by the taxpayer, based on specific situations or scenarios, namely, when the taxpayer made use of an advisor, when the shortfall identified is as a result of an arithmetical error, advice was sought from SARS, complex law or law interpretation, destruction of records or a specific employee is to blame.

It is suggested that additional flowcharts can be developed over time as more recurring situations or scenarios arise.

The following fact sheet should be completed in as much detail as possible to obtain a full background on the taxpayer. The information gathered must not be viewed in isolation, but as a whole to determine whether reasonable care has been taken, based on the taxpayer's specific background and personal circumstances. Due consideration is to be given to the number of times that the "reasonable care not taken" option is selected.

Table 4.1.1: Natural persons (own construct)

1. Obtain confirmation of the taxpayer's highest education qualification.
2. Obtain confirmation of the ability of the taxpayer to write, speak, read and understand English.
3. Confirm the age of the taxpayer.
4. List any possible infirmity, sickness, disability or anxiety from which the taxpayer might suffer, supported by evidence to suggest that this was an operative cause in the

failure to comply with the provisions of the Income Tax Act or Tax Administration Act.

5. Confirm the nature of the understatement, including the relevant tax laws.
6. Consider and document what actions a reasonable person in the same circumstances as that of the taxpayer would have taken to prevent the risk.
7. Consider and document whether a reasonable person in the same circumstances as that of the taxpayer would reasonably have foreseen the consequences of his or her actions and taken steps to avoid such consequences.
8. Consider the information provided by the taxpayer in support of why the error should be treated as a "*bona fide* inadvertent error".

Taking points 1 – 8 into account and based on the category of taxpayer, the following questions must be considered and where the answer is in the affirmative, consider the possibility that the error was a *bona fide* inadvertent error. Where the answer is "no", consider the possibility that reasonable care was not taken.

9. Have the matters referred to in points 1 – 4 above hampered the taxpayer in exercising business acumen?
10. Is the taxpayer inexperienced in the income tax area (has no professional expertise in the income tax area)?
11. Is there no indication of systematic or "innocent" omissions of income over a number of years?
12. Does the understatement appear to have been made in an impulsive and unsophisticated approach (as opposed to a sophisticated, premeditated, business-like approach)?
13. Consider the magnitude of the understatement. Is the understatement identified considered to be modest amount (as opposed to an excessive amount or considerable value)?
14. Does the taxpayer appear to have a genuine or *bona fide* belief that the amount in question was not taxable or was tax deductible?
15. Did the taxpayer fail to claim permissible deductions which could have been claimed?
16. Are there any circumstances which made it impossible for the taxpayer to comply with the provisions of the Income Tax Act or the Tax Administration Act (for

example, the financial director was unable to discharge the tax obligations)? Due consideration is to be given to whether the impossibility is absolute.

17. Did the taxpayer display ignorance of the taxation laws?
18. Was the taxpayer coerced, threatened or pressurised into submitting incorrect information to SARS?
19. Did the taxpayer show remorse by pleading guilty or genuinely appear to have the intention of not wanting to transgress the law again?
20. Is it unlikely that a reasonable person, in the same circumstances as the taxpayer, would have foreseen the likelihood of the tax shortfall? (Note, the question is not whether the taxpayer foresaw the shortfall.)
21. Is the seriousness of the risk low in relation to the cost of guarding against it? (Note, a failure to respond to every foreseeable risk will not necessarily mean that reasonable care is absent.)
22. Does it appear that the taxpayer had no knowledge of the understatement?
23. Is the existence of the understatement not obvious on review?
24. Is the process of explaining the understatement and how it led to the tax shortfall an uncomplicated process?
25. Is the understatement as a result of a mistake in the calculation or recording of numbers in a return?
26. Is the understatement as a result of completely misunderstanding a known statutory obligation or law? (Note that if the taxpayer was not aware of the statutory obligation or law, reasonable care not taken should be selected.)
27. Is the understatement as a result of a timing difference?
28. Was a sincere and honest attempt made by the taxpayer to ensure that the submission to SARS was without errors?
29. Was an investigative approach displayed to the steps and risks associated with the tax position taken?
30. Does the degree of the investigation reflect the size of the risk?
31. Did the taxpayer effectively manage the risks identified during the investigative approach undertaken?

N.B.:

(1) Even if the taxpayer adopts a tax treatment that is inconsistent with the Commissioner's view, reasonable care will still be shown where a genuine effort is made to research the issue, provided that there is a basis for the position taken.

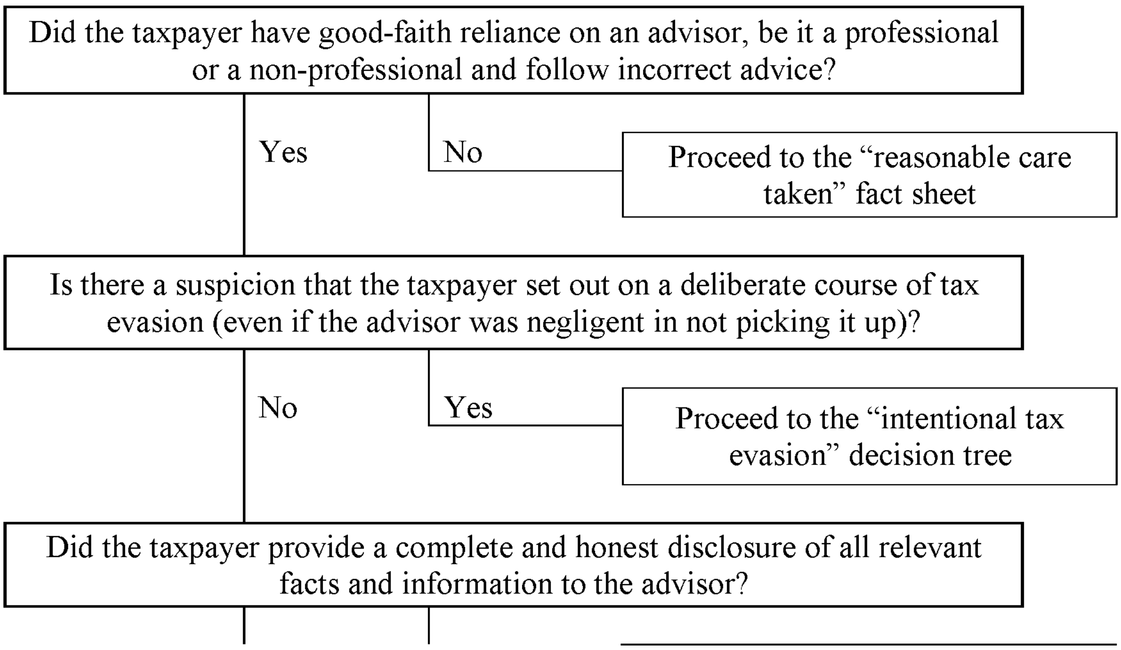
(2) If at any stage it appears that the taxpayer had motive or intention to evade taxes, consider “intentional tax evasion”.

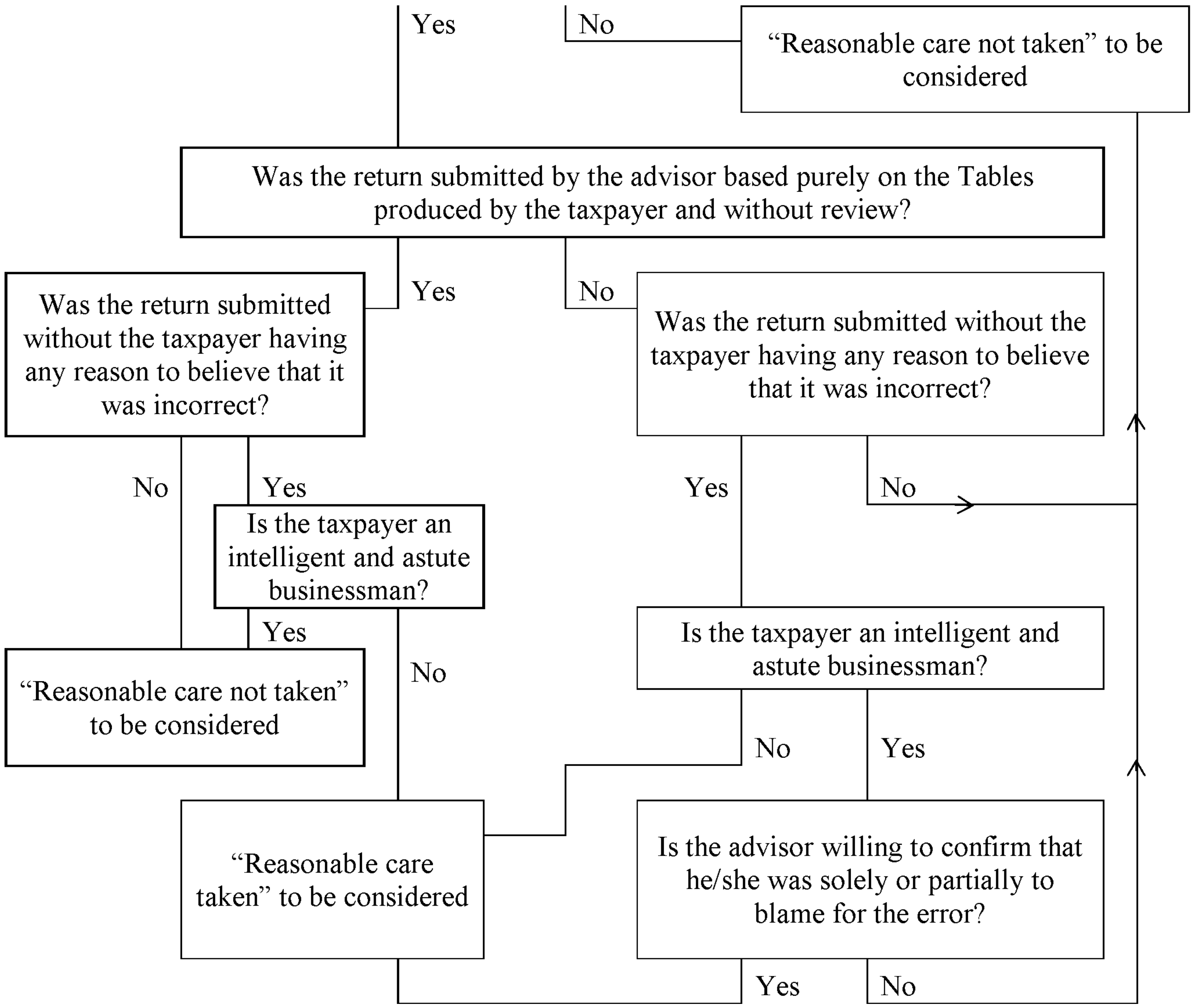
Table 4.1.2: Persons other than natural persons (own construct)

1. Obtain confirmation of the nature, size and character of the entity and its position in the marketplace. Consider whether an appropriate record-keeping system has been put into place to ensure that income and expenditure is correctly recorded for tax purposes.
2. Consider whether the corporate character and ownership of the entity changed since the understatement has occurred.
3. Consider whether the members or shareholders are professionals or experienced in the income tax area.

NB: If the accounting systems and internal controls are appropriately designed and monitored to ensure that the likelihood of error is reduced to an acceptable level, this will be consistent with taking reasonable care.

Table 4.2: Use of an advisor decision tree for natural persons and persons other than natural persons (own construct)





NB: The advisor’s intention must not be inferred onto the taxpayer.

Table 4.3: Arithmetical error (own construct)

Question whether the taxpayer in question falls into the normal salary and wage earner category. Proceed to comparing the size of the error in relation to the over-all taxes paid or correct income and expenses.

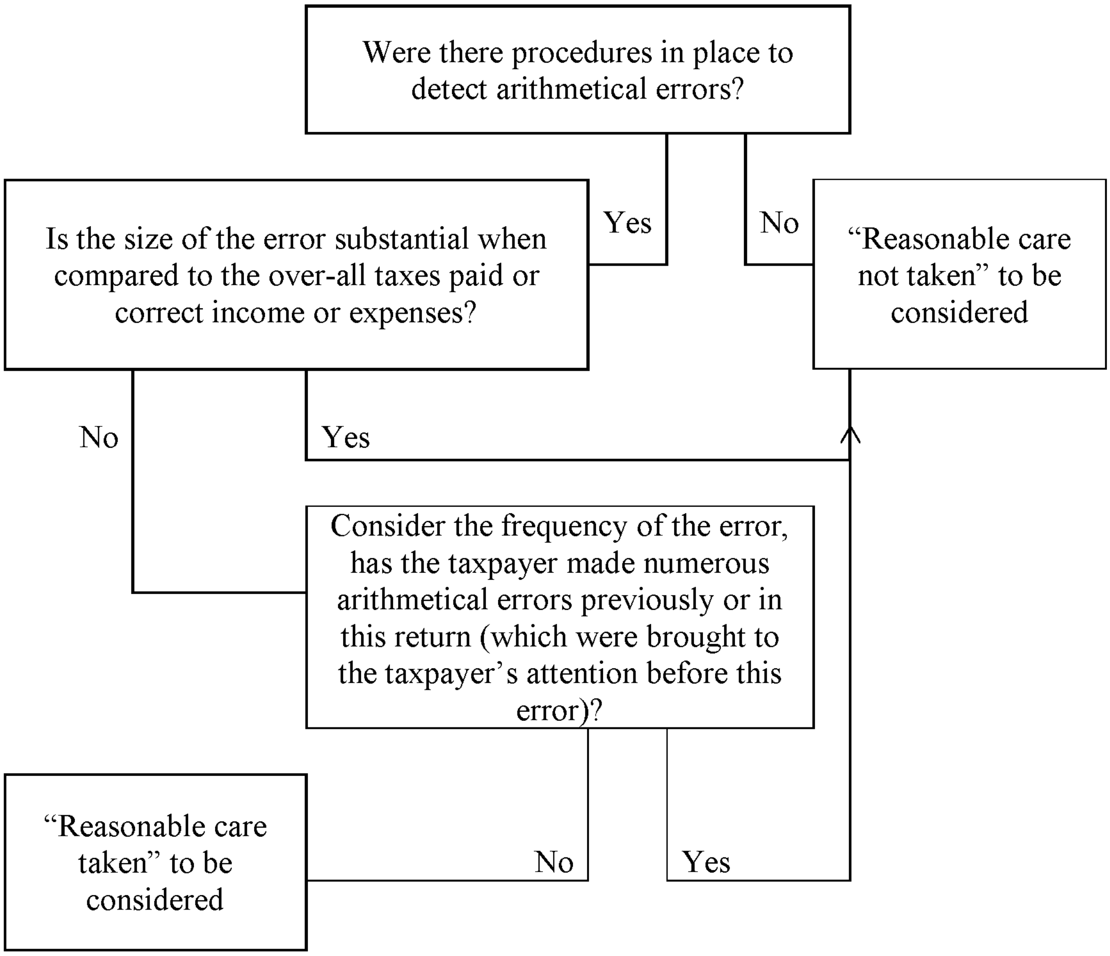


Table 4.4: Relying on a revenue official (own construct)

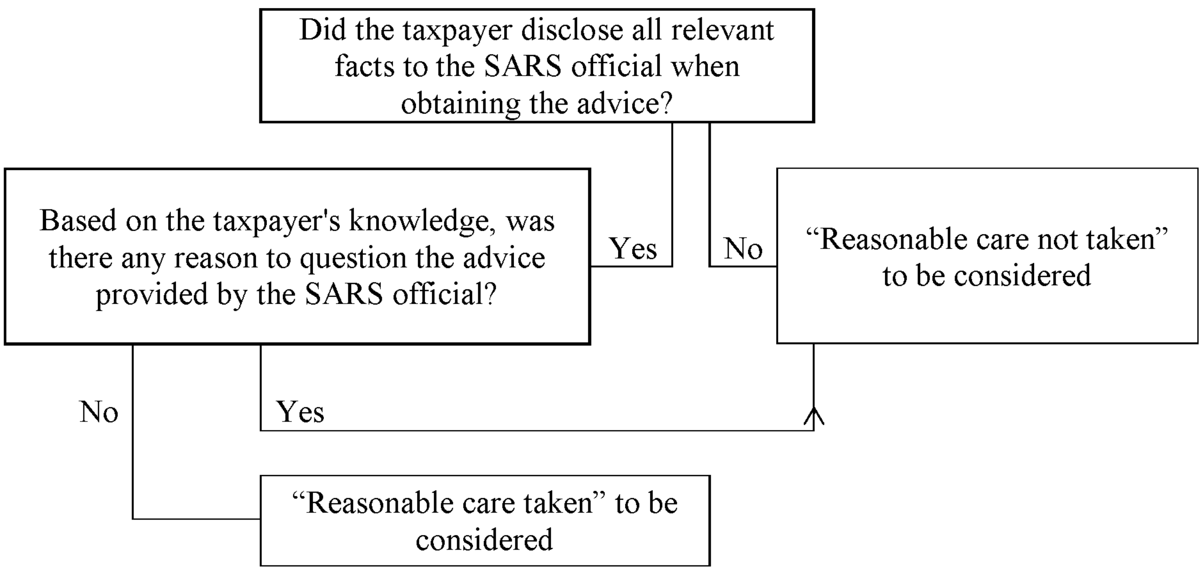


Table 4.5: Complex law or law interpretation (own construct)

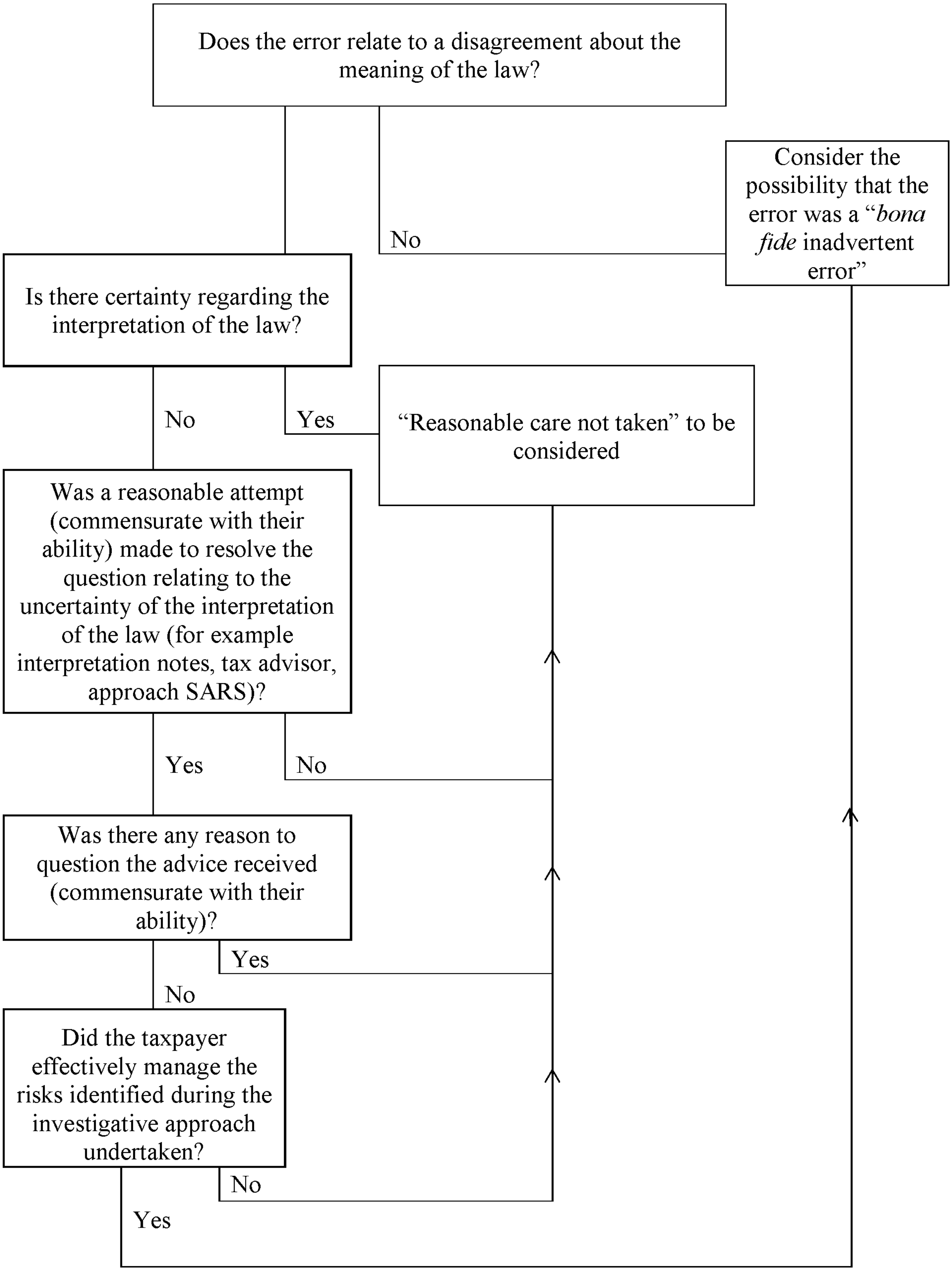


Table 4.6: Destruction of records (own construct)

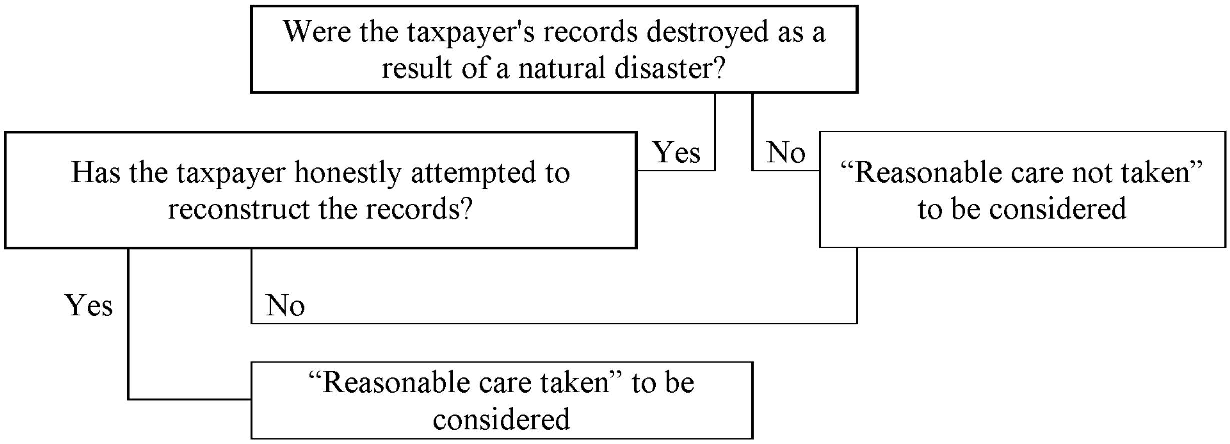
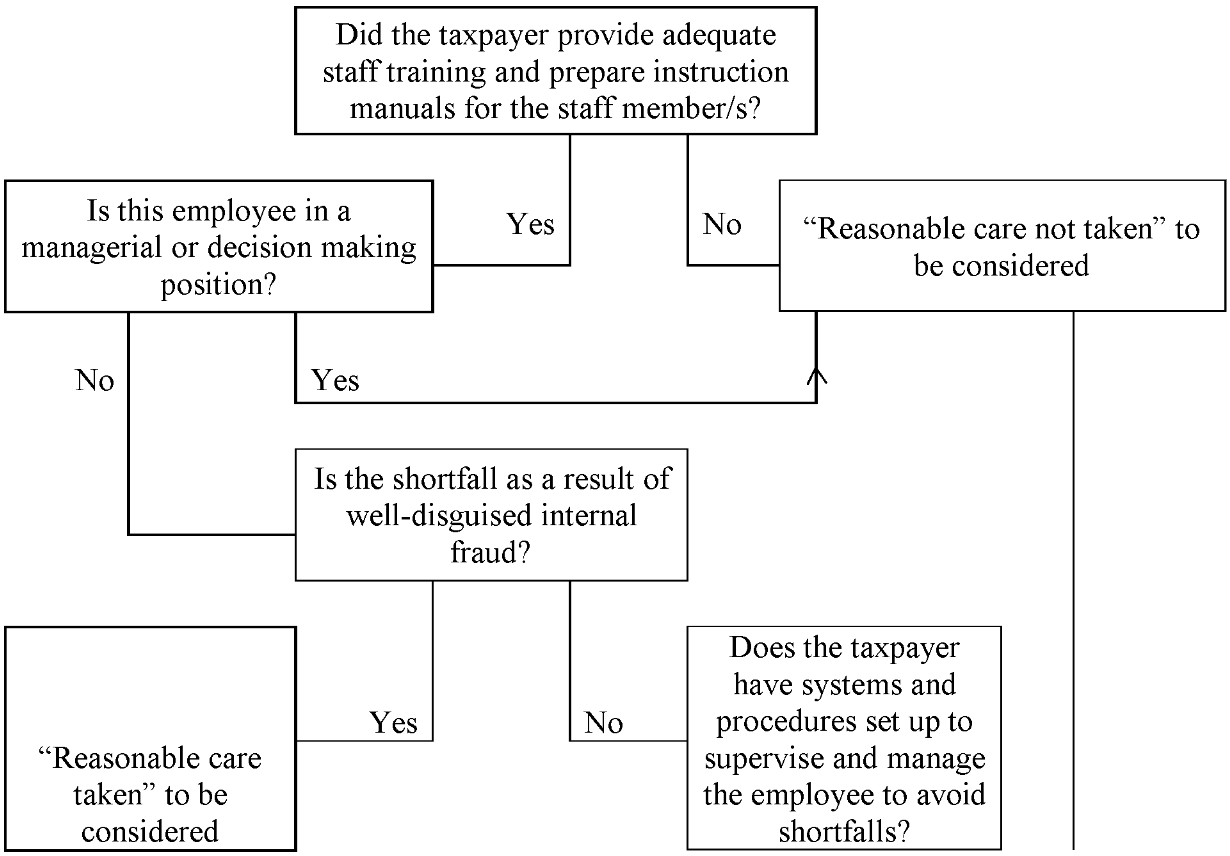
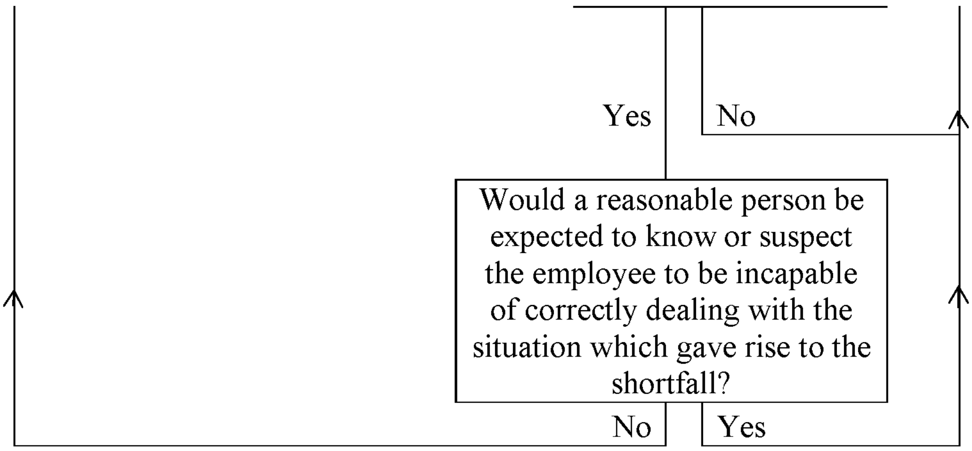


Table 4.7: Specific employee is to blame (own construct)



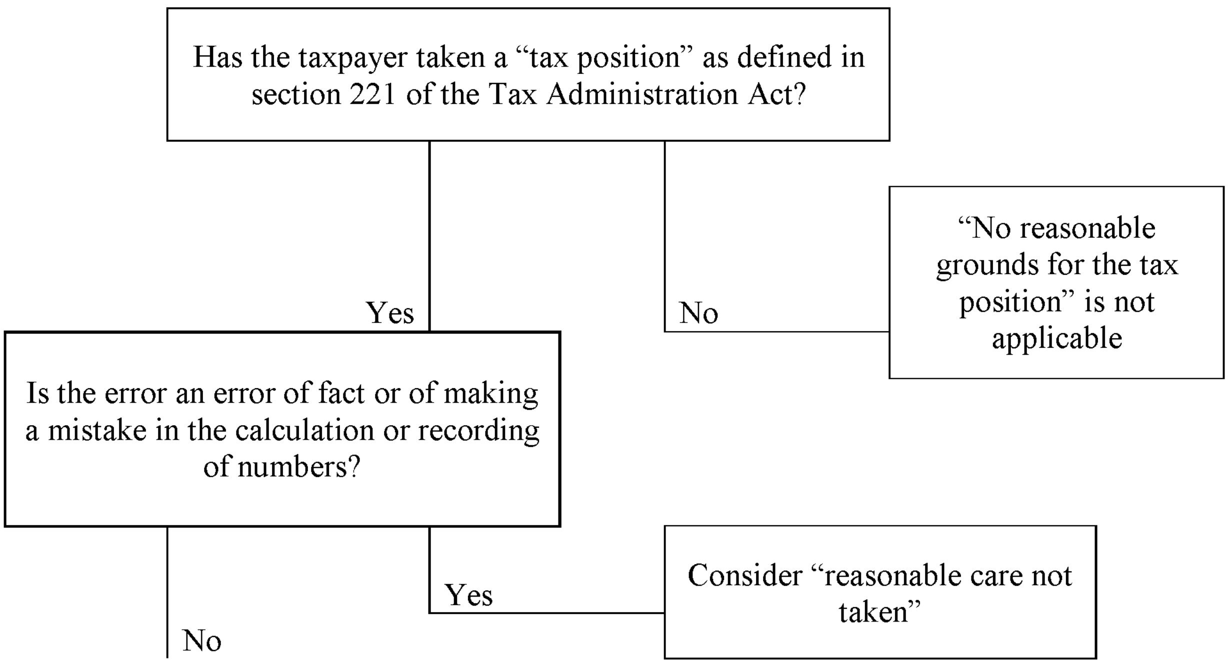


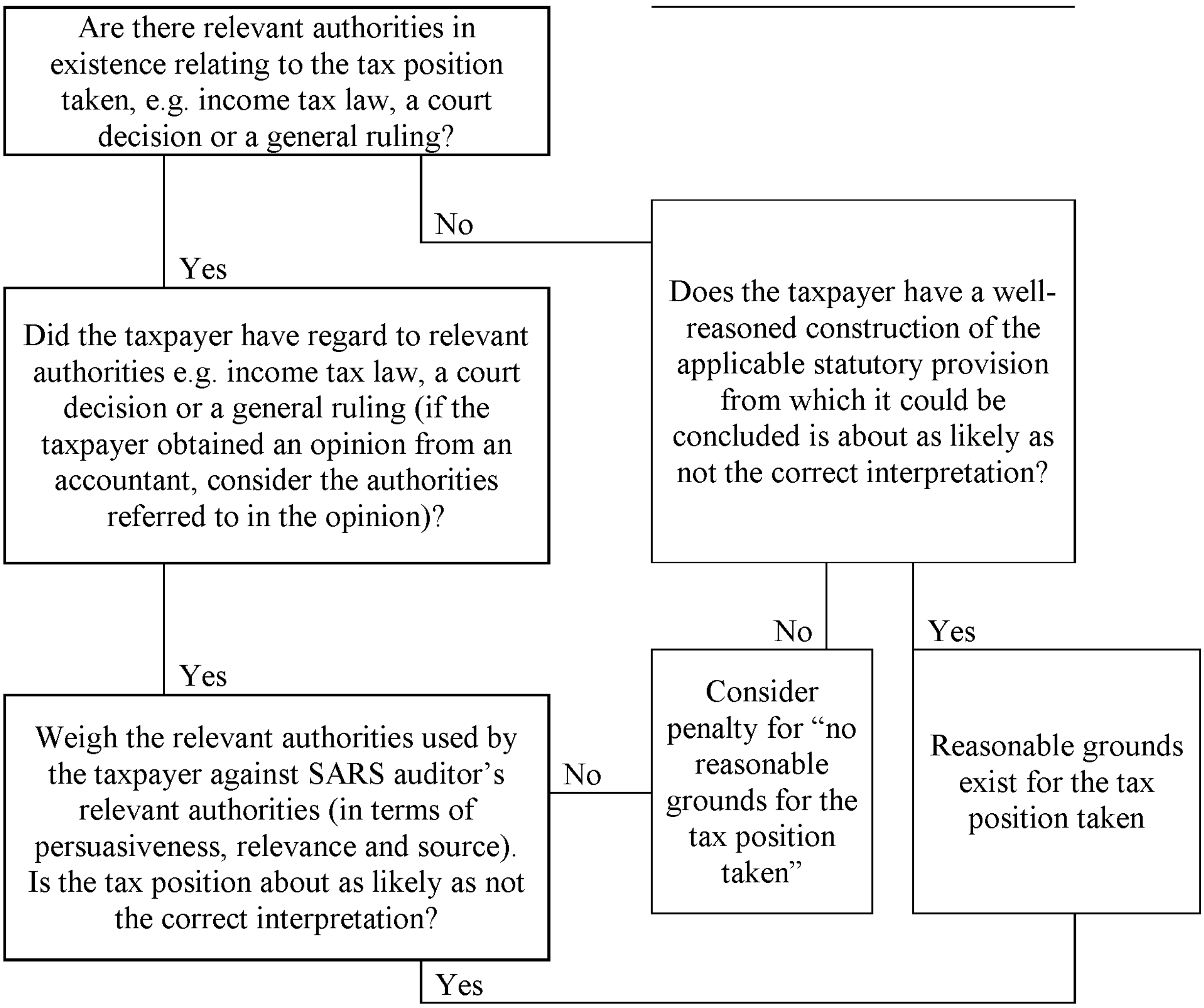
NB: The personal circumstances of the employee e.g. age, health, background are not applicable in this test.

4.3 Guidance on the interpretation of "no reasonable grounds for the tax position taken"

Based on the discussion in Chapter 3, guidelines for whether an understatement penalty should be imposed for "no reasonable grounds for the tax position taken" have been constructed as follows:

Table 4.8: "No reasonable grounds for the tax position taken" decision tree for natural persons and persons other than natural persons (own construct)



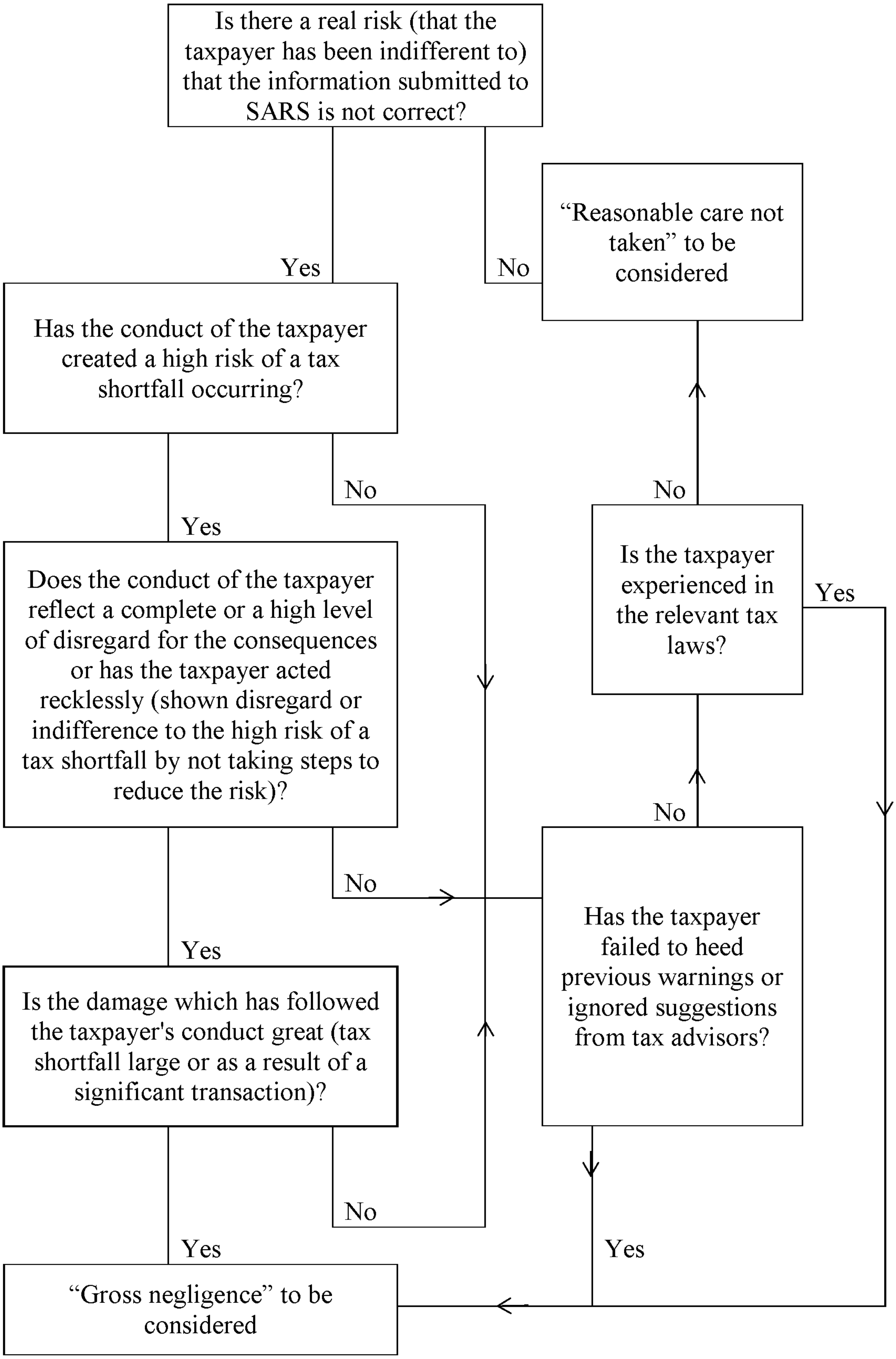


4.4 Guidance on the interpretation of “gross negligence”

From the discussion in Chapter 3, guidelines for whether an understatement penalty should be imposed for “gross negligence” have been constructed as follows:

Table 4.9: “Gross negligence” decision tree for natural persons and persons other than natural persons (own construct)

1. Consider and document whether a reasonable person in the same circumstances as that of the taxpayer would reasonably have foreseen the consequences of his actions.
2. Consider and document what actions a reasonable person in the same circumstances as that of the taxpayer would have taken to prevent the risk.

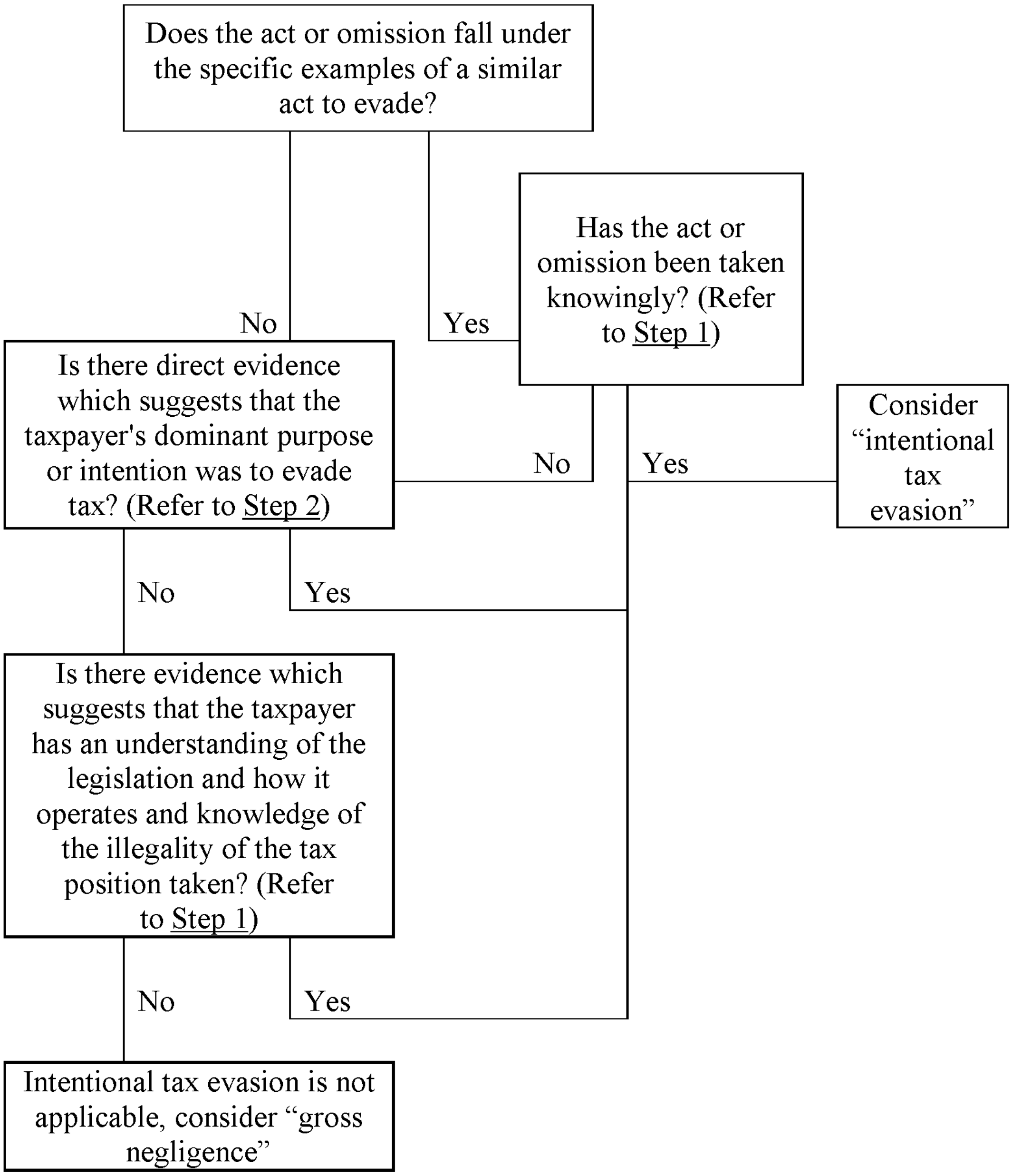


NB: It is not necessary to consider whether the taxpayer was aware of being grossly negligent or whether he or she intended to be grossly negligent.

4.5 Guidance on the interpretation of "intentional tax evasion"

Table 4.10 reflects the flowcharts based on the guidelines for "intentional tax evasion" discussed in Chapters 2 and 3.

Table 4.10.: "Intentional tax evasion" decision tree for natural persons and persons other than natural persons (own construct)



<u>Step 1:</u> <u>Knowingly</u>

1. Obtain confirmation of the taxpayer's highest education qualification.
2. Confirm whether the taxpayer is an intelligent and astute businessman.

3. Consider whether the taxpayer, members or shareholders have professional knowledge in the income tax area.
4. Consider the experience or inexperience of the taxpayer with regard to income tax matters.

Due consideration should be given to the number of times "consider 'intentional tax evasion'" is selected on the flowchart. All selections must be supported by documented evidence and written reasons for the selection.

The following questions must be considered and where the answer is in the affirmative, consider the possibility that the error was intentional tax evasion. Where the answer is "no", consider the possibility of gross negligence.

1. Is there any indication that the taxpayer is systematically committing income tax fraud?
2. Is there evidence to indicate that the taxpayer benefitted personally from the taxes saved as a result of the understatement identified?
3. Is there evidence to indicate that the taxpayer has concealed any assets or funds obtained as a result of the understatement identified?
4. Is the taxpayer likely to be in a position to continue to commit similar offences or understatements in the future?
5. Is the understatement identified as a result of fictitious information or based on non-existent transactions?
6. Consider the magnitude of the understatement. Is the understatement identified considered to be an excessive amount?
7. Will the majority of the shortfall identified remain unrecovered by the *fiscus*?
8. Did the taxpayer play a crucial role in the commission of the understatement which gave rise to the shortfall identified?
9. Does the shortfall identified appear to have been done in a way that was planned?
10. Has the taxpayer disregarded, ignored or treated something as being unimportant which lead to the creation of the shortfall?
11. Has the taxpayer acted in a way which appears to be untruthful, deceitful or dishonest (for example, concealed any information)?

12. Does the taxpayer appear to have been aware or strongly suspected that the actions or conduct in question at the time of taking the tax position that gave rise to the shortfall were in breach of a tax obligation?

13. Did the taxpayer realise the possibility of the consequences of a finding of "intentional tax evasion" when taking the tax position which gave rise to the shortfall identified?

NB: The taxpayer must not be made to bear the brunt of the punishment in the absence of the primary perpetrator.

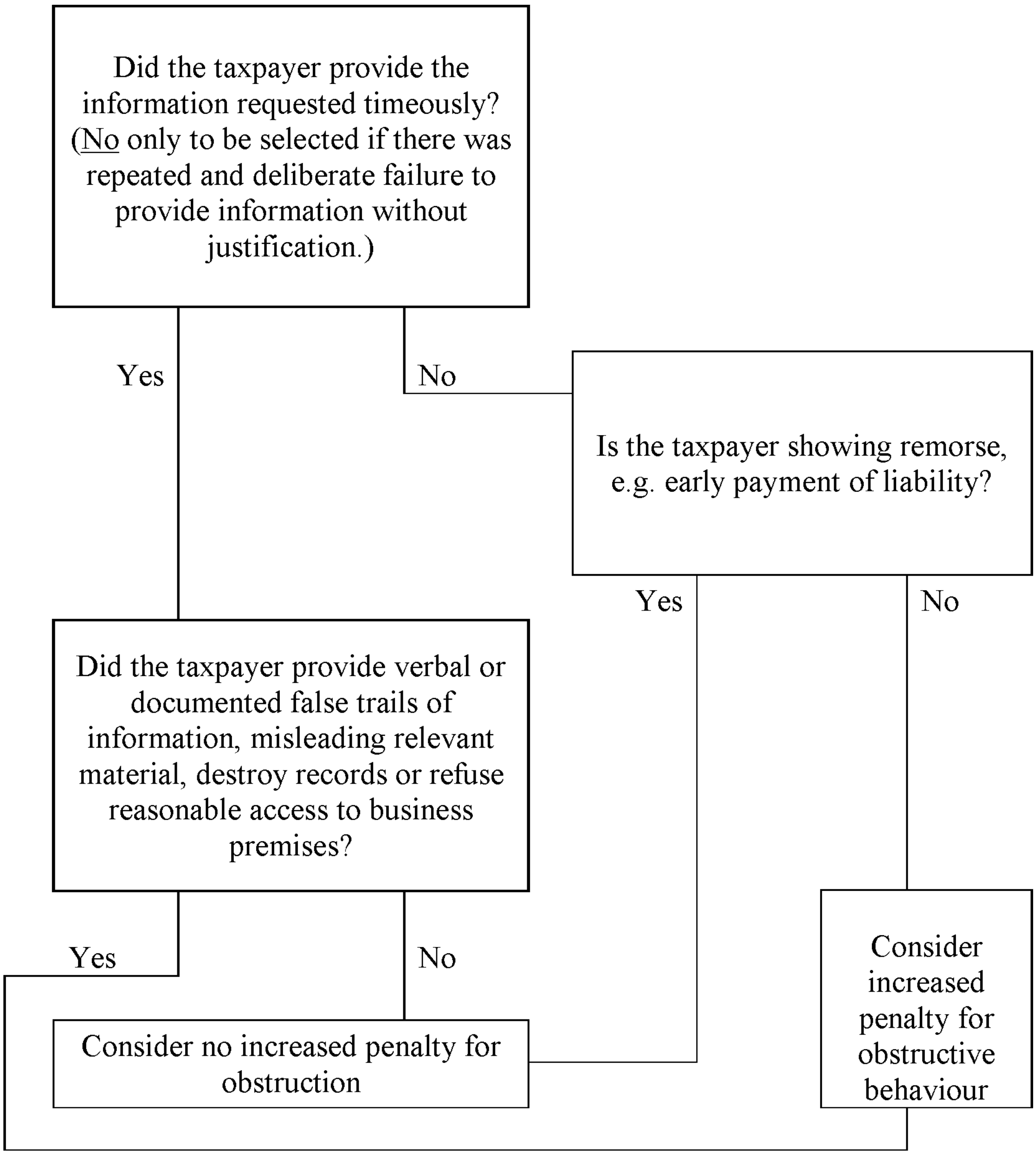
<u>Step 2: Guidelines to determine the dominant purpose:</u>

1. Determine and document what the most important or influential reason was for the taxpayer taking the tax position at the time of taking the tax position which gave rise to the shortfall identified.
2. Determine whether a deliberate choice was made to ignore the relevant legislation.
3. Determine and document whether the transaction which gave rise to the shortfall identified seems to have been designed to appear to comply with legislation. Give due consideration to the commercial reality of the arrangement.
4. Determine and document whether there is any circular funding, which results in income being incorrectly treated as exempt.
5. Determine and document whether the taxpayer has concealed any information.
6. Determine and document whether there is evidence of spurious interpretation of tax laws or whether the tax position taken is frivolous.

4.6 Guidance on the interpretation of "obstructive"

From the discussion in Chapters 2 and 3, it is proposed that the following flowchart is followed by a SARS official to determine whether the conduct, character, attitude and behaviour of the taxpayer amount to "obstructive" behaviour:

Table 4.11: Increased penalty for "obstructive" behaviour decision tree for natural persons and persons other than natural persons (own construct)



NB: The standard of proof for obstruction is on the balance of probabilities.

4.7 Conclusion

The guidance developed for the use of SARS officials to assist with the interpretation of the various behaviour categories introduced in the table in section 223 of the Tax Administration Act, namely, "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence", "intentional tax evasion", "obstructive" and "*bona fide* inadvertent error" is as follows:

- A fact sheet and flow chart was developed to assist in determining whether a penalty for "reasonable care not taken in completing return" is applicable. Due consideration is to be given to the number of times "reasonable care not taken" is selected in completing the flow charts.
- A flow chart was developed which will assist in determining whether an understatement penalty for "no reasonable grounds for the tax position taken" should be imposed. The flow chart reiterated the meaning of about as likely as not correct and provided clarity on how to weigh relevant authorities in terms of persuasiveness, relevance and source.
- A flow chart was developed that will assist in determining whether a high degree of negligence is displayed or the conduct falls significantly short of the standard of care expected of a reasonable person in the same circumstances of the entity, resulting in an understatement penalty for "gross negligence".
- A flow chart was developed that will assist in determining whether an understatement penalty for "intentional tax evasion" should be imposed. The flow chart also caters for situations where there is no direct evidence of the taxpayer's intention and the intention needs to be determined based on a balance of probabilities. Due consideration is to be given to the number of times "intentional tax evasion" is selected in completing the flow charts when determining whether a penalty for "intentional tax evasion" based on a balance of probabilities is applicable.
- A flow chart was developed that will assist in determining whether an increased penalty for "obstruction" should be imposed. The flow chart confirmed that the standard of proof for obstruction is on a balance of probabilities.

The discussion in Chapters 2 and 3 relating to the "extenuating circumstances" referred to in the now repealed section 76(2)(a) of the Income Tax Act and the relevant case law, tax rulings and guidelines relating to the specific behaviours listed on the penalty tables or systems in New Zealand to develop guidance on the interpretation of the various behaviour categories introduced in the table in section 223 of the Tax Administration Act was of assistance.

The final chapter will present a summary of the findings of the study.

CHAPTER 5
Conclusion

5.1 Introduction

The Tax Administration Act became effective on the 1 October 2012 and introduced the understatement penalty regime under Chapter 16, which replaced section 76 of the Income Tax Act. There are five behaviours reflected in the understatement penalty table in section 223 of the Tax Administration Act, comprising "substantial understatement", "reasonable care not taken in completing return", "no reasonable grounds for tax position taken", "gross negligence" and "intentional tax evasion". "Substantial understatement" is the only behaviour defined in the Tax Administration Act. Section 222(1) of the Tax Administration Act requires SARS to impose the penalty reflected in the table in the event of an "understatement", unless the "understatement" results from a "*bona fide* inadvertent error". The term "*bona fide* inadvertent error" is also not defined in the Tax Administration Act, nor is the term "obstructive". The Memorandum on the Objects of the Tax Administration Laws Amendment Bill (SARS, 2013: 40) stated that guidance would be developed in this regard for the use of taxpayers and SARS officials. This guidance has not yet been released.

The primary goal of this study was to obtain a better understanding of the meaning of the new behaviours and terms introduced in the understatement penalty table in section 223 of the Tax Administration Act. In addressing this main goal, the penalty tables and behaviours in legislation New Zealand were analysed to determine whether the penalty regime was comparable with South Africa's understatement penalty. Reference was also made to relevant provisions in the United Kingdom and Australian legislation and guidelines. The similarities and differences between the understatement penalty imposed in terms of Chapter 16 of the Tax Administration Act and the additional tax previously imposed in terms of section 76 of the Income Tax Act were discussed to determine whether this would be of assistance in enabling a better understanding of the meaning of the behaviours and terms in section 223 of the Tax Administration Act. These analyses were carried out in order to develop guidance on the interpretation of the various behaviours and terms and proposing a definition for the meaning of "*bona fide* inadvertent error" and "obstructive".

5.2 Summary of the findings

Chapter 2 provided an overview of the legislation relating to the understatement penalty imposed under Chapter 16 of the Tax Administration Act and the new behaviours and terms introduced in the understatement penalty table in section 223 of the Tax Administration Act. "Substantial understatement" is the lowest of the shortfall penalties in terms of rate of penalties charged which are charged at a rate of 0 – 20 percent. "Reasonable care not taken in completing a return" is the lowest penalty in terms of culpability and is charged at a rate of between 0 – 50 percent. The penalty imposed for "gross negligence" is 5 – 125 percent, which is much greater than "reasonable care not taken in completing a return" and thus reflects a higher level of culpability. The highest shortfall penalty in terms of culpability and seriousness of the breach is "intentional tax evasion". The penalty percentage applied of between 10 – 200 percent reflects the seriousness of the breach. It was demonstrated that the lack of definitions in the Tax Administration Act and the delay by SARS in issuing the comprehensive guidelines has resulted in uncertainty regarding the new understatement penalty regime, which could create a risk of subjectivity and inconsistent application of the understatement penalty table by SARS officials.

Chapter 2 also provided a comprehensive comparison between the understatement penalty imposed in terms of Chapter 16 of the Tax Administration Act and additional tax previously imposed in terms of section 76 of the Income Tax Act. An analysis of the general meaning of "extenuating circumstances" referred to in section 76(2)(a) of the Income Tax Act revealed that some of the "extenuating circumstances" which have influenced the level of the penalty imposed in terms of section 76 of the Income Tax Act were of assistance in the development of guidance for the new behaviours and terms introduced in Chapter 16 of the Tax Administration Act. In particular, the general meaning of "extenuating circumstances" was of assistance in determining whether the taxpayer acted with "reasonable care", "intentional tax evasion", was "obstructive" as well as in the determination of whether the "understatement" amounts to a "*bona fide* inadvertent error". In addition the comparison revealed that section 76(1) of the Income Tax Act is distinctly similar to the definition of "understatement" in section 221 of the Tax Administration Act and sections 76(5), (6) and (7) can be of assistance in understanding the meaning of the term "omission" referred to in section 221 of the Tax Administration Act. The comparison revealed four inconsistencies between section 76 of the Income Tax Act and Chapter 16 of the Tax Administration Act.

- Firstly, under the Income Tax Act provisions, the taxpayer had the responsibility to provide reasons as to why additional tax should not be imposed. Currently, SARS bears the burden of proving the facts on which understatement penalty is imposed.
- Secondly, the treatment of the penalties imposed on reducing an assessed loss as a result of an omission when applying the two Acts is not consistent. Additional tax was previously only imposed on the reduction of an assessed loss in the year in which the determination of taxable income did not result in an assessed loss. An understatement penalty is now imposed on the reduction of an assessed loss in the year that the assessed loss is reduced, even if the reduction does not result in taxable income. This is a contentious issue which may need to be clarified in the Tax Administration Act.
- Thirdly, the calculations of the two penalties differ. Previously, under the Income Tax Act, an additional tax of 200 percent was imposed. Currently, the penalty is determined by locating each "understatement" within the understatement penalty table in Chapter 16 of the Tax Administration Act that assigns a percentage to different criteria, where a SARS official has to identify the behaviour of the taxpayer.
- Lastly, the two penalty provisions differ with regard to the discretion given to the Commissioner to remit the penalties. Under the previous penalty regime in section 76 of the Income Tax Act, the Commissioner was provided the discretion to remit the penalty imposed based on the "mitigating" and "extenuating circumstances" presented by the taxpayer. Currently, the Commissioner may only remit the penalty if there is a "substantial understatement", subject to the requirements of section 223(3) of the Tax Administration Act being met.

Chapter 3 introduced and analysed the penalty system in operation in New Zealand and compared it to South Africa's understatement penalty system. It was determined that there are similarities which will assist in obtaining a better understanding of the new behaviours and terms introduced in Chapter 16 of the Tax Administration Act and to develop guidance for the interpretation of the terms. The terms used in the penalty systems in South Africa and New Zealand can be compared as follows:

South Africa	New Zealand
Understatement	Taxpayer's tax position
Repeat case	None
Tax	Tax
Tax position	Tax position
Shortfall	Tax shortfall
Understatement penalty	Shortfall penalty
Behaviour	Seriousness of breach
Substantial understatement	None
Reasonable care not taken in completing return	Lack of reasonable care
No reasonable grounds for tax position taken	Unacceptable tax position
Gross negligence	Gross carelessness
Intentional tax evasion	Evasion
Obstructive	Obstructing the investigator
Bona fide inadvertent error	Genuine error, clear mistake and simple oversight

In addition, Chapter 3 identified dissimilarities between the penalty systems in operation in New Zealand and South Africa which may be potential omissions from the Tax Administration Act.

- New Zealand has specific penalty rules that specify the person liable for the penalties in companies, trusts and partnerships. In contrast, South Africa does not have separate penalty rules for companies, trusts and partnerships.
- If there is tax evasion, in New Zealand, two penalties could potentially be imposed, firstly on the person for whom the refund or payment was sought and a secondly on the enabling taxpayer. The New Zealand legislation provides for the penalty for "intentional tax evasion" to be apportioned between the taxpayer and the officers involved. The South African penalty legislation does not make provision for the allocating of penalties to the person responsible for the shortfall or for the remission of the understatement penalty if the shortfall is not as a direct result of the taxpayer's actions.
- There is no consistency with regard to the remission of penalties in South Africa and New Zealand. The Commissioner in New Zealand is authorised to remit all penalties for disclosure and reduce all penalties by up to 50 percent, subject to certain conditions. In South Africa, the Commissioner can only remit the penalty imposed

for a “substantial understatement”. However, a lower penalty percentage is built into the understatement penalty table for voluntary disclosure before and after the audit.

- New Zealand has a monetary threshold in place for behaviour equivalent to “no reasonable grounds for the tax position taken” in South Africa. There is no such threshold in South Africa.
- The South African penalty legislation does not make provision for the reduction of penalties for temporary shortfalls, as specified in the New Zealand legislation.
- New Zealand has three penalty provisions of interest:

- Firstly, the shortfall penalty payable by the taxpayer may be reduced if the taxpayer makes adequate disclosure of the “tax position” at the time that the tax position is taken.
- Secondly, there is a cap of $50 000 on the penalty amount for an “unacceptable tax position”.
- Lastly, a taxpayer in an income tax loss situation can elect to use the losses to pay for shortfall penalties imposed by Inland Revenue.

Chapter 3 also analysed the relevant case law, tax rulings and guidelines relating to the specific behaviours listed on the penalty tables and penalty system in operation in New Zealand. The analysis revealed that where a high degree of carelessness by the taxpayer is displayed, the conduct falls significantly short of the standard of care expected of a reasonable person in the same position or circumstances as that of the taxpayer, there is a real risk which the taxpayer showed indifference to by not taking steps to reduce it, or the tax shortfall is large or significant when compared to the taxpayer’s business or taxable activity, a penalty for “gross negligence” should be considered rather than for “reasonable care not taken in completing the return”. “Gross negligence” requires objective recklessness. The analysis also revealed that where there is an element of intention or *mens rea* or subjective recklessness, a penalty for “intentional tax evasion” should be considered. A definition was proposed for the term “*bona fide* inadvertent error” and “obstructive”. Limited reference was also made to the relevant legislation and guidelines in the United Kingdom and Australia.

Chapter 4 built on the foundation already laid in Chapters 2 and 3 with regard to enabling a better understanding of the meaning of the behaviours and terms in section 223 of the Tax Administration Act. Guidance and flowcharts were developed for the interpretation of the various behaviour categories introduced in the understatement penalty table in section 223 of the Tax Administration Act as follows:

- A fact sheet and flow chart was developed to determine whether a penalty for "reasonable care not taken in completing return" is applicable. The fact sheet should be completed in as much detail as possible by Revenue authorities to obtain a full background on the taxpayer. The information gathered should not be viewed in isolation, but as a whole to determine whether reasonable care has been taken, based on the taxpayer's specific background and personal circumstances. Due consideration is to be given to the number of times "reasonable care not taken" is selected in completing the flow charts when determining whether a penalty for "reasonable care not taken in completing return" is appropriate.
- A flow chart was developed which will assist in determining whether an understatement penalty for "no reasonable grounds for the tax position taken" should be imposed. The meaning of "relevant authorities" relied on by the taxpayer in relation to defending a tax position, referred to in the SARS Short Guide (SARS, 2013: 80), was expanded to make it clear what is meant by the term, how to weigh the relevant authorities against each other and what to do in a situation where there are no relevant authorities. In addition, the meaning of "at least as likely as not, correct" was interpreted.
- An example was designed to be used to expand the SARS Short Guide (SARS, 2013: 80) explanation of "gross negligence" and a flow chart was developed that will assist in determining whether an understatement penalty for "gross negligence" should be imposed.
- A flow chart was developed that will assist in determining whether an understatement penalty for "intentional tax evasion" should be imposed. The guidance includes steps to follow to determine whether the taxpayer should have an understanding of the legislation and how it operates, whether the taxpayer had knowledge of the illegality of the tax position taken and how to determine the taxpayer's dominant purpose. The flow chart also caters for situations where there is no direct evidence of the taxpayer's intention and the intention needs to be determined based on a balance of probabilities.
- A flow chart was developed which will assist in determining whether an increased penalty for "obstruction" should be imposed.

5.3 The research questions

A "substantial understatement" is the only behaviour defined in section 221 of the Tax Administration Act as a case where the prejudice to SARS or the *fiscus* exceeds the greater of five percent of the amount of tax properly chargeable or refundable under a tax Act for the relevant tax period, or R1 million. A "substantial understatement" is based on the size of an "understatement" as opposed to the lack of or existence of a specific behaviour. It was determined that the meaning has been clearly defined in the Tax Administration Act and no further guidance was required to be developed.

The comparison of South Africa and New Zealand's penalty provisions revealed that "reasonable care" is not a defined term and accordingly takes on its ordinary meaning and the determination is an objective test that parallels the law of negligence or negligence in *tort* and the principles formulated by the courts to determine whether there has been a breach of the standard of care expected of a reasonable person in common law can be used to provide guidance on the meaning of the term "reasonable care". The likelihood of the tax shortfall or the likelihood of the risk that the "tax position" taken is incorrect is a relevant factor in deciding whether "reasonable care" has been exercised by the taxpayer. The seriousness of the risk should be weighed against the costs of guarding against it. The size of the shortfall in relation to the overall tax payable is also an indicator of the magnitude of the risk involved. The ability to prevent the tax shortfall is also a factor which should be considered, which in turn is dependent on the class of the taxpayer. A wage or salary earner will satisfy the reasonable care test by following a tax guide, whereas a taxpayer with more complex tax affairs, or a company, will be expected to implement appropriate record keeping systems and, where appropriate, to approach a tax practitioner. The compliance history of the taxpayer is also an important consideration in determining whether "reasonable care" was taken.

The analysis revealed that the "reasonable care" standard does not mean perfection and refers to a reasonable and genuine attempt to comply with obligations imposed under a tax law. In addition, the analysis showed that the nature of a reasonable person in the same circumstances as that of the taxpayer is established by obtaining a full background on the taxpayer's personal circumstances. The information gathered must not be viewed in isolation, but as a whole, to determine whether "reasonable care" has been taken, based on the taxpayer's specific background and personal circumstances. The information to be obtained on the taxpayer includes: the highest educational qualification, the level at which the taxpayer can write, speak, read and understand English, whether there is any possible infirmity, sickness, disability or anxiety from which the taxpayer suffers, the age of the taxpayer and whether the taxpayer has the financial means to pay the penalty due. Once this information has been obtained, it should be determined whether any of these factors has hampered the taxpayer in showing good business acumen or is an operative cause in the failure to comply with the provisions of any Act.

The analysis also revealed that where the "shortfall" identified is not a first offence, or appears to have been made in a business-like, planned or premeditated approach, or the magnitude of the shortfall is not of a trivial nature, "reasonable care not taken" should be considered. Where the taxpayer appears to have a genuine or *bona fide* belief that the amount was not taxable or was tax deductible, records were destroyed as a result of a natural disaster and the taxpayer has honestly attempted to reconstruct the records, the taxpayer was coerced, threatened or pressurised into submitting incorrect information to SARS, or circumstances existed which made it impossible for the taxpayer to comply with the provisions of any Act, "reasonable care taken" should be considered. It was demonstrated that this is also applicable to a corporate taxpayer. However, in addition, the background obtained should include factors such as the size and character of the entity and its position in the market place, whether appropriate record-keeping systems were put into place to ensure that income and expenditure is correctly recorded, the relative profitability of the entity, whether ownership has changed over a period of time and whether a specific individual is to blame for the "understatement" and this individual's role in the entity. The analysis revealed that where a specific employee is to blame for the "understatement" and inadequate staff training was provided, no systems and procedures were set up to manage and supervise employees or the employee is in a managerial position, the "reasonable care" standard will not have been met. However, this may not be the case where the "shortfall" identified is a result of well-disguised internal fraud.

In addition to the above, the analysis revealed that generally:

- Where a taxpayer who is not an astute businessman has made use of an advisor, be it a professional or a non-professional advisor, and a complete and honest disclosure of all relevant facts and information was provided to the advisor, "reasonable care" has been demonstrated by the taxpayer, provided that a reasonable person in the same circumstances as the taxpayer would have no reason to believe that the information submitted to SARS was incorrect. If the taxpayer did not provide a complete and honest disclosure of all relevant facts and information to the advisor, has professional knowledge in the income tax area or is an astute businessman, "reasonable care" has not been demonstrated by the taxpayer, unless the advisor is willing to confirm that he or she was solely or partially to blame for the error.

- Where the taxpayer has relied on incorrect information or advice obtained from a reputable third party and did not know or reasonably could not have been expected to know that the information provided was incorrect, it is unlikely that the "reasonable care" standard will have been breached.
- Arithmetical errors do not necessarily point to a failure to take reasonable care. Where the taxpayer has procedures in place to detect these types of errors, the size of the error is not substantial when compared to the over-all taxes paid and such errors are rarely made, "reasonable care" may have still been taken.
- Where a taxpayer has relied on a SARS official, provided that all relevant facts were disclosed to the SARS official when obtaining the advice and there was no reason for the taxpayer to question the advice provided, the analysis revealed that the "reasonable care" standard will not have been breached.
- In the situation where the area of law is complex, provided that the taxpayer displayed an investigative approach to the steps and risks associated with the "tax position" taken, the degree of this investigation reflects the size of the risk and the risks identified were effectively managed, the analysis revealed that "reasonable care" may still have been taken.

The analysis of the penalty system in New Zealand revealed that a penalty for "no reasonable grounds for the tax position taken" is an objective test that can only be considered if, having regard to the relevant authorities at the time the tax position is taken, what is being argued by the taxpayer is at least as likely as not, to be correct. The comparison revealed that a penalty for "no reasonable grounds for the tax position taken" cannot be applied to mistakes. It was also determined that "relevant authority" refers to an income tax law, a court decision or a general ruling, which should be weighed according to persuasiveness, relevance and source. In this regard, an authority that provides extensive analysis of relevant case law and facts would be more persuasive than one that simply states a conclusion. The analysis revealed that "about as likely as not, correct" can be interpreted by the court to mean about a 50 percent chance of being correct.

The analysis of the New Zealand penalty regime showed that "gross negligence" refers to a complete or high level of disregard for an obvious risk. The test is an objective test where the intention of the taxpayer is not relevant. It was shown that grossly negligent conduct creates a high risk of a tax shortfall occurring where the risk involved and the consequences thereof would have been foreseen by a reasonable person in the same circumstances as that of the taxpayer. The analysis revealed that recklessness occurs in the situation where the risk and damage is great, there is a large tax shortfall, there is a real as opposed to a fanciful risk or the transaction involved is significant.

The analysis of the New Zealand penalty system revealed that a penalty for "intentional tax evasion" should be considered where there is evidence to suggest that the taxpayer played a crucial role in the commission of the "understatement", benefitted personally from the transaction, concealed information, provided fictitious information or utilised non-existent transactions. In addition, a penalty for "intentional tax evasion" should be considered where the taxpayer should reasonably have foreseen the possibility that the information submitted to SARS which gave rise to the "understatement" was based on false figures or entries which were not true. The taxpayer must have knowledge of the illegality of the "tax position" taken, together with an understanding of the legislation and how it operates, and made a deliberate choice to ignore the relevant legislation, for a penalty for "intentional tax evasion" to be applicable. The analysis revealed that there are four steps that should be considered in order to prove "intentional tax evasion". The SARS official must have sufficient direct evidence or evidence inferred from the surrounding circumstances which supports the finding that:

- the taxpayer had knowledge of the illegality of the tax position taken;
- the taxpayer had an understanding of the legislation and how it operates;
- the taxpayer's dominant purpose or intention was to evade tax; and
- if there is no direct evidence supporting the above conclusions, the SARS official must make a decision based on the balance of probabilities; where there is no direct evidence of the taxpayer's intention, intention may be inferred from the surrounding

circumstances and background, business experience and conduct are to be taken into account when considering evidence inferred from surrounding circumstances.

The term "obstructing the investigator" in the New Zealand provides that the conduct of the taxpayer must be "obstructive", without justification or lawful excuse and the steps taken to hinder the investigation must be active (as opposed to passive) for an increased penalty for "obstruction" to apply. The definition for "obstructive" was proposed as: "Deliberately interfering with, causing difficulties (impeding) or delays in or preventing the progress of a SARS audit or review."

Based on the investigation of the guidance available in New Zealand on the concepts "genuine error" and "clear mistake or simple oversight", the definition for "*bona fide* inadvertent error" was proposed as: "An honest mistake made or simple oversight, which the taxpayer was not aware of, despite taking reasonable care and displaying a prudent attitude while making a genuine attempt to comply with all applicable tax obligations."

5.4 Key contributions

The findings of this thesis propose modifications or improvements to the existing SARS Short Guide (SARS, 2013) to enable taxpayers, tax practitioners and SARS officials to have a better understanding the new behaviours and terms detailed on the understatement penalty table in section 223 of the Tax Administration Act and to assist SARS officials to apply the understatement penalty table objectively and consistently in order to determine the correct understatement penalty in relation to each shortfall identified. Appendix A reflects the recommended changes to be made to Chapter 16 of the SARS Short Guide (SARS, 2013). The proposed adjustments have been highlighted. The decision-making flowchart in the Appendix is the final outcome of the thesis.

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Appendices

Appendix A – Recommended changes to be made to Chapter 16 of the SARS Short Guide to the Tax Administration Act (SARS: 2013)

16. CHAPTER 16 - UNDERSTATEMENT PENALTY

16.1 – 16.5.2 of the SARS Short Guide (SARS: 2013) is to remain unchanged and has not been included.

16.5.3. *Bona fide* inadvertent error

A "*bona fide* inadvertent error" is defined as follows: "An honest mistake made or simple oversight, which the taxpayer was not aware of, despite taking reasonable care and displaying a prudent attitude while making a genuine attempt to comply with all applicable tax obligations."

For the purposes of determining whether an understatement identified should be classified as a "*bona fide* inadvertent error":

- An honest mistake is a genuine, true or sincere error or fault resulting from defective judgment, deficient knowledge, carelessness, a misinterpretation or misunderstanding.
- A simple oversight is an inadvertent omission or error, the existence of which is plain and obvious on review and the reasons for which are clearly identifiable and understood. The process of explaining the mistake and how it leads to the tax shortfall should not be a complicated process.
- Taking reasonable care means that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the same circumstances as that of the taxpayer would take to fulfil his or her tax obligations, taking the taxpayer's personal circumstances into account, to ensure that the submission to SARS is free of any possible understatements.

- Making a genuine attempt means making a sincere and honest attempt. A taxpayer who displays an investigative approach to the steps and risks associated with the tax position and effectively manages these risks should be considered to have made a genuine attempt. Whether an investigative approach was in fact displayed should be considered on a case by case basis. It is also expected that the degree of the investigation must reflect the risk. A riskier transaction with greater financial implications will be expected to have been subject to greater efforts to investigate the correct tax position.

The following are examples of what could be seen as investigative behaviour:

- obtaining confirmation of the accountant or provider's tax practitioner number, licence details or whether they are registered with the South African Institute of Chartered Accountants (SAICA);
- determining whether there is a product disclosure statement;
- obtaining independent advice from an advisor who has no connection with the seller or the arrangement;
- assessing or evaluating the material or information gathered;
- determining whether there are any appropriate SARS guides or interpretation notes;
- approaching the nearest SARS office for guidance;
- applying for an advance ruling from SARS; and
- ensuring that the advice received is followed appropriately.

The following principles are relevant to determining whether an error is a "*bona fide* inadvertent error":

- all relevant factors relating to the error must be ascertained, for example, the reason for the error and the length of time that has passed since the error was made;
- the facts and tax laws relating to the error must be clear and unambiguous;
- the error must not relate to disputed statutory interpretation, that is, it must not be as a result of a disagreement about the meaning of the law;
- incorrect tax positions arising from arithmetical, transportation and other types of obvious errors must be clear and easily verified; and
- if changes need to be made to other tax returns as a result of the adjustment, they should also be treated as "*bona fide* inadvertent errors".

The onus of proof in relation to whether an error is a "*bona fide* inadvertent error" is on the taxpayer. The taxpayer should provide the SARS official with the following information:

- a description of the understatement including the background circumstances and the reason for the occurrence;
- the nature of the understatement, including the relevant tax laws;
- reasons as to why the understatement was not identified at the time of submission;
- where relevant, details of any incorrect advice given directly to the taxpayer by SARS or a tax practitioner or accountant together with confirmation on how the taxpayer relied on that advice; and
- the action/s required and confirmation of the implementation date to ensure that the understatement is not repeated going forward.

The following situations are examples of when the term "*bona fide* inadvertent error" can be applied:

- in situations when a particular outcome is intended, but that outcome later turns out not to be achieved as a result of a miscalculation, misunderstanding or unintentional omission;
- to a mistake in the calculation or recording of numbers in a return;
- to overlooking or completely misunderstanding a statutory obligation; and
- timing differences which relate to multiple tax types, tax periods, or in some cases other taxpayers.

The following situations are examples of when the term "*bona fide* inadvertent error" cannot be applied:

- where the taxpayer did not know about the law, the reason for this being that taxpayers have a duty to be aware of their obligations;
- where the taxpayer knows the law but chooses to ignore it; and
- where the taxpayer repeatedly makes similar mistakes.

The list is not exhaustive; neither does it imply that if the understatement identified fits the example, that the understatement should automatically be treated as a "*bona fide* inadvertent error". All facts and circumstances surrounding the understatement identified must still be investigated and taken into account before making an informed decision.

16.5.4. Reasonable care not taken

Reasonable care is not defined, so the ordinary meaning must apply. Taxpayers are legally responsible for their tax affairs. A taxpayer must take reasonable care in keeping records and in providing complete and accurate information to SARS. In this regard, the ordinary meaning of "reasonable care" in the context of making a statement to the Commissioner means an approach that accords appropriately serious attention to complying with the obligations imposed under a taxation law to avoid risk. It is important to provide evidence to support the conclusion that the actions which resulted in the tax shortfall fall short of what would be reasonably expected in the circumstances. Negligence must be established. A shortfall amount does not automatically indicate a failure to take reasonable care.

Reasonable care means that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the circumstances of the taxpayer would take to fulfil his or her tax obligations; where a reasonable person would have reasonably foreseen the consequences of the actions and taken steps to avoid such consequences. Where the conduct of the taxpayer does not comply with this standard, it would be seen as reasonable care not taken. It means, for example, a taxpayer must try his or her best to lodge a correct tax return. Although a taxpayer is liable for the actions of their employees, the question of whether the taxpayer has taken reasonable care must still be considered. The reasonable care standard does not mean perfection, but refers to the effort required commensurate with the reasonable person in the taxpayer's circumstances.

All personal circumstances of the taxpayer such as education, literacy, low intelligence and naiveté, loss of employment, hardship, insolvency and reliance on the taxpayer by dependants, age, infirmity, sickness, general poor health, anxiety and sanity, gender, lifestyle, intoxication, drugs, influence of others and provocation, previous good character, and death, insolvency or liquidation, must be taken into account when determining the behaviour of a reasonable person in the taxpayer's same circumstances. Due consideration should be given to whether or not the personal circumstances hampered the taxpayer in the exercising of good business acumen and whether there is any evidence to suggest that any possible infirmity, sickness, disability or anxiety from which the taxpayer may suffer was an operative cause in the failure to comply with the provisions of the Income Tax Act or Tax Administration Act.

Perfection or the use of increased knowledge or experience based on hindsight after the event should form no part of the enquiry relating to what is reasonable in all the circumstances. It is important to note that professional persons with specialist tax knowledge will be subject to a higher standard of care that reflects the level of knowledge and experience a reasonable person in their circumstances will possess.

Where the shortfall identified is as a result of the taxpayer relying on information provided by a reputable third party, for example, from a financial institution, or a reasonable person in the same circumstances as the taxpayer would be likely to find the information relied upon extremely complex or specialised, the taxpayer is unlikely to have breached the reasonable care standard.

The reasonable care test should be applied to a category of taxpayer, rather than to that of the individual taxpayer concerned to assist with ensuring that the reasonable care standard is applied fairly and consistently.

The categories of natural persons are as follows:

- Normal salary and wage earners. This will include all taxpayers whose income is subject to employees' tax (Pay-As-You- Earn (PAYE)). Taxpayers in this category will generally satisfy the reasonable care test by carefully following the tax guides and guidance available on the SARS website and consulting SARS where they are uncertain as to the tax treatment of an issue. Due consideration must be given to the particular person's abilities and circumstances.
- Business taxpayers. This will include all provisional taxpayers, commission earners, taxpayers who receive rental income and taxpayers who receive any other non-salary or wage income, for example director's remuneration or simple share or capital gains tax transactions. In addition to the above, taxpayers in this category will generally satisfy the reasonable care test by consulting a tax advisor where they are uncertain as to the tax treatment of an issue.

- High net worth individuals. This will include taxpayers with an annual income of R7 million or more, taxpayers who make use of trusts or offshore accounts and taxpayers with complex share or capital gains tax transactions. In addition to the above, a taxpayer in this category will generally satisfy the reasonable care test by having appointed a tax advisor, as well as displaying an investigative approach where the degree of the investigation reflects the size of the risk and the risks identified are effectively managed.

The categories of persons other than natural persons are as follows:

- Micro business, share block schemes and bodies corporate. This will include entities with a gross income equal to or less than R1 million and total assets equal to or less than R5 million. An entity in this category will generally satisfy the reasonable care test by having basic book keeping practices in place.
- Small companies. This will include entities with a gross income equal to or less than R20 million and total assets equal to or less than R10 million. An entity in this category will generally satisfy the reasonable care test by implementing adequate record keeping systems appropriate for the size of the business and the number and complexity of the transactions to ensure it complies with tax obligations. In addition, having an appointed auditor or tax advisor, ensuring staff are well trained and displaying an investigative approach, where the degree of the investigation reflects the size of the risk and the risks identified are effectively managed, will reflect that the entity has acted with reasonable care.
- Medium to large businesses. This will include all entities with a gross income of R20 million or more and total assets of R10 million or more. In addition to the above, an entity in this category will generally satisfy the reasonable care test by implementing appropriate internal controls and monitoring these internal control activities.

The following tables should be completed by a SARS official to determine whether reasonable care has been taken by the taxpayer, based on specific situations or scenarios:

- Table 16.1 is to be completed by a SARS official to obtain as much background on the taxpayer as possible before determining whether reasonable care has been taken by a natural person.

- Table 16.2 is to replace points 1 – 4 on table 16.1 if the taxpayer is a person other than a natural person.
- Table 16.3 is to be completed where the taxpayer makes use of an advisor. Where the taxpayer provides incomplete or inaccurate information to the advisor, or does not detect an error made by the advisor which a reasonable person in their circumstances would have detected, or had reason to believe the advice provided was not correct, an understatement penalty should be considered.
- Table 16.4 is to be completed where the error identified is as a result of an arithmetical error. The nature of the error and the circumstances under which it was made must be considered. Once this has been established, it must be determined whether there are any procedures in place to detect arithmetical errors and whether the error identified has previously been brought to the attention of the taxpayer. In addition, the magnitude and frequency of the error must be considered.
- Table 16.5 is to be completed where the shortfall identified is as a result of the taxpayer relying on advice provided by a SARS official. Provided that the taxpayer has reasonable proof that they have disclosed all relevant facts to the SARS official, followed the advice of a SARS official and interpreted the advice correctly, the understatement identified should be treated as a "*bona fide* inadvertent error", depending on the personal circumstances of the taxpayer.
- Table 16.6 is to be completed where the shortfall identified is relates to interpreting the law. Firstly, the class of taxpayer should be considered and thereafter the certainty of the law. Once this has been established, it must be determined whether reasonable efforts have been made to obtain the correct advice and resolve the question. Due consideration should be given to whether a penalty for 'no reasonable grounds for tax position taken' is applicable.
- Table 16.7 is to be completed where the shortfall identified is as a result of a natural disaster.
- Table 16.8 is to be completed where the shortfall identified is as a result of an error made by a member of staff of the taxpayer.

If at any stage it is clear that a *high degree* of negligence is displayed, the conduct falls *significantly* short of the standard of care expected of a reasonable person in the same position or circumstances of the entity, there is a real risk which the taxpayer showed indifference to by not taking steps to reduce the risk, or the tax shortfall is large or significant when compared to the taxpayer's business or taxable activity, consider "gross negligence".

Table 16.1: Natural persons

The following fact sheet should be completed in as much detail as possible to obtain a full background on the taxpayer. The information gathered must not be viewed in isolation, but as a whole to determine whether reasonable care has been taken, based on the taxpayer's specific background and personal circumstances. Due consideration is to be given to the number of times that the "reasonable care not taken" option is selected.

1. Obtain confirmation of the taxpayer's highest education qualification.
2. Obtain confirmation of the ability of the taxpayer to write, speak, read and understand English.
3. Confirm the age of the taxpayer.
4. List any possible infirmity, sickness, disability or anxiety from which the taxpayer might suffer, supported by evidence to suggest that this was an operative cause in the failure to comply with the provisions of the Income Tax Act or Tax Administration Act.
5. Confirm the nature of the understatement, including the relevant tax laws.
6. Consider and document what actions a reasonable person in the same circumstances as that of the taxpayer would have taken to prevent the risk.
7. Consider and document whether a reasonable person in the same circumstances as that of the taxpayer would reasonably have foreseen the consequences of his or her actions and taken steps to avoid such consequences.
8. Consider the information provided by the taxpayer in support of why the error should be treated as a "*bona fide* inadvertent error".

Taking points 1 – 8 into account and based on the category of taxpayer, the following questions must be considered and where the answer is in the affirmative, consider the possibility that the error was a *bona fide* inadvertent error. Where the answer is "no", consider the possibility that reasonable care was not taken.

9. Have the matters referred to in points 1 – 4 above hampered the taxpayer in exercising business acumen?
10. Is the taxpayer inexperienced in the income tax area (has no professional expertise in the income tax area)?
11. Is there no indication of systematic or "innocent" omissions of income over a number of years?
12. Does the understatement appear to have been made in an impulsive and unsophisticated approach (as opposed to a sophisticated, premeditated, business-like approach)?
13. Consider the magnitude of the understatement. Is the understatement identified considered to be modest amount (as opposed to an excessive amount or considerable value)?
14. Does the taxpayer appear to have a genuine or *bona fide* belief that the amount in question was not taxable or was tax deductible?
15. Did the taxpayer fail to claim permissible deductions which could have been claimed?
16. Are there any circumstances which made it impossible for the taxpayer to comply with the provisions of the Income Tax Act or the Tax Administration Act (for example, the financial director was unable to discharge the tax obligations)? Due consideration is to be given to whether the impossibility is absolute.
17. Did the taxpayer display ignorance of the taxation laws?
18. Was the taxpayer coerced, threatened or pressurised into submitting incorrect information to SARS?
19. Did the taxpayer show remorse by pleading guilty or genuinely appear to have the intention of not wanting to transgress the law again?
20. Is it unlikely that a reasonable person, in the same circumstances as the taxpayer, would have foreseen the likelihood of the tax shortfall? (Note, the question is not whether the taxpayer foresaw the shortfall.)

21. Is the seriousness of the risk low in relation to the cost of guarding against it? (Note, a failure to respond to every foreseeable risk will not necessarily mean that reasonable care is absent.)

22. Does it appear that the taxpayer had no knowledge of the understatement?

23. Is the existence of the understatement not obvious on review?

24. Is the process of explaining the understatement and how it led to the tax shortfall an uncomplicated process?

25. Is the understatement as a result of a mistake in the calculation or recording of numbers in a return?

26. Is the understatement as a result of completely misunderstanding a known statutory obligation or law? (Note that if the taxpayer was not aware of the statutory obligation or law, reasonable care not taken should be selected.)

27. Is the understatement as a result of a timing difference?

28. Was a sincere and honest attempt made by the taxpayer to ensure that the submission to SARS was without errors?

29. Was an investigative approach displayed to the steps and risks associated with the tax position taken?

30. Does the degree of the investigation reflect the size of the risk?

31. Did the taxpayer effectively manage the risks identified during the investigative approach undertaken?

N.B.:

(1) Even if the taxpayer adopts a tax treatment that is inconsistent with the Commissioner's view, reasonable care will still be shown where a genuine effort is made to research the issue, provided that there is a basis for the position taken.

(2) If at any stage it appears that the taxpayer had motive or intention to evade taxes, consider "intentional tax evasion".

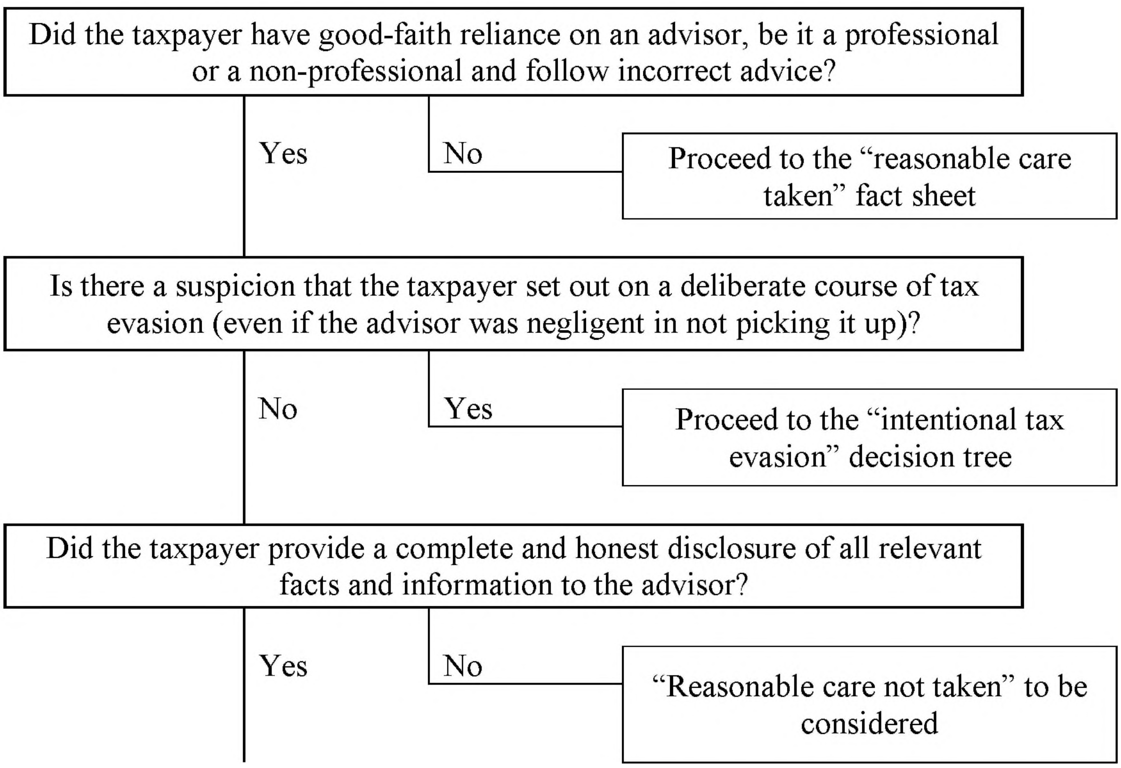
Table 16.2: Persons other than natural persons

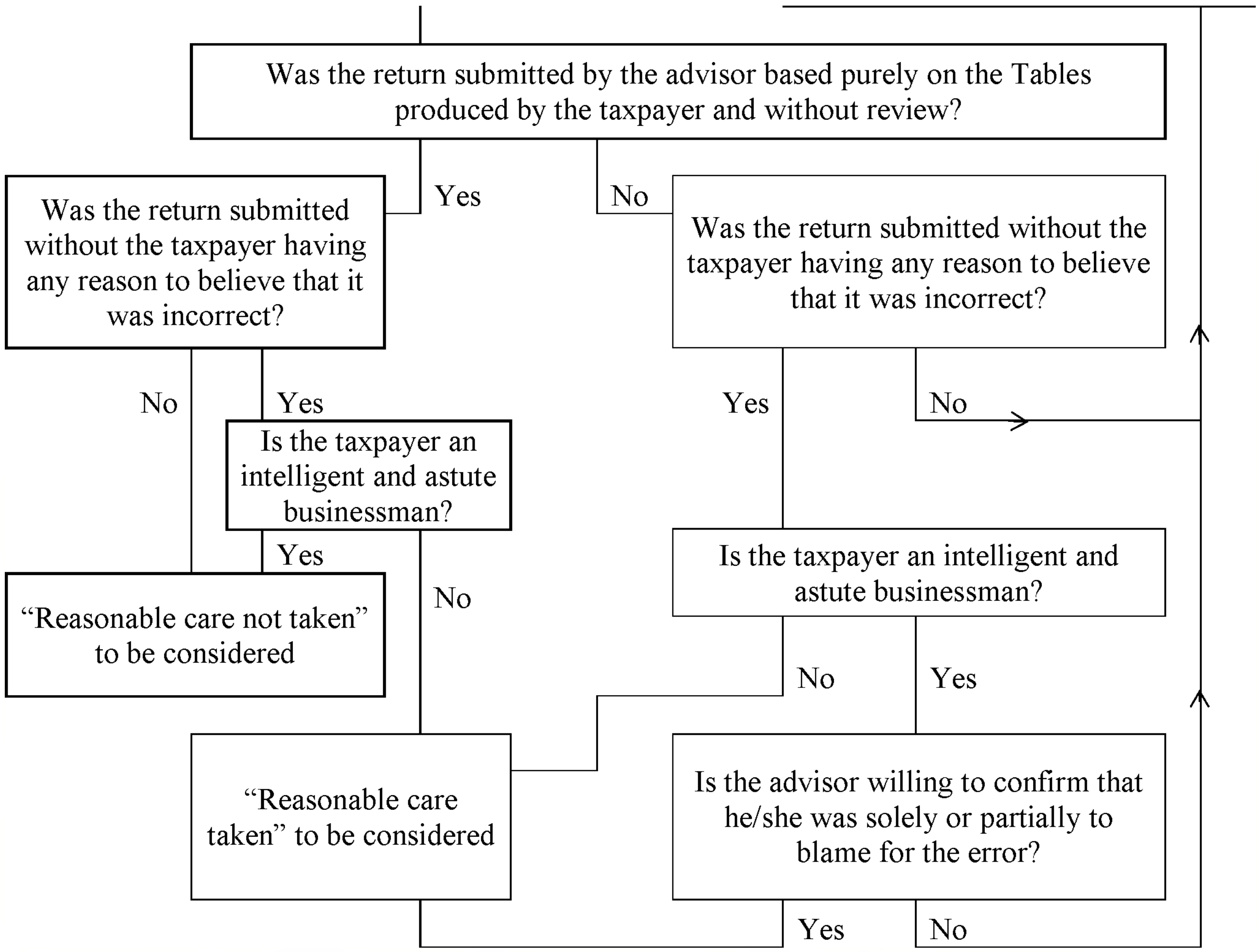
Table 16.2 is to replace points 1 – 4 on table 16.1 if the taxpayer is a person other than a natural person).

1. Obtain confirmation of the nature, size and character of the entity and its position in the marketplace. Consider whether an appropriate record-keeping system has been put into place to ensure that income and expenditure is correctly recorded for tax purposes.
2. Consider whether the corporate character and ownership of the entity changed since the understatement has occurred.
3. Consider whether the members or shareholders are professionals or experienced in the income tax area.

NB: If the accounting systems and internal controls are appropriately designed and monitored to ensure that the likelihood of error is reduced to an acceptable level, this will be consistent with taking reasonable care.

Table 16.3: Use of an advisor decision tree for natural persons and persons other than natural persons

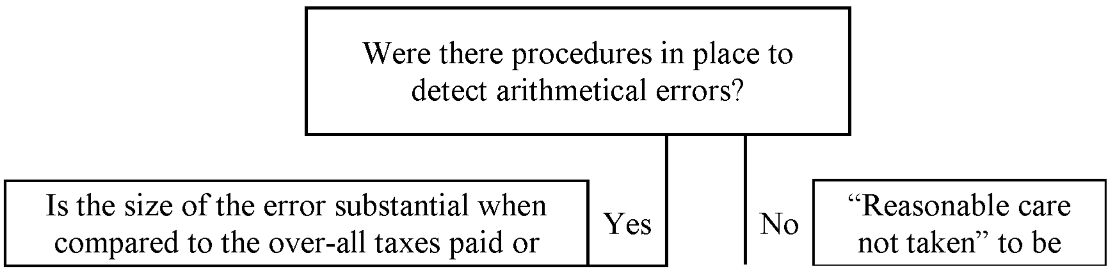




NB: The advisor's intention must not be inferred onto the taxpayer.

Table 16.4: Arithmetical error

Question whether the taxpayer in question falls into the normal salary and wage earner category. Proceed to comparing the size of the error in relation to the over-all taxes paid or correct income and expenses.



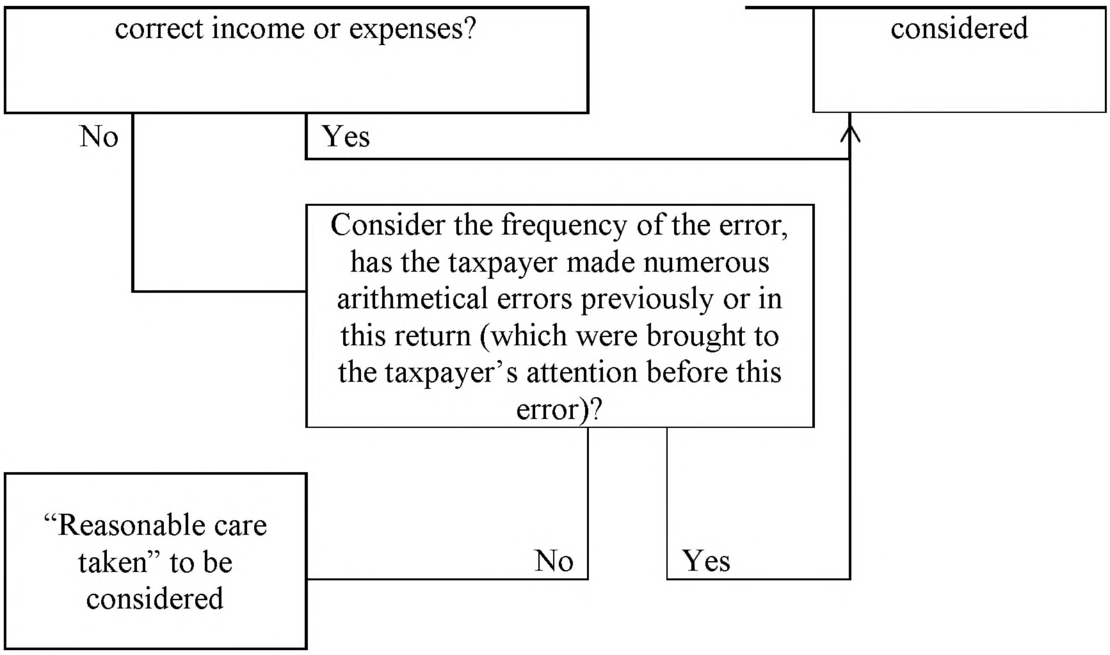


Table 16.5: Relying on a revenue official

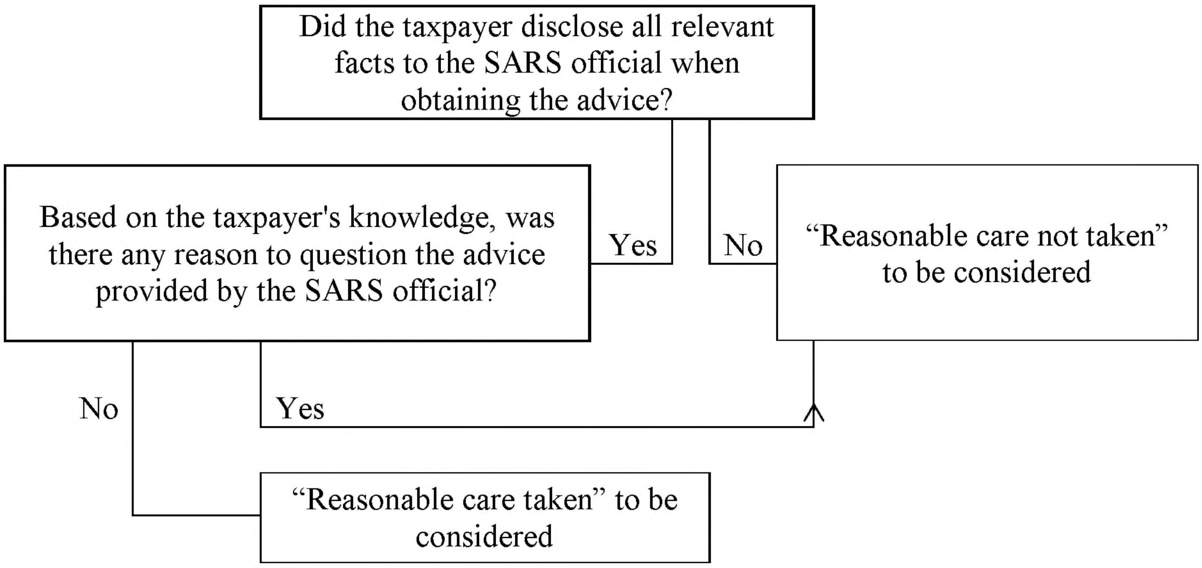
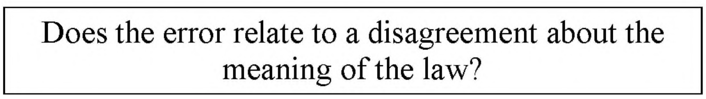


Table 16.6: Complex law or law interpretation



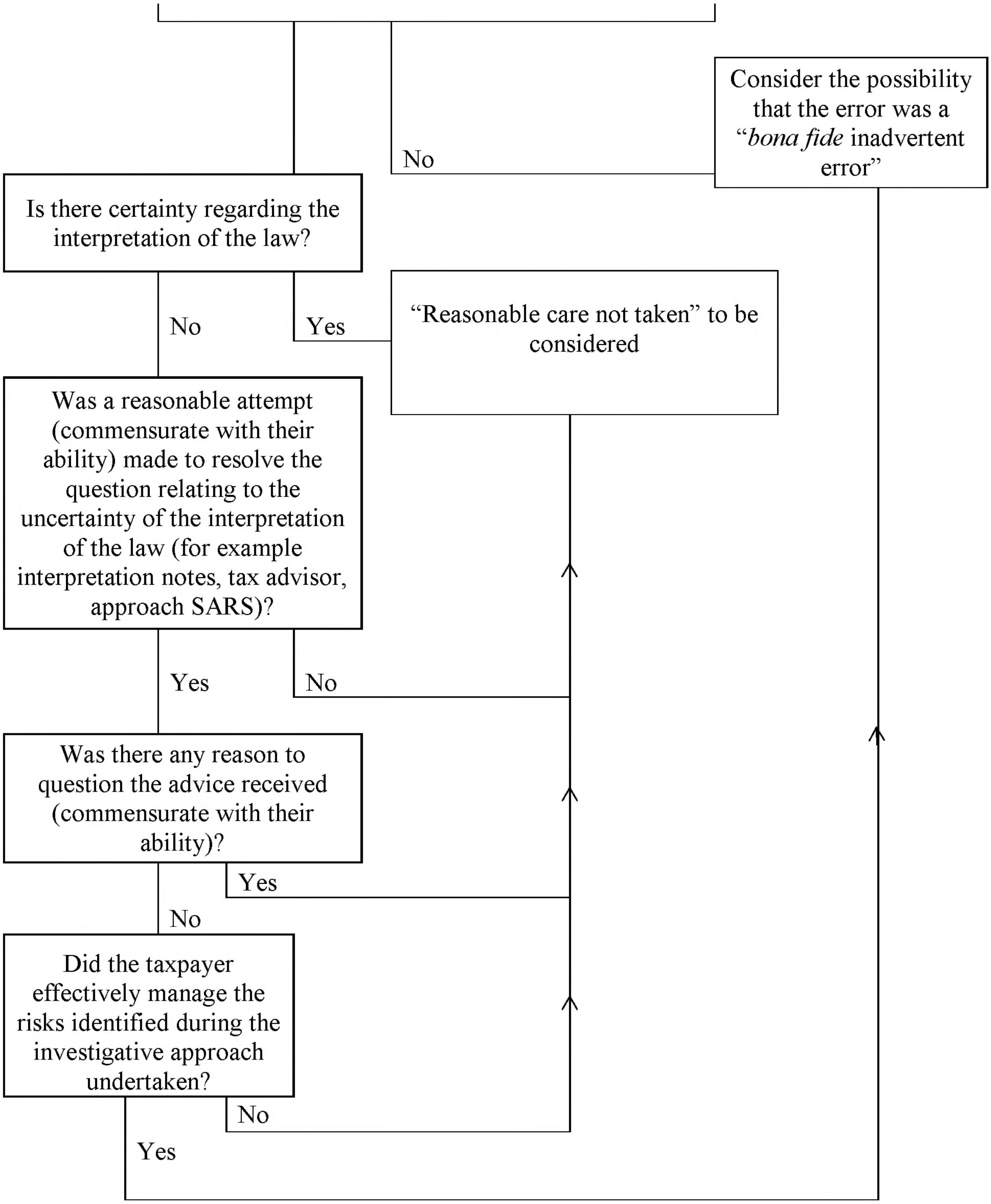


Table 16.7: Destruction of records

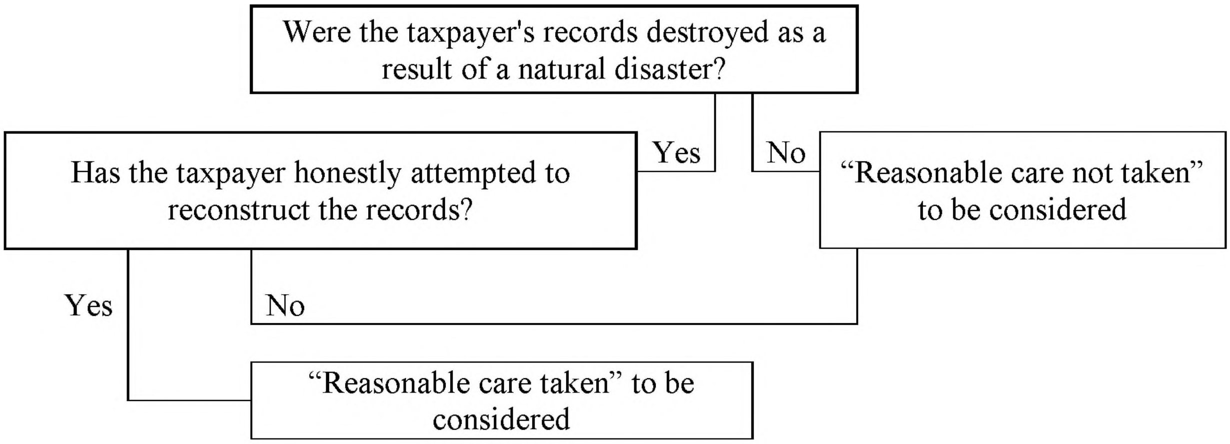
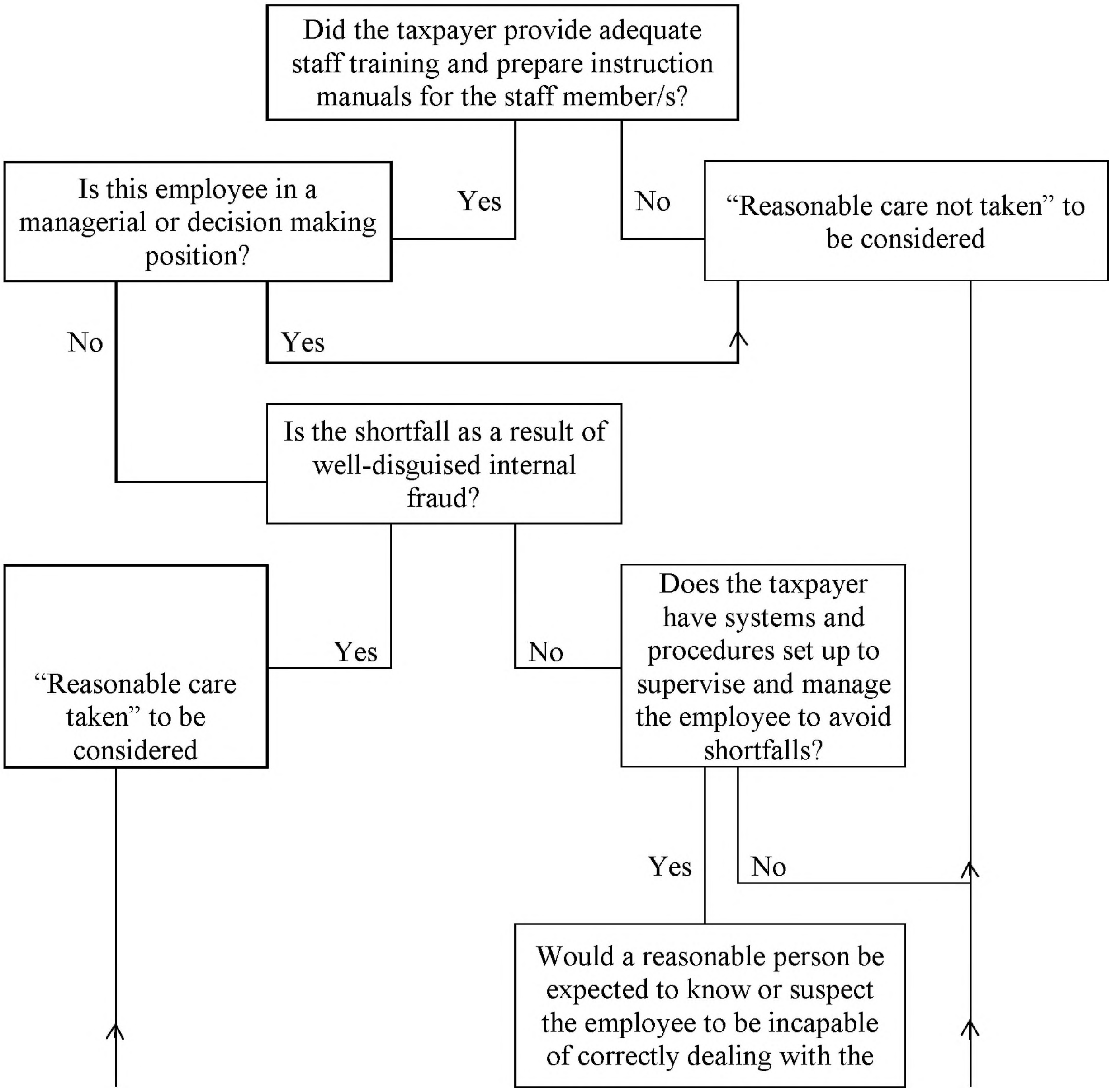


Table 16.8: Specific employee to blame



situation which gave rise to the shortfall?

No | Yes

NB: The personal circumstances of the employee e.g. age, health, background are not applicable in this test.

16.5.5. No reasonable grounds for the tax position

Where an underpayment of tax occurs due to a taxpayer's interpretation of the application of a tax Act, an understatement penalty is payable if the taxpayer does not have a reasonably arguable position. The test for "no reasonable grounds for the tax position taken" is an objective test. A taxpayer's interpretation of the application of the law is reasonably arguable if, having regard to the relevant authorities at the time the tax position is taken, for example an income tax law, a court decision or a general ruling, it would be concluded that what is being argued by the taxpayer is at least as likely as not, correct.

Tax position is defined to mean an assumption underlying one or more aspects of a tax return, including 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 than the maximum applicable to that class of taxpayer, transaction, event or item applies; or
- an amount qualifies as a reduction of tax payable.

Relevant authorities must be weighed according to their:

- persuasiveness (an authority that has extensive reasoning, relating relevant law and facts, would be more persuasive than one that simply states a conclusion);
- relevance (an authority that has some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is inapplicable to the tax treatment at issue); and
- source (a High Court decision on all fours with the tax treatment in question will be

accorded more weight than a Federal Court decision, which in turn would be accorded more weight than a decision of the Tax Court).

In the absence of authority for a particular position, other than the legislation itself, a well-reasoned construction of the applicable statutory provision which it could be concluded was about as likely as not the correct interpretation is sufficient. At least as likely as not, correct in the context of "no reasonable grounds for the tax position taken" is interpreted to mean about a 50 percent chance of being correct in the view of the Court.

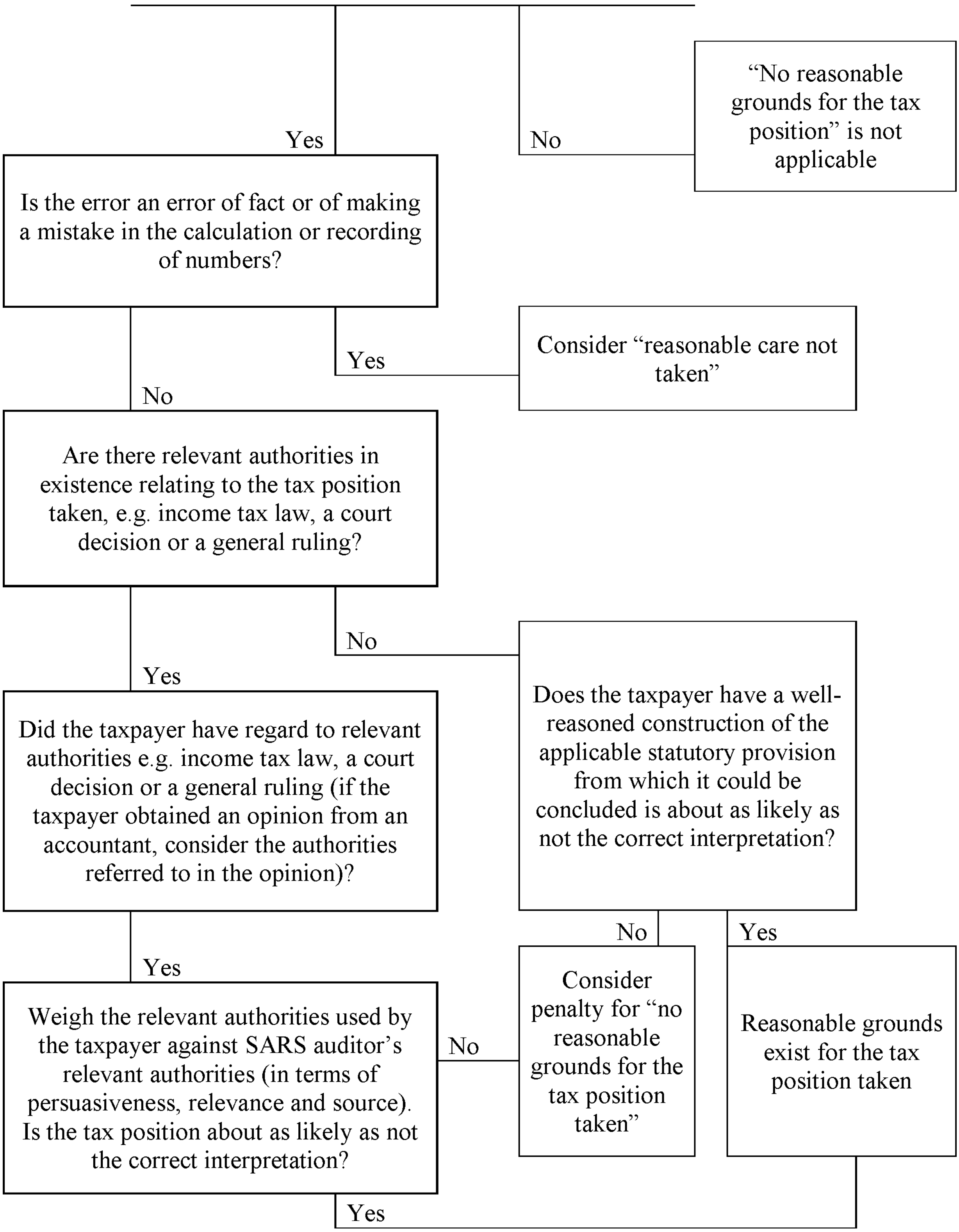
A penalty for "no reasonable grounds for the tax position taken" cannot be imposed for a mistake in the calculation or recording of numbers in a return. Instead, it may be necessary to consider whether the entity has taken reasonable care. However, an error of judgement is considered to be a deliberate choice and a penalty for "no reasonable grounds for the tax position taken" may be applicable.

If a shortfall arises because of a substantive disagreement concerning the application of a taxation provision, this understatement penalty will be imposed if the taxpayer's position is not based on reasonable grounds. The purpose is not to levy a penalty when SARS disagrees with a position adopted by a taxpayer but to attach a penalty where a taxpayer assumes a position unreasonably. As there is an inherent risk in assuming a tax position, taxpayers are expected to adopt a sensible approach in the process of adopting a tax position and to also have considered the integrity of the tax position taken.

Table 16.9 is to be followed by a SARS official to assist in determining whether a penalty for "no reasonable grounds for the tax position taken" is applicable.

Table 16.9: "No reasonable grounds for the tax position taken" decision tree for natural person and persons other than natural persons

Has the taxpayer taken a "tax position" as defined in section 221 of the Tax Administration Act?



16.5.6. Gross negligence

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

The following example is provided to assist in determining whether an understatement penalty should be imposed for "gross negligence":

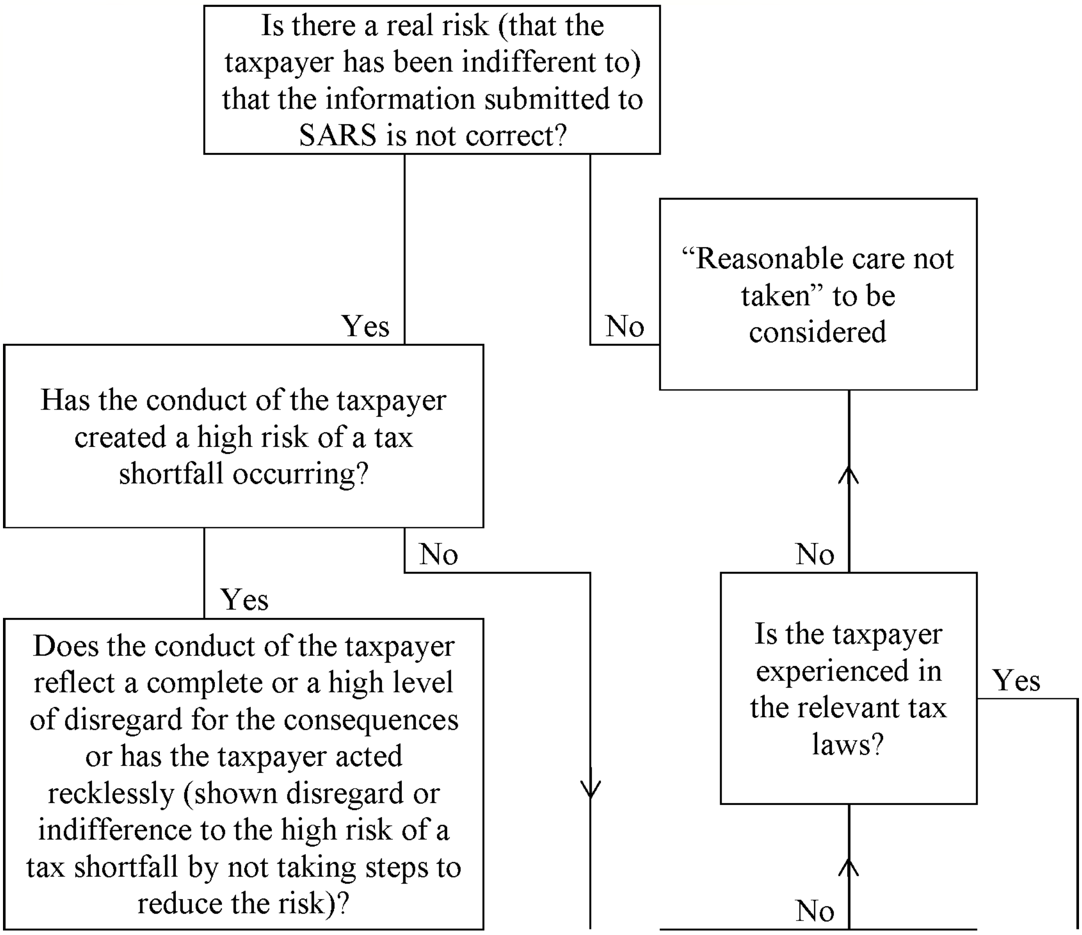
> *The taxpayer owned a company which was involved in land development and speculative building transactions. The taxpayer did not make use of a book keeper or accountant and completed and submitted the company's VAT201 returns to SARS himself, as he believed that the SARS e-filing system had simplified the process enough for him to be able to correctly submit the VAT returns without assistance. He had been submitting the company's VAT201 returns for a number of years with no major findings by SARS. In the past two years, the company had grown substantially. The taxpayer continued to keep manual records and was of the opinion that purchasing an accounting programme was a waste of money. The VAT201 return was selected for verification by SARS and it was found that the taxpayer had entered into an agreement to sell a property which had been purchased approximately 3 months previously and did not declare output tax on the sale of the property. The taxpayer claimed that he was not aware that the output tax needed to be declared on the sale. The SARS official determined that on the purchase of the property, the taxpayer had correctly claimed the input VAT.*

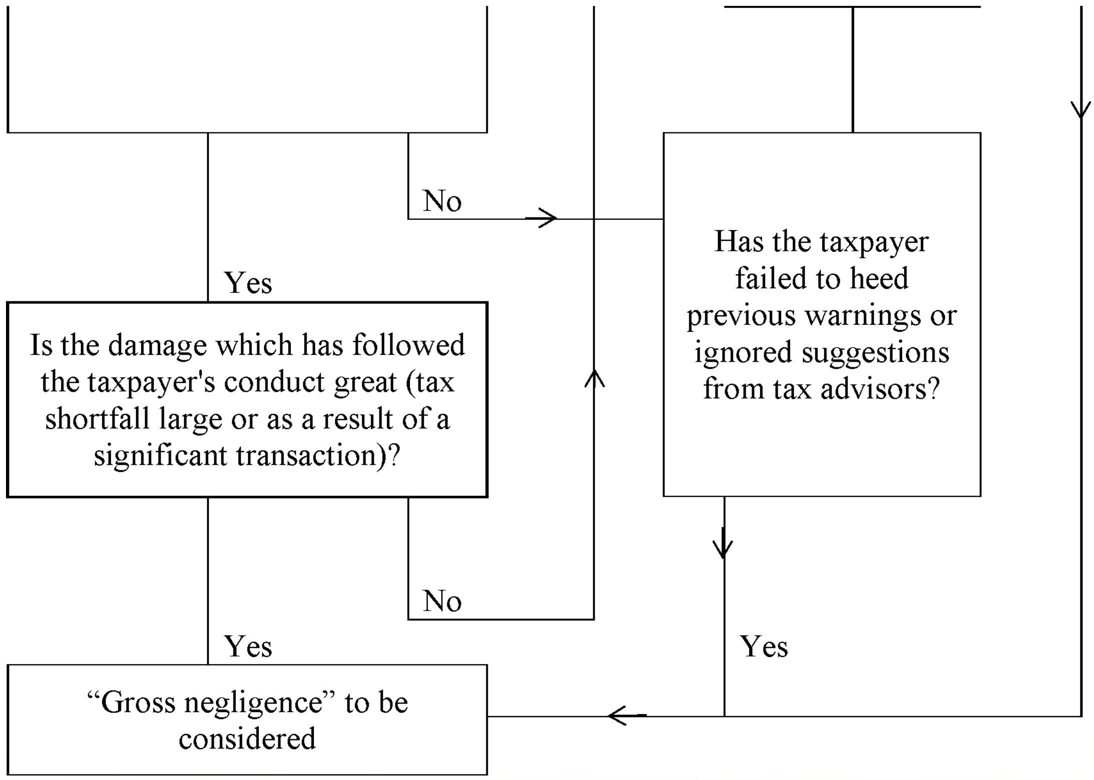
This example illustrates "gross negligence" as opposed to "reasonable care not taken". The taxpayer's refusal to purchase an accounting programme, even though his business had grown substantially, reflects an indifference to an obvious risk of a possible tax shortfall occurring. There was a relatively short period of time between the purchase and sale of the property and the taxpayer recognised the tax effect of the purchase correctly. The taxpayer has been submitting VAT returns for a number of years and should therefore have experience in the relevant tax laws.

Table 16.10 is to be followed by a SARS official to assist in determining whether a penalty for "gross negligence" is applicable.

Table 16.10: "Gross negligence" decision tree for natural persons and persons other than natural persons

1. Consider and document whether a reasonable person in the same circumstances as that of the taxpayer would reasonably have foreseen the consequences of his actions.
2. Consider and document what actions a reasonable person in the same circumstances as that of the taxpayer would have taken to prevent the risk.





NB: It is not necessary to consider whether the taxpayer was aware of being grossly negligent or whether he or she intended to be grossly negligent.

16.5.7. Intentional tax evasion

The most severe penalty is preserved for cases where a taxpayer has acted with the intention to evade tax or similar act. The acts or omissions that will constitute a "similar act" to "intentional tax evasion" are discussed further below. To evade tax includes actions that are intended to reduce or extinguish the amount that should be paid, or which inflate the amount of a refund that is correctly refundable to the taxpayer. Subjective recklessness is sufficient *mens rea* for evasion. Recklessness is satisfied where the taxpayer strongly suspects that the actions will result in a breach of a tax obligation and proceeds regardless.

Intentional tax evasion can exist where a taxpayer makes a false statement in a return, and even where a person does not file a return. The most important factor is that the taxpayer must have acted with intent to evade tax. Intention is a wilful act, that exists when a person's conduct is meant to disobey or wholly disregard a known legal obligation, and knowledge of illegality is crucial. Whether SARS acts on or accepts a false declaration is irrelevant. If SARS does not accept the declaration, but audits the taxpayer and determines the correct tax position the original intent to evade tax is not excused. Intention may, at times, be difficult to distinguish from an act that is grossly negligent.

The taxpayer's dominant purpose (the most important or influential reason for the taxpayer at the time of taking the tax position which gave rise to the shortfall identified) must be determined. In determining the taxpayer's dominant purpose, due consideration should be given to the commercial purpose of the transaction, whether transactions have been designed to appear to comply with legislation, whether a tax avoiding arrangement has been entered into, information has been concealed or is not available and whether the tax position taken is frivolous or has no or very little basis at law.

If there is no direct evidence of the taxpayer's intention, intention may be inferred from the surrounding circumstances (the taxpayer must be presumed to intend the natural consequences of his own act) and can also be determined based on a balance of probabilities. Background, business experience and conduct are to be taken into account when considering evidence inferred from the surrounding circumstances. The natural consequence of the act must also be determined and documented.

Since the application of tax law to a particular taxpayer may be complex, it may be that a genuine misunderstanding of the practical application of a taxing provision does not indicate intentional tax evasion. If the taxing provision is uncertain, for instance if there are conflicting judgments on the issue, and the taxpayer applies a reasonable interpretation, it is doubtful that intent to evade could be established and that the more appropriate behavioural category would be whether the taxpayer had taken a tax position on unreasonable grounds or, at worse, that the taxpayer has been grossly negligent. This is an area that is also influenced by the nature of the actions that underlie an understatement and the circumstances of the taxpayer.

The following information must be obtained and documented by the SARS official, together with supporting evidence where possible:

- whether the taxpayer has been previously prosecuted and/or been subject to shortfall penalties for evasion;
- the reason given by the taxpayer for his/her behaviour;
- the degree of the culpability of the taxpayer;

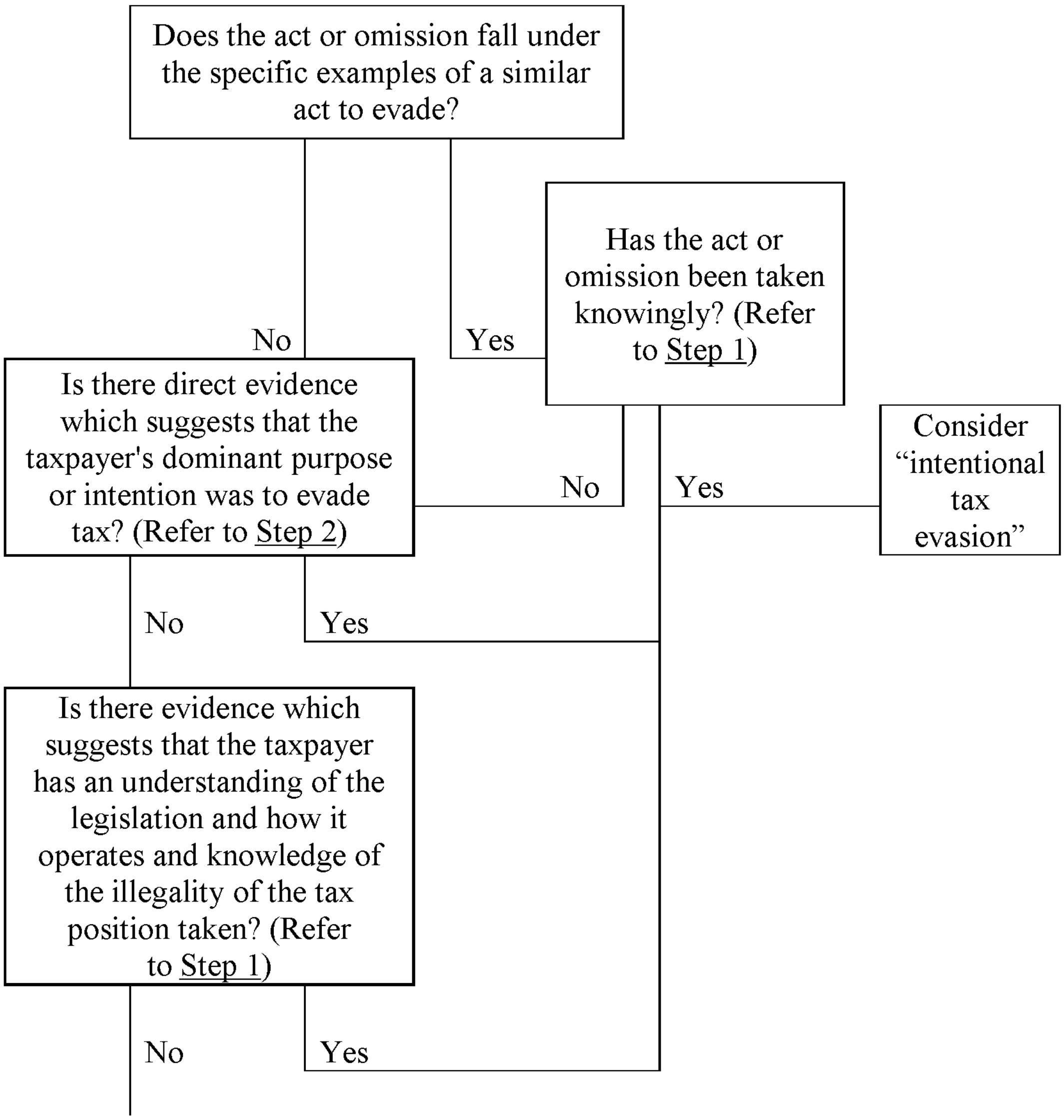
- the likelihood of future compliance;
- the degree of cooperation received from the taxpayer;
- the effect on promoting voluntary compliance; and
- the duty to protect the integrity of the tax system.

The following acts or omissions constitute a “similar act” to “intentional tax evasion” and may lead to an understatement penalty being imposed for “intentional tax evasion”:

- systematically paying wages without accounting for employees’ tax;
- knowingly failing to record all sales, especially where there is a pattern to the under-recording, such as omitting all transactions with a particular customer or at a particular time of the week, month or year;
- deliberately describing transactions inaccurately or in a way likely to mislead;
- submitting a VAT return to SARS that includes an amount of net VAT due that is too low because the person does not have the cash at that time to pay the full amount, and later informing SARS of the true figure when the funds to pay are available;
- claiming a deduction for personal expenses of such a size or frequency that the inaccuracy must have been known;
- deliberately not making any attempt to ensure that money withdrawn for personal use from an incorporated business is treated correctly for tax purposes;
- deliberately omitting a known asset, rather than making enquiries about its value, on the basis that the asset can be included in a corrective account later;
- creating false invoices to support inaccurate figures in the return;
- backdating or postdating contracts or invoices;
- creating false minutes of meetings or minutes of fictitious meetings;
- destroying books and records so that they are not available;
- systematically diverting takings into undisclosed bank accounts and covering the traces;
- invoice routing, for example the purported sale or purchase of goods through a tax haven company (with no activity undertaken by that company even though contracts exist showing the contrary) and leaving profits untaxed in that company;

- creating sales records that deliberately understate the value of the goods sold;
- describing expenditure in the business records in such a way as to make it appear to be business related when it is in fact private; and
- altering genuine purchase invoices to inflate their value.

Table 16.11: "Intentional tax evasion" decision tree for natural persons and persons other than natural persons



Intentional tax evasion is not applicable, consider "gross negligence"

Step 1: Knowingly

1. Obtain confirmation of the taxpayer's highest education qualification.
2. Confirm whether the taxpayer is an intelligent and astute businessman.
3. Consider whether the taxpayer, members or shareholders have professional knowledge in the income tax area.
4. Consider the experience or inexperience of the taxpayer with regard to income tax matters.

Due consideration should be given to the number of times "consider 'intentional tax evasion'" is selected on the flowchart. All selections must be supported by documented evidence and written reasons for the selection.

The following questions must be considered and where the answer is in the affirmative, consider the possibility that the error was intentional tax evasion. Where the answer is "no", consider the possibility of gross negligence.

14. Is there any indication that the taxpayer is systematically committing income tax fraud?
15. Is there evidence to indicate that the taxpayer benefitted personally from the taxes saved as a result of the understatement identified?
16. Is there evidence to indicate that the taxpayer has concealed any assets or funds obtained as a result of the understatement identified?
17. Is the taxpayer likely to be in a position to continue to commit similar offences or understatements in the future?
18. Is the understatement identified as a result of fictitious information or based on non-existent transactions?
19. Consider the magnitude of the understatement. Is the understatement identified considered to be an excessive amount?
20. Will the majority of the shortfall identified remain unrecovered by the *fiscus*?

21. Did the taxpayer play a crucial role in the commission of the understatement which gave rise to the shortfall identified?

22. Does the shortfall identified appear to have been done in a way that was planned?

23. Has the taxpayer disregarded, ignored or treated something as being unimportant which lead to the creation of the shortfall?

24. Has the taxpayer acted in a way which appears to be untruthful, deceitful or dishonest (for example, concealed any information)?

25. Does the taxpayer appear to have been aware or strongly suspected that the actions or conduct in question at the time of taking the tax position that gave rise to the shortfall were in breach of a tax obligation?

26. Did the taxpayer realise the possibility of the consequences of a finding of "intentional tax evasion" when taking the tax position which gave rise to the shortfall identified?

NB: The taxpayer must not be made to bear the brunt of the punishment in the absence of the primary perpetrator.

Step 2: Guidelines to determine the dominant purpose:

7. Determine and document what the most important or influential reason was for the taxpayer taking the tax position at the time of taking the tax position which gave rise to the shortfall identified.

8. Determine whether a deliberate choice was made to ignore the relevant legislation.

9. Determine and document whether the transaction which gave rise to the shortfall identified seems to have been designed to appear to comply with legislation. Give due consideration to the commercial reality of the arrangement.

10. Determine and document whether there is any circular funding, which results in income being incorrectly treated as exempt.

11. Determine and document whether the taxpayer has concealed any information.

12. Determine and document whether there is evidence of spurious interpretation of tax laws or whether the tax position taken is frivolous.

16.5.8. Obstructive

"Obstructive" is defined as: "Deliberately interfering with, causing difficulties (impeding) or delays in or preventing the progress of a SARS audit or review."

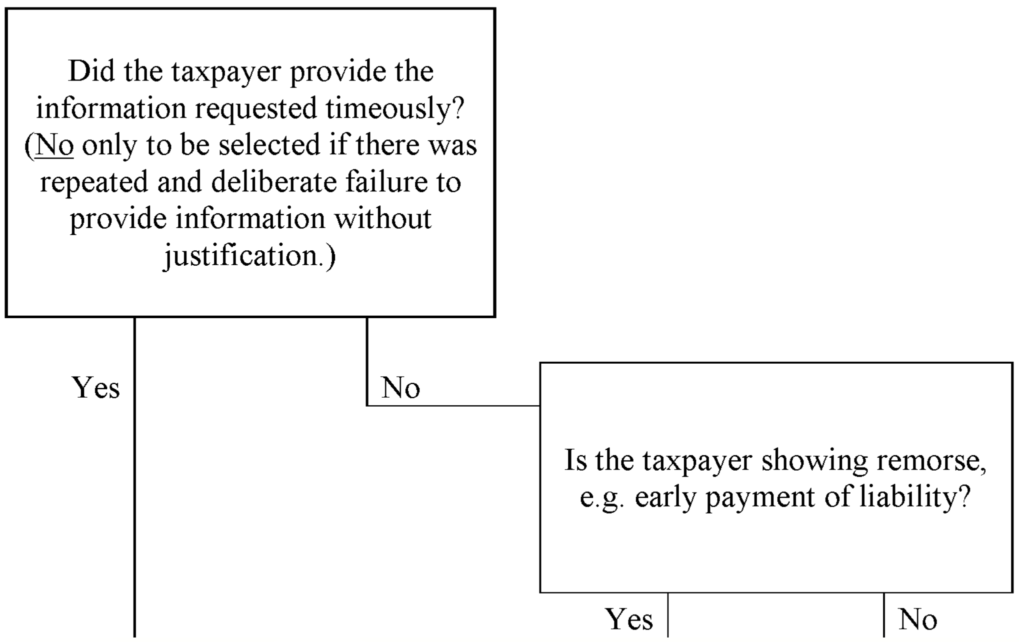
The following factors should be present before a penalty can be imposed for obstruction:

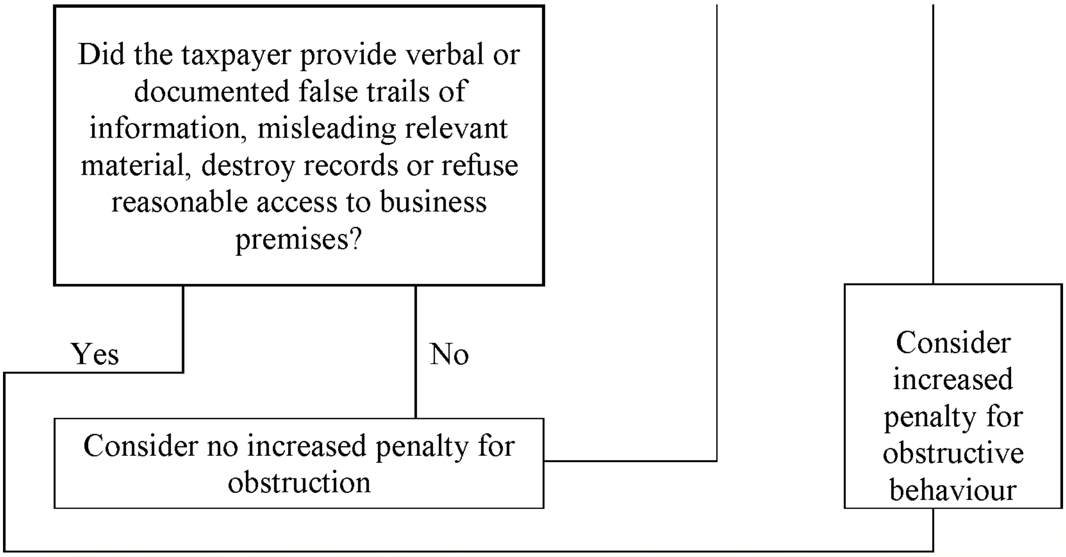
- the conduct must be obstructive;
- it must be without justification or lawful excuse; and
- the steps taken to hinder the investigation must be active as opposed to passive.

An increased penalty for obstruction can only be imposed if it is the taxpayer who obstructs the SARS official. The onus of proof is on the taxpayer to prove that their conduct was with lawful justification or excuse. The standard of proof for obstruction is on the balance of probabilities.

Table 16.12 is to be followed by a SARS official to assist in determining whether an increased penalty for "obstruction" is applicable.

Table 16.12: Increased penalty for "obstructive" behaviour decision tree for natural persons and persons other than natural persons





NB: The standard of proof for obstruction is on the balance of probabilities.