FAIRNESS AND EFFICACY OF THE PENALTY PROVISIONS IN THE TAX ADMINISTRATION ACT 28 OF 2011

by

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DECLARATION

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SUMMARY

The purpose of this treatise was to examine the fairness and efficacy of the penalty provisions in the Tax Administration Act (the Act). An integrative literature review research method was used. The study commenced with a review of the local and international literature on tax compliance and the fairness and efficacy of penalties. This was followed by a study of the stated objectives of the Fiscus in respect of the strategy and approach to maintaining and improving taxpayer compliance and an analysis of the penalty regime of the Act. A comparative analysis was then performed of the relevant taxing legislation of five countries, which were chosen using a purposeful sample selected from the major trading partners of the Republic and countries with a similar tax framework. Following this, a review was performed of a cross section of the most recent tax related court cases in South Africa in order to assess the extent, consistency and fairness of the application of the penalty provisions. The study then concluded with an integrated assessment of the fairness and efficacy of the penalty provisions in light of the research conducted, and highlighted areas where the legislation appears to meet this objective, followed by recommendations for amendments in respect of policy and implementation. Finally recommendations were made for areas of further research which might improve the validity of the conclusions with respect to the stated objectives of the present research and to inform policy formulation.

**Key words:** Administrative penalty, compliance, deterrence, efficacy, fairness, non-compliance, penalties, prejudice, understatement, Tax Administration Act.
CHAPTER 1

INTRODUCTION AND BACKGROUND

‘The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing.’ (Colbert, 1665)

1.1 Introduction to the research

The Tax Administration Act\(^2\), (the Act) commenced on 1 October 2012, under Proclamation 51, 2012\(^3\). This Act contains two chapters which deal with the penalties a taxpayer may be subjected to, namely:

- Chapter 15: Administrative non-compliance penalties and
- Chapter 16: Understatement penalties.

The Explanatory Memorandum on the Draft Taxation Administration Bill, 2009 gives the purpose of the Bill as:\(^4\)

‘a project to incorporate into one piece of legislation certain generic administrative provisions, which are currently duplicated in the different tax Acts… Generally, the TAB seeks to provide a single body of law that outlines common procedures, rights and remedies and to achieve a balance between the rights and obligations of both SARS and taxpayers in a transparent relationship.’

(Emphasis added.)

\(^2\) 28 of 2011.
\(^3\) P 51, Government Gazette 35687 of 14 September 2013.
1.2 Research objective

The purpose of this study is to examine the fairness and efficacy of the penalty provisions in the Act.

1.3 Research questions

The research questions for this study are as follows:

- What are the local and international research findings in respect of taxpayer compliance behaviour and specifically the fairness and efficacy of penalties?
- What are the stated compliance objectives of the Fiscus?
- What are the penalty provisions of the Act?
- How do the penalty provisions of the Act compare with international legislation?
- To what extent are the penalty provisions fairly and consistently addressed and enforced by the courts?

1.4 Significance of the study

On 31 March 2013, there were 17 926 869 taxpayers on the South African Tax Register. This includes individuals, companies and trusts. In addition there were 391 254 registered employers and 650 540 registered VAT vendors. The SARS 2012/2013 Annual Report reflected overdue taxpayer debt comprising penalties and additional tax of R11 184 647 312 as at 31 March 2013. The amount is R12 147 652 361 at 31 March 2014 according to the South African Revenue Services Annual Report 2013-2014. According to the same tables, the amount related specifically to administrative penalties was R3 553 597 005 and

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5 2013 Tax Statistics at 1 Revenue Collections_tables.
R4 916 571 154 for 2013 and 2014 respectively.\(^8\) The 2012/2013 Annual Report\(^9\) indicates that on time filing of Company Income Tax was 40.9% in 2014 compared to 50.6% in 2011.

The penalty provisions of the Act, therefore, impact a large portion of South African taxpayers and represent substantial monetary amounts. This begs the question as to whether the legislation supports a fair and effective framework for the efficient collection of taxes and promotion of an effective tax administration.

1.5 Proposed research design and method

The proposed research method is an integrative literature review. Mouton\(^10\) defines a literature review as follows:

‘Studies that provide an overview of scholarship in a certain discipline through an analysis of trends and debates.’

This method entails a design classification that is non-empirical and based on secondary data.

1.6 The scope of the research

The scope of the research is limited to the following chapters of the Act:

- Chapter 15: Administrative non-compliance penalties\(^11\), and
- Chapter 16: Understatement penalty.

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\(^8\) This represents an increase of 38% of overdue administrative penalty debt year on year. The comparable increase from 2012 to 2013 was 34%, from R2 647 871 337 as published in the 2012/2013 report above.

\(^9\) Op cit 37.


\(^11\) Excluding reportable arrangements as discussed in 4.4.
The impact of these chapters in respect of the Income Tax Act\(^\text{12}\) (the Income Tax Act), and the Value-Added Tax Act\(^\text{13}\) (the VAT Act) will be studied. However, penalties which are specifically related to the pay-as-you-earn (PAYE) system of tax collection, and non-compliance offences subject to criminal prosecution are not within the scope of this study. Furthermore the scope of the research excludes legislation promulgated or judgments handed down after 31 August 2015.

Section 33 of the Constitution\(^\text{14}\) entrenches the right to administrative action that is ‘lawful, reasonable and procedurally fair’. According to the learned judge Chaskalson, the Promotion of Administrative Justice Act\(^\text{15}\) (the PAJA)\(^\text{16}\)

‘is the national legislation that was passed to give effect to the rights contained in section 33’.

As an organ of the state, SARS is subject to the PAJA. However, legislative functions of Parliament are excluded from the definition of ‘administrative action’ by the proviso to the definition par (dd). Therefore the legislation embodied in the Act itself is not subject to the PAJA. Since the aim of this treatise is to analyse the provisions of the Act with reference to the research questions above, the PAJA is not central to the study. However the relevance of the legislation is acknowledged and will be considered where applicable. It is proposed that a study of the relationship between the PAJA and the tax administrative actions that are taken by SARS in the context of Chapter 15 and Chapter 16 of the Act would be of value.

\(^{12}\) Act 58 of 1962

\(^{13}\) Act 89 of 1991

\(^{14}\) Constitution of the Republic of South Africa.

\(^{15}\) Act 3 of 2000.

\(^{16}\) Minister of Health and Another v New Clicks South Africa (Pty) Ltd and Others [2006] JOL 1536 (CC) at 95.
CHAPTER 2

A REVIEW OF THE INTERNATIONAL AND LOCAL LITERATURE ON TAX COMPLIANCE AND ITS RELATIONSHIP WITH THE FAIRNESS AND EFFICACY OF PENALTIES

‘Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.’

2.1 Introduction

The purpose of this chapter is to review the local and international research with respect to taxpayer compliance and its relationship with the fairness and efficacy of penalties in order to benchmark the penalty provisions of the Act.

Firstly the relevant definitions of the term ‘compliance’ and conversely non-compliance are investigated. Then the theories with respect to tax compliance behaviour are considered, followed by an analysis of the research into the impact of penalties as a deterrent to non-compliance and therefore their efficacy.

2.2 Defining compliance behaviour

The literature acknowledges that the concept of taxpayer compliance is difficult to measure and indeed to define, as identified by Long and Swingen.

17 Commissioner of Internal Revenue v. Newman No. 16, Docket 20211; 159 F.2d 848 (1947) at 7.

According to the Organisation for Economic Cooperation and Development (OECD):\(^\text{19}\)

‘while specific obligations of taxpayers will vary from one taxation role to another and from one jurisdiction to the next, four universal categories of obligation are likely to exist for almost all taxpayers. These are 1) registration in the tax system; 2) the timely filing of tax returns; 3) reporting of complete and accurate information in tax returns; and 4) payment of tax obligations on time...taxpayers who fail to meet any of them may be considered to be “non-compliant”, although the reason for their non-compliance may fall along a continuum extending from unintentional error to deliberate actions.’

Long and Swingen\(^\text{20}\) emphasise that non-compliance refers to both over-reporting as well as under-reporting of taxes. Two important elements of non-compliance are identified by them, namely:

‘(1) what compliance means when requirements are ambiguous, and

(2) whether motivation should be a defining factor for noncompliance behavior.’

Ambiguity may arise in respect of the meaning of statutory language or the application of the law to specific facts and evidentiary issues. Taking that into consideration, it is submitted that the viewpoint above provides an important lens through which to view compliance legislation.

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\(^{20}\) Op cit 646.
They state:\textsuperscript{21}

‘Forcing honest disagreements to fit into an analytical framework that views them as a decision over "noncompliance"\textsuperscript{22} does fundamental violence to their nature and may produce answers with little validity for the real issues we seek to address.’

The second element refers to research which shows that non-compliance is often unintentional. This is considered further below.

2.3 \textbf{Theories on compliance behaviour}

Two key theories emerge in the study of taxpayer compliance behaviour, namely the deterrence and accommodative theories as identified and expanded upon by Murphy\textsuperscript{23}, Scholtz and Pinney,\textsuperscript{24} Doran\textsuperscript{25} and others.

2.3.1 \textbf{Deterrence theory or utility theory}

According to Smith and Kinsey\textsuperscript{26}, this has been the ‘primary theoretical framework applied to tax cheating’

\textsuperscript{21} Op cit 649.

\textsuperscript{22} The term “noncompliance” is used in certain articles. This spelling has not been changed when quoting directly. However “non-compliance” as used in the Act has been employed in all other respects.


Becker expanded on the economic models developed in the eighteenth and nineteenth centuries by Beccaria and Bentham in developing this theory, which builds an economic model in which the benefit of the illegal behaviour is balanced against the cost of the punishment. The culprit would essentially compare the benefit to be derived from the activity against a combination of the harshness of the punishment and the probability of detection. The utility of the benefit to be derived, in this instance taxes saved, is weighed against the risk and magnitude of the penalties.

2.3.2 Accommodative theory or norms model

The alternative to deterrence theory is less clearly defined and has been attributed different titles. The emergent themes refer to matters such as taxpayers’ perceptions of justice, taxpayers’ attitudes and morals and the views taxpayers hold with respect to the taxing authority. The perceived legitimacy of the authority is also emphasised by Murphy, Andreoni et al and Doran. Doran suggests that if penalties are too harsh, then taxpayers may perceive that this is indicative of widespread non-compliance, lessening the sense of obligation that the taxpayer feels and causing the opposite effect to that intended by the penalties.

According to Trivedi et al, the traditional economic model does not fully explain taxpayer compliance. Theories extend beyond economic measures to include moral reasoning, value

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30 Op cit 112.
orientation, reference theory and equity theory. They identify that compliance has been found to be higher than predicted by utility theory and they indicate that\textsuperscript{32}

‘tax compliance is a complex decision, influenced not only by economic decisions but also by the personal conditions of individuals.’

The findings highlight the importance of taxpayer attitudes towards the Fiscus and the equity of the taxpayer regime in influencing compliance decisions and conclude that\textsuperscript{33}:

‘the psychological attributes that influence compliance are as important, if not more so, than the regulatory (audit) and the societal (tax equity, and peer reports), variables.’

Abrie and Doussy\textsuperscript{34} indicate that taxpayers pay more tax than the economic models predict and refer to the expansion of taxpayer compliance research to include background factors, equity, fairness, and taxpayer beliefs and norms. They also make reference to the influence of tax complexity and the cost of compliance. In conclusion to their research on tax compliance obstacles encountered by small and medium businesses in South Africa, the complexity of the tax system and high cost of compliance are identified as substantial stumbling blocks to compliance. They state:\textsuperscript{35}

‘it is important to ensure that any changes do not result in an even more complex tax system. It is clear that small businesses (and probably other taxpayers as well) would prefer simple cuts in tax rates and penalties rather than elaborate tax incentive schemes which require sophisticated systems and skilled staff and often result in increasing compliance costs rather than provide real tax relief.’

\textsuperscript{32} Op cit 192.

\textsuperscript{33} Op cit 20.

\textsuperscript{34} W Abrie and E Doussy ‘Tax compliance obstacles encountered by small and medium enterprises in South Africa’ (2006) 14 No. 1 Meditari Accountancy Research 1 at 3.

\textsuperscript{35} Op cit 11.
The phenomenon of taxpayer compliance exceeding that predicted by deterrence theory is also highlighted by Mariott and Doran. In their experimental investigations of tax cheating, Robben et al. noted a high incidence of unintentional errors. The authors also referred to the ‘puzzling’ matter of three percent of the subjects overpaying their taxes by a non-trivial amount. Andreoni et al. also refer to the extent to which the standard economic model over-predicts non-compliance.

Smith and Kinsey indicate that:

‘conformity itself is an act involving, at least for many, considerable planning and initiative.’

Reference is made to the idea that non-compliance may to a large extent be the result of inertia, or indifference as opposed to a deliberate or intentional decision on the part of the taxpayer, specifically within the context of a complicated tax system which requires a substantial investment of time, energy and money to properly comply. They state:

‘Moreover, while the social problem may be the broad category of tax non-compliance, most people probably do not approach taxpaying in terms of a single decision to comply or not to comply. Rather, they undertake or fail to undertake a series of actions whose cumulative result is compliance or non-compliance.’

37 Op cit 123.
39 Op cit 855.
40 Op cit 641.
41 Op cit 643.
Nadler and McAdams\textsuperscript{42} find that taxpayer compliance increases when taxpayers are treated with fairness and respect, and contrast the approaches of sanctions (economic) and legitimacy in achieving legal compliance.

2.4 The efficacy of penalties as a deterrent to taxpayer non-compliance

Within the ambit of deterrence theory, penalties are widely used by taxation authorities in an attempt to reduce tax non-compliance. Becker postulates that\textsuperscript{43}

‘fines have several advantages over other punishments: for example, they conserve resources, compensate society as well as punish offenders…’.

This is essentially rebutted by Mariott, who states:\textsuperscript{44}

‘Research to date is inconclusive on the extent to which penalties deter crime. Despite the findings of deterrence theory, there is a large body of literature that supports the view that punishment is not effective;’

Although focussing on tax non-compliance, she considers a wide body of research, including sensitivity to penalties under circumstances of general criminal activity. She continues to establish that while severity of punishment is an important factor of the process, ‘it has typically been accepted that certainty of detection and punishment is a greater deterrent than severity of penalty.’


\textsuperscript{43} Op cit 208.

\textsuperscript{44} Op cit 879.
Madeo, et al conducted a study using amount of income, source of income, penalty for cheating, and rate structure as independent variables. The authors found that:\textsuperscript{45} 

‘In general, therefore, the taxpayer's source of income can be interpreted as three times as important as the next most heavily weighted variable (Penalty).’

Smith and Kinsey state:\textsuperscript{46} 

‘It bears emphasising that taxpayer’s perceptions of material gains and losses are of necessity based upon what they know and perceive to be true about situational opportunities and constraints (Ajzen and Fishbein, 1980)...Kidder and McEwan (1986) and Mason (in press) also stress the need for further research on how people obtain their information about tax laws and enforcement practices.’

The importance of a taxpayer’s attitude towards the tax system is also highlighted. Scholtz and Pinney\textsuperscript{47} reinforce the importance of taxpayer knowledge, finding that stricter penalties and increased audit probability will not improve compliance when taxpayers do not know about the change. Doran\textsuperscript{48} postulates that penalties not only promote tax compliance, but also define tax compliance. This would imply that by setting a target, tax penalties might direct taxpayer conduct.


\textsuperscript{46} Op cit 653.

\textsuperscript{47} Op cit 509.

\textsuperscript{48} Op cit 113.
According to Murphy\textsuperscript{49}, regulation should ensure long term voluntary compliance and a penalty that is perceived to be unreasonable or unfair could result in active resistance against the relevant authority.

\section*{2.5 Application to the current research}

It is clear from the literature that the role of penalties in influencing taxpayer compliance is complex and difficult to quantify. Penalties may have a deterrent role, but this seems to be outweighed by other factors such as probability of detection and taxpayer knowledge. In addition they may lose efficacy or, in fact, be counterproductive if they are not understood by taxpayers or if they are viewed as an indication of widespread non-compliance.

The consistent findings that taxpayers tend to comply at a higher level than anticipated might also bring into question the efficacy of a penalty based regime in directing taxpayer behaviour. It seems that the efficacy of a system based on deterrence theory might be diluted by a much wider social and moral framework. The research findings above are used to benchmark the penalty regime in the current study.

\textsuperscript{49} Op cit 4.
CHAPTER 3

A REVIEW OF THE COMPLIANCE OBJECTIVES SET BY THE FISCUS

‘That which we contribute in our taxes, we get back through the high quality of our public services...justice rules us, because just laws make community possible.’ – National Development Plan 2030. 50

3.1 Introduction

The purpose of this chapter is to investigate the stated compliance objectives set by the Fiscus, in order to understand the context within which the penalty provisions of the Act are enacted and enforced.

3.2 Compliance objectives set by the Fiscus

The Constitution51 is the supreme law of the Republic. Section 2 stipulates that ‘law or conduct that is inconsistent with it is invalid, and the obligations imposed by it must be fulfilled.’ All taxing Acts are therefore subject to the Constitution.

The Katz Commission52 emphasises that the fairness of tax administration and the fair, impartial and consistent treatment of taxpayers is important.53 In the foreword to the SARS Strategic Plan 2014/2015 to 2018/2019, the Minister of Finance, NM Nene states that “Over the past two decades, South Africa has built a progressive tax system founded on the principles of equity, efficiency, simplicity, transparency and certainty.”54

50 National Development Plan 2030 (Executive Summary) at 8.
51 Op cit.
53 Op cit 12.1.5, 12.1.6, 12.2.12.
54 SARS Strategic plan 2014 2015 to 2018 2019 at 5.
The Draft Explanatory Memorandum on the Draft Tax Administration Bill, 2009 \(^{55}\) indicates that international best practices were given due consideration in the drafting of the legislation, including efficiency and effectiveness. The memorandum then refers to the following principles\(^{56}\):

‘*Equity and fairness* to ensure that the tax system is fair and also *perceived to be fair*, which should in turn *enhance compliance*;

*Certainty and simplicity* so that tax administration is not seen as arbitrary but transparent, clear and as simple as the complexity of the system allows;’

(Emphasis added.)

Within this context, SARS have emphasised the importance of taxpayer compliance.

According to the SARS Strategic plan 2014 2015 to 2018 2019: \(^{57}\)

‘SARS’s mandate is to ensure optimal compliance with all the laws that SARS administers…SARS must achieve compliance in a manner that does not impede trade, economic growth and development, by imposing an excessive and unfair administrative compliance burden on taxpayers, traders and businesses…Given this mandate, SARS established four enduring core outcomes that continue to guide and inform current and future strategies. These four core outcomes are to: (1) Increase customs compliance; (2) Increase tax compliance; (3) Increase ease and fairness of doing business with SARS; (4) Increase cost effectiveness and institutional respectability…*We will strengthen our enforcement capabilities through the use of our penalty regime to address those taxpayers and traders who persistently and deliberately do not comply.*’

(Emphasis added.)

\(^{55}\) Op cit.

\(^{56}\) Op cit at 2.5.

\(^{57}\) Op cit 17.
In addition, the 2013 Tax Statistics publication postulates that increasing numbers of taxpayers have registered in order to avoid severe tax penalties. To this end, the SARS 2014/2015 annual performance plan indicates an intention to increase the use of administrative penalties.

3.3 Conclusion

It seems that the stated compliance objectives of the Fiscus, both in the preparation of the relevant legislation as well as in the form of public statements, acknowledges international research and embraces a multi-faceted approach to encouraging compliance, combining deterrent and accommodative factors. It is also clear that SARS and the legislature considers the penalty regime to be an important tool for addressing taxpayer non-compliance. Within this context, the importance of the balance between taxpayer’s obligations to comply with the law and powers of the revenue authority, specifically in respect of the penalty provisions is emphasised by Croome, and is considered be relevant in the current study. In the following chapter, the penalty provisions which have been designed to this end are analysed.

58 2013Tax Statistics at 1.
CHAPTER 4

AN ANALYSIS OF THE PENALTY PROVISIONS OF THE ACT

4.1 Introduction

This analysis is based on the Act as amended by the Tax Administration Laws Amendment Act, 2015.\(^6\)

4.2 Definition of “penalty”

In order to analyse the penalty provisions of the Act, it is necessary to define a “penalty” and to analyse the meaning of the word in the context of this Act. The word penalty is used to describe two penalty types. The first is the administrative non-compliance penalty which is defined as follows in s1 and s208 of the Act respectively:

“administrative non-compliance penalty” has the meaning assigned in section 208:

‘administrative non-compliance penalty’ or ‘penalty’ means a “penalty” imposed by SARS in accordance with this Chapter or a tax Act other than this Act, and excludes an understatement penalty referred to in Chapter 16.’

The second is the understatement penalty which is defined in s1 of the act:

“understatement penalty” means a penalty imposed by SARS in accordance with Part A of Chapter 16.’

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4.3 Application to the taxing Acts

The Act ‘applies to every person who is liable to comply with a provision of a tax act (whether personally or on behalf of another person) and binds SARS’. 62

Tax Act is defined as follows in s1 of the Act:

“tax Act” means this Act or an Act, or portion of an Act, referred to in section 4 of the SARS Act, excluding the Customs and Excise Act, the Customs Control Act, 201463 and the Customs Duty Act, 201464

Schedule 1 of the SARS Act lists 22 Acts. The scope of this work will be limited to the following Acts which are included in Schedule 1:

- Income Tax Act, 1962 (Act 58 of 1962), and

4.4 Administrative non-compliance penalties

Administrative non-compliance penalties were first introduced by way of s75B of the Income Tax Act, and gave wide powers to the Minister to make regulations prescribing the procedural and administrative matters regarding the imposition and possible remission of such penalties. This section was repealed in 2011.

The administrative non-compliance penalties are now encompassed in Chapter 15 of the Act. Section 209 states that the purpose of the Chapter is to ensure:

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63 31 of 2014.
64 30 of 2014.
‘(a) the widest possible compliance with the provisions of a tax Act and the effective administration of tax Acts; and

(b) that an ‘administrative non-compliance penalty’ is imposed impartially, consistently, and proportionately to the seriousness and duration of the non-compliance.’

Chapter 15 of the Act provides for three discrete administrative non-compliance penalties, namely the fixed amount penalty, the reportable arrangement penalty and the percentage based penalty. Reportable arrangements are complex and specific and are considered to be outside of the scope of this study. For this reason only the fixed amount and percentage based penalties will be considered.

4.4.1 Fixed amount penalties

The fixed amount penalties are dealt with in ss210 – 211 of the Act.

‘s210(2) Non-compliance is failure to comply with an obligation that is imposed by or under a tax Act and is listed in a public notice issued by the Commissioner, other than—

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

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

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

To date there has only been one such public notice, namely Government Gazette 35733.65

Under this notice a natural person who fails to submit an income tax return for years ending on or after 1 March 2006, and that already has at least two income tax returns outstanding (which relate to years of assessment after such date) will be subject to this penalty. The current public notice therefore appears to have a narrow focus, penalising only natural

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65 NN 790 Government Gazette 35733 of 1 October 2012 at 24.
persons who effectively have three income tax returns outstanding. This seems to contradict the stated purpose of the chapter, which s209 purports to be to ensure the ‘widest possible compliance’.

The fixed amount penalties are listed in a table in s211 of the Act. The penalties increase monthly by the relevant fixed amount, which is based on the assessed loss or taxable income of the preceding year of assessment. This reasoning appears circuitous, since the penalty can currently only arise in the instance of two or more outstanding returns, which implies that the taxable income of the preceding year of assessment may not be available at the time that the penalty is imposed. The penalties range from R250 to R16 000 per month and accumulate for either 35 or 47 months, effectively resulting in a maximum penalty of R752 000. It is curious that the accumulation is over the longer period if SARS does not have a current address and is therefore not able to deliver the penalty assessment (in which case the taxpayer may be unaware of the accumulating penalty).

In respect of administrative penalties it also seems relevant to question how non-compliant taxpayers are identified. As at the end of July 2014, there were 15 480 920 registered taxpayers of which 6 483 837 were expected to submit returns for the 2013 year of assessment. Of those expected to submit, 79.8% had been assessed. Therefore according to

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66 It is conceded that under s 211(4), SARS may estimate this amount and correct it when the actual taxable income is known; however it is submitted that the wording remains circuitous and difficult to apply.

67 It is submitted that the issue of a penalty assessment might amount to an administrative action which could adversely affect the rights or legitimate expectations of a taxpayer. In this event this provision may be subject to challenge under the PAJA s 3(2)(b)(i) which requires adequate notice of the proposed administrative action.


69 The key reason for the disparity between registered taxpayers and those expected to submit returns is the compulsory registration of all employees from the 2011 year of assessment. As a result many employees who do not meet the requirements for the submission of tax returns have tax registration numbers.

the 2014 Tax Statistics publication, this implies that up to 1 309 265 taxpayers might be
considered to be non-compliant.\textsuperscript{71} Using the 2013 year of assessment statistics, this means
that there are effectively 8 997 083 registered taxpayers who are not expected to submit a tax
return on a year to year basis compared to the 1 309 265 estimated non-compliant taxpayers,
which raises the question as to how SARS might identify the proverbial needle in a haystack,
namely those who indeed have not complied when they should.

\subsection*{4.4.2 Percentage based penalty}

In terms of s213 of the Act:

\textquote{—(1) If SARS is satisfied that an amount of tax was not paid as and when required under a
tax Act, SARS must, in addition to any other ‘penalty’ or interest for which a person may be
liable under this Chapter,\textsuperscript{72} impose a ‘penalty’ equal to the percentage of the amount of
unpaid tax as prescribed in the tax Act.’

It is respectfully submitted that this section is unduly vague, specifically with reference to the
delineation of its ambit. The use of the words ‘as and when’ seems to imply that the
percentage based penalty applies to the late payment of taxes under a tax Act, however non-
payment would also fall within the description above.

This section is in ‘addition to any other “penalty”’ and does not exclude Chapter 16 and
therefore if a taxpayer fails to pay a tax, then the tax must be both late and understated with

\textsuperscript{71} Op cit 35. According to this publication: “Expected submission counts for each tax year now include all
taxpayers who have been assessed for a tax year as well as taxpayers with an “active” status who were assessed
in any of the two previous years but who do not have an assessment for the tax year in question.” The 1 309 265
taxpayers represent those who are expected to submit but have not been assessed. There may be taxpayers in this
number who have submitted their returns (and are therefore compliant) but have not yet been assessed by SARS.
However, taxpayers are usually assessed after a very short time (often seconds on e-filing). Therefore it is
submitted that this provides an imperfect but still useful estimate of individual non-compliance. This is
acknowledged in the publication, (also at 35): “As the years progress, the level of assessment for any given tax
year increases as outstanding returns are submitted.”

\textsuperscript{72} Chapter 15.
respect to Chapter 16 and could attract two discrete overlapping penalties. The applicable percentage is determined in the relevant tax Act.

In light of the discussion above, it is of interest that para 20A of the Fourth Schedule of the Income Tax Act was repealed by s 11(1) of the Tax Administration Laws Amendment Act, 2014\(^{73}\) along with an amendment to para 20 (1) of the Schedule. The purpose of this amendment was to prevent a situation where a taxpayer was subject to an underestimate penalty and also a penalty for the failure to submit an estimate arising due to the same action. In the explanatory memorandum SARS states that\(^{74}\) ‘This constitutes administrative double jeopardy as both penalties arise from the same default. This is constitutionally impermissible as being contrary to the right to administrative justice.’

This amendment also provides that a penalty for underpayment of provisional tax as a result of underestimation must be reduced by any penalty for late payment imposed under para 27(1). It is respectfully submitted that while this amendment highlights the constitutional imperative for administrative justice, it appears not to resolve the problem highlighted above for two reasons. Firstly, the underestimate penalty embodied in the Fourth Schedule of the Income Tax Act is deemed to be a percentage based penalty under Chapter 15 of the Act and is therefore not an understatement penalty under Chapter 16. Charging both an underpayment penalty under para 20 and a late payment penalty under para 27 would have resulted in two percentage based penalties. Secondly, the amendment is limited to the Fourth Schedule and therefore does not consider the other defaults that the percentage based penalty addresses.

\(^{73}\) Act 44 of 2014.

\(^{74}\) Draft Memorandum on the objects of the Tax Administration Laws Amendment Bill, 2014 at 2.10.
The SARS Short Guide to the Tax Administration Act, 2011 (the SARS Short Guide)\textsuperscript{75} lists the penalty for late payment of VAT imposed in terms of s 39 of the VAT Act as an example of the application of the percentage based penalty. In another section of the guide an example is given to explain the understatement penalty. This example refers to a taxpayer who has failed to file a VAT return and has therefore effectively understated the full amount of the VAT due, making the taxpayer subject to the understatement penalty\textsuperscript{76}. There is no apparent offset as in para 20(1) of the Fourth Schedule above. This situation is differentiated from the late payment of provisional tax in that two different penalty types apply. However this still leads to two penalties arising from one default and therefore seems to impinge on the Constitutional right to administrative justice as highlighted by SARS\textsuperscript{77}.

It is submitted that the Act should be amended to set off late payment penalties against understatement penalties, should they arise from the same default.

4.4.3 Remittance of penalty

A taxpayer who is aggrieved by a penalty assessment may request SARS to remit the penalty under various grounds. This request must be made on or before the payment due date. After such date, entertainment of a remittance request is at the discretion of SARS. A decision by SARS not to remit a ‘penalty’ in whole or in part is subject to objection and appeal under Chapter 9\textsuperscript{78} of the Act.

Under the 2014 Tax Administration Laws Amendment Act.\textsuperscript{79}


\textsuperscript{76} Op cit 16.2.

\textsuperscript{77} As discussed at 1.6 it seems that the PAJA would not be relevant to this matter as it relates to the wording of legislation and not a decision made by SARS.

\textsuperscript{78} At s220.

\textsuperscript{79}Op cit.
‘If a tax Act other than this Act provides for remittance grounds for a ‘penalty’, SARS may
despite the provisions of section 216, 217 or 218 remit the ‘penalty’ or a portion thereof under
such grounds.’

4.5 Understatement penalties

Prior to the promulgation of the Act, these penalties were contained in the various taxing acts.
S76 of the Income Tax Act provided for an additional tax of 200 percent in the case of an
omission from or incorrect statement in a return. The Commissioner had wide discretion to
remit such additional charges. However in the instance of intentional tax evasion, remission
was only allowed in “extenuating circumstances”. The decision of the taxpayer was subject to
objection and appeal.

Under the current regime, Chapter 16 of the Act defines and sets out the so called
understatement penalties. Understatement penalties are payable in addition to the understated
tax and are calculated based on the percentages listed in s223 below, effectively multiplied by
the current or future tax saving resulting from the understatement. The new regime therefore
embodies the principle of the previous legislation, while limiting the discretion of the
Commissioner and introducing a range of percentages based on taxpayer behaviour.

4.5.1 The meaning of understatement in the context of Chapter 16 of the Act

For the purposes of Chapter 16, understatement is defined as:

‘understatement’ means any prejudice to SARS or the fiscus as a result of—

(a) a default in rendering a return;

(b) an omission from a return;

(c) an incorrect statement in a return; or

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80 S60 of the VAT Act contained similar rules.
(d) if no return is required, the failure to pay the correct amount of ‘tax’."

Since the term ‘understatement’ is the foundation of this penalty type, it is considered appropriate to perform an in depth analysis of this definition.

4.5.2 ‘Prejudice to SARS or the fiscus’

First the meaning of ‘prejudice’ is considered. This word is not defined in the Act. A search of various dictionary definitions indicates an emphasis on preconceptions, intolerance, dislike, and opinions, which are not relevant within the current context. The most relevant definition was found in the Oxford advanced learner’s dictionary: ‘verb [VN]…..2 (formal) to have harmful effect on something: Any delay will prejudice the child’s welfare.’

The test for identifying an understatement is therefore harm to SARS or the fiscus. The use of the word understatement implies that the harm inflicted on SARS or the fiscus would be a tax benefit taken by the taxpayer. The taxpayer has unduly ignored the responsibility to pay tax, or acted in a manner that resulted in a tax burden which is lower than it should be under the law. The Income Tax Act defines the term tax benefit to include ‘any avoidance, postponement or reduction of any liability for tax’. It is submitted that a prejudice to the Fiscus would effectively be an undue tax benefit on the part of taxpayer. This term was previously used in s35(2) of the Act to describe reportable arrangements which the Commissioner may list by Public Notice. The Draft Memorandum on the 2014 Draft Taxation Laws Amendment Bill acknowledges that ‘There has been some uncertainty about when a tax benefit is “undue”.’ The term has subsequently been removed from the section. It is submitted that, subject to its own clear definition in the Act, this term might be of

82 At s1. The same definition is found at s34 of the Act.
83 Op cit 62.
assistance in defining ‘understatement’. Alternatively, a definition of the term prejudice would be beneficial.

The reference to SARS in this phrase is of interest. SARS is established under South African Revenue Service Act.84 Under this Act, the objectives of SARS are outlined in s3 as follows:

‘3. Objectives.—SARS’s objectives are the efficient and effective—

(a) collection of revenue; and

(b) control over the import, export, manufacture, movement, storage or use of certain goods.’

The function of SARS is therefore the enforcement of relevant legislation and the provision of advice to the Finance Minister and Minister of Trade and Industry as stipulated in s4. S4(2) of the Act requires SARS to ‘perform its functions in the most cost-efficient and effective manner and in accordance with the values and principles mentioned in section 195 of the Constitution’. Based on the objectives and functions of SARS, it seems that the only way that a taxpayer can prejudice SARS is by hindering the efficient and effective carrying out of its duties. The reference to SARS should therefore be in Chapter 15 and not Chapter 16.

There is no quantification of the prejudice for the purposes of the Act. The event of a prejudice is identified, and it is then quantified by s222 (discussed below).

4.5.3 ‘A default in rendering a return’

Taking this phrase at face value, a taxpayer who has not submitted a return will be subject to the understatement penalty in chapter 16 of the Act. It is interesting that s210(2)(b) excludes non-compliance in respect of which an understatement penalty under Chapter 16 has been

84 Act 34 of 1997
imposed. It is submitted that under a literal interpretation of the words of the Act, a default in rendering a return could lead to two possible prejudicial events:

1. Prejudice to the fiscus: this would result from the taxpayer not rendering a return for the purposes of not declaring tax which is due to the fiscus, resulting in a loss to the fiscus, or

2. The event of the non-submission of the return itself, with or without a loss to the fiscus, would prejudice SARS as administrator, due to the delays and additional administration involved in securing and finalising the tax affairs of the errant taxpayer.

It is therefore respectfully submitted that the wording of the definition of “understatement” effectively circumvents s210-211, although this is apparently not the intention of the legislature.

4.5.4 ‘An omission from a return or an incorrect statement in a return;’

At first reading this appears to be straight-forward: a taxpayer omits or misstates a relevant item on a tax return resulting in the underpayment of taxes. The reasons for such omissions and misstatements are numerous and range from a bona fide inadvertent error (which will not attract a penalty under this chapter) to tax evasion. The understatement penalty table has been designed to take account of the taxpayer’s behaviour.

It is noted that s222 of the Act deals with each tax period as a discrete event. This practice is well established by case law in respect of income taxes. In CIR v Delfos,85 Wessels CJ stated that ‘it is important to note that the tax is an annual one and is to be levied on the “taxable income” received by or accrued to any person during the year of assessment.’

85 1933 AD 242, 6 SATC 92 at 105.
In *Concentra (Pty) Ltd v CIR*\(^{86}\), Howes J held that a taxpayer who had failed to claim travel expenses in the year in which they were incurred was not entitled to claim the deduction in a later year of assessment. The learned judge stated:\(^{87}\)

> ‘The basis of the income tax law is the assessment of the yearly income: the amounts earned and the expenses incurred’

Then (with reference to the taxpayer’s failure to claim such expenditure in the previous year of assessment) the learned judge indicated:

> ‘and if, by not doing so, the company has lost the opportunity for using the expenditure as a deduction from its income then it is its own fault\(^{88}\).’

This presents the possibility of a scenario in which a taxpayer claims expenditure in a year of assessment but subsequent to assessment it transpires that the expenditure should have been claimed in a prior year of assessment and the deduction is lost. In this case, an understatement arises in the year of assessment in question. However, it is submitted SARS would have not have grounds to impose an understatement penalty on the basis that the definition of “understatement” in section 221 contains no reference to a year of assessment and overall the Fiscus would not have been prejudiced but would rather have benefited from the taxpayer losing the deduction. Therefore no understatement arises to be considered in s222.\(^{89}\)

An understatement may also arise when a taxpayer seeks a deduction which is then found to be claimed in an earlier year of assessment than it ought to be. Disputes of this nature are

\(^{86}\) 12 SATC 95.

\(^{87}\) *Op cit* 95.

\(^{88}\) *Op cit* 95.

\(^{89}\) It is acknowledged that this interpretation may not reflect the intention of the legislature. In addition, the restriction to a single year of assessment is implied by the discussion above. However in the event of SARS viewing the relevant year of assessment in isolation and imposing a penalty in addition to the disallowance of the deduction, it is submitted that a double jeopardy would arise.
illustrated in *Greases (SA) Ltd v CIR*, 90 *Gud Holdings (Pty) Ltd v C SARS,*91 *Edgars Stores Ltd v Commissioner of Inland Revenue*92 and *Nasionale Pers Bpk v KBI.*93 In such a case, it seems that the understatement would be calculated using the full amount of the denied deduction, since the s222(2) and 222(3) are confined to the relevant return and tax period respectively.

It is submitted that this leads to an overstated penalty. In an instance where a disallowed deduction would rank for deduction in future years, the penalty should be calculated based on the prejudice suffered by the Fiscus. This prejudice would be no more than the time value of the money resulting from the postponement of the payment of the tax.

4.5.5 ‘If no return is required, the failure to pay the correct amount of tax’

This subsection appears straightforward and is not considered further.

4.5.6 Understatement penalty

In terms of s 222, in the event of an ‘understatement by a taxpayer’, the taxpayer must pay a penalty calculated under this section. The penalties are calculated based on the understatement penalty percentage table in s 223 and are set out below for ease of reference:

90 1951 (3) SA 518 (A), 17 SATC 358.
92 1988 (3) SA 876 (A).
93 1986(3) SA 549(A).
223. Understatement penalty percentage table.—(1) The understatement penalty percentage table is as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Behaviour</th>
<th>Standard case</th>
<th>If obstructive, or if it is a ‘repeat case’</th>
<th>Voluntary disclosure after notification</th>
<th>Voluntary disclosure before notification</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>‘Substantial understatement’</td>
<td>10%</td>
<td>20%</td>
<td>5%</td>
<td>0%</td>
</tr>
<tr>
<td>(ii)</td>
<td>Reasonable care not taken in completing return</td>
<td>25%</td>
<td>50%</td>
<td>15%</td>
<td>0%</td>
</tr>
<tr>
<td>(iii)</td>
<td>No reasonable grounds for ‘tax position’ taken</td>
<td>50%</td>
<td>75%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>(iv)</td>
<td>Gross negligence</td>
<td>100%</td>
<td>125%</td>
<td>50%</td>
<td>5%</td>
</tr>
<tr>
<td>(v)</td>
<td>Intentional tax evasion</td>
<td>150%</td>
<td>200%</td>
<td>75%</td>
<td>10%</td>
</tr>
</tbody>
</table>

*Figure 1 South African understatement penalty percentage table*

94 The SARS Short Guide provides guidance on the meaning of the behaviours above at 16.5.2-16.5.6. Key descriptions have been extracted from the guide and are listed below:

Reasonable care not taken in completing 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. 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.

No reasonable grounds for the tax 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.

Gross negligence: 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.

Intentional Tax Evasion: 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.

95 Of audit or investigation.

96 Of audit or investigation.
In terms of s102(2) of the Act:

‘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.’

Of the behaviour categories listed above, only substantial understatement is defined in the Act in s 221, being ‘a case where the prejudice to SARS or the fiscus exceeds the greater of five percent of the “tax” properly chargeable or refundable under a tax Act for the relevant tax period, or R1 000 000’.

This implies firstly that such an event will be subject to a penalty even if reasonable care was taken in preparing the return. Section 223(3) compels SARS to remit the penalty imposed on a ‘substantial understatement’ providing that the taxpayer had made full disclosure of the arrangement by no later than the date the relevant return was due and was in possession of an opinion by an independent registered tax practitioner that was issued by no later than the date that the relevant return was due, which confirms, based on full disclosure by the taxpayer that the taxpayer’s position is more likely than not to be upheld if the matter proceeds to court.

Conversely, if the prejudice is less than R1 000 000 and the taxpayer can show that reasonable care was taken in preparing the return, then it will escape the penalty table above, but in the event of items (ii) to (v) applying, the escape clause of 223(3) would not assist. The remaining terms are not defined in the Act.

4.5.7 Objection and appeal

In terms of s 224, the imposition of an understatement penalty under s 222 or a decision by SARS not to remit an understatement penalty under s 223(3), is subject to objection and appeal. It is noteworthy that s 224 was substantially widened by the amendments of the
Taxation Laws Amendment Act of 2013, along with a reduction in many of the percentages in the understatement table.

4.6 Summary of findings

The wording of certain relevant sections does not seem to clearly express the intention of the legislator and in certain instances may be ambiguous and contradictory. The construction of the sections is also relatively complex.

Chapter 15 seems to be designed to cast a wide net, however the current implementation is narrow, in contradiction with both the stated objectives of the Fiscus as considered in Chapter 3, as well as the stated purpose of the Chapter itself and indicated in s209.97

Chapter 16 does not take the overlap of understatements in a taxpayer’s tax periods into account resulting in possible excessive penalties. It is submitted that the reference to ‘SARS’ in Chapter 16 should be reconsidered and the term ‘prejudice’ should be defined. The wording of the definition of ‘understatement’ may inadvertently circumvent ss 210 and 211 and should be reconsidered. The wording of s 223 seems to result in the risk of overlapping penalties arising on one taxpayer action as discussed in 4.4.2.

Therefore, there are aspects of the legislation that may detract from the fairness and efficacy of the penalty provisions.

In the following chapter, these penalty provisions will be benchmarked against a selection of comparative countries.

97 See 4.4.
CHAPTER 5

A COMPARISON OF THE PROVISIONS OF THE TAX ADMINISTRATION ACT WITH OTHER TAX JURISDICTIONS

‘The Hardest Thing in the World to Understand is Income Taxes’ – Albert Einstein⁹⁸

5.1 Introduction to the comparative study

The Organisation for Economic Co-operation and Development (OECD) performs extensive research and monitoring of the global taxation landscape through the Centre for Tax Policy and Administration. The Centre for Tax Policy and Administration has developed an information series which ‘provides internationally comparative data on aspects of tax systems and their administration in OECD and selected non-OECD countries.’⁹⁹ South Africa is a non-OECD participating member of the surveys. In developing the approach to this chapter, the comparative studies of 2010¹⁰⁰ and 2013¹⁰¹ were of particular relevance.

For the purposes of the Tax Administration 2013 survey, revenue bodies were asked a range of questions concerning the offence of taxpayers failing to correctly declare their tax liabilities. Based on the findings:¹⁰²

- 86 percent of countries surveyed indicated that they had a common administrative framework for this offence across the major taxes,¹⁰³

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¹⁰⁰ Op cit. The 2010 survey, while less recent, includes a more in-depth survey of penalty provisions and provided a valuable point of departure for this comparative study.
¹⁰² Op cit. These results have been summarised from the responses contained in Table 9.14 at 331. Not all the questions in the survey have been included above.
¹⁰³ Corporate Income Tax (CIT), Personal Income Tax (PIT) and Value Added Tax (VAT). For three countries this only applies to CIT and PIT, and two countries indicated “NO VAT”.

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• 80 percent of countries indicated that penalties imposed generally take account of the taxpayer’s culpability, and

• 57 percent of countries indicated that the revenue body was empowered under existing law to offer reduced penalties for voluntary disclosures; it is noted that South Africa indicated in the negative to this question, however this appears to be due to the timing of the survey.104

According to the 2013 survey:105

‘The most commonly-observed acts of non-compliance in practice tend to be:
1) the failure to file tax returns on time;
2) the failure to pay taxes on time; and
3) the failure to correctly declare all tax liabilities.’

Items 1) and 2) above are comparable to the administrative non-compliance penalties (fixed amount penalties and percentage based penalties respectively) and item 3) is comparable to the understatement penalties described in the Act. Therefore this comparative study analyses the penalty regimes of the countries selected in accordance with these OECD groupings. A fourth ‘general’ category is used for any other relevant matters.

5.2 Selection of countries

According to Marshall,106 a purposeful or judgemental sample is commonly used in qualitative research. The sample selected for analysis is determined by the researcher in order to most effectively answer the research question and requires a flexible approach.

104 The notes to the table indicate that the Limited Voluntary Disclosure Program (VDP) under the Voluntary Disclosures and Taxation Laws Amendment Act, 2008 had expired and then reference is made to the permanent VDP framework under the Tax Administration Act.

105 Op cit at 332.

Firstly major trading partners of the Republic were selected. The starting point for identifying the major trading partners of the Republic was the ‘Summary of all Treaties for the Avoidance of Double Taxation’\(^{107}\) as published by the South African Revenue Service (SARS). In accordance with this table, South Africa currently has 73 double tax agreements in force, and 14 which are in progress. Only countries which have a double tax agreement with South Africa were considered. Countries were then ranked based on the sum of total imports and exports per the Cumulative Bilateral Trade by Country 2013.\(^{108}\) Based on this ranking, the three biggest trading partners, namely China, Germany and the United States of America were selected.\(^{109}\)

Secondly, countries with a similar or relevant tax framework were considered. In his introduction to the SARS Compliance Programme 2012/13–2016/17, the then Commissioner for SARS, Oupa Magashula stated:\(^{110}\)

> ‘Many tax administrations publish similar compliance programmes (including Australia, Brazil, Canada, Denmark, Netherlands, New Zealand, Poland, Spain, Sweden, Turkey, USA, UK) and we have based our Compliance Programme and this publication on their ground-breaking work.’

According to the SARS Comprehensive Guide to Capital Gains Tax:\(^{111}\)


\(^{109}\) This ranking is also identified in the SARS 2013 Tax Statistics, Op cit Table A5.3.1: Import VAT and Customs duties: Customs value, Import VAT, Customs duties and \(Ad \ valorem\) import duties (Duty 1-2B) by country of origin, 2009/10 – 2012/13.


‘In designing the Eighth Schedule reference was made to the legislation of a number of countries most notably Australia and the United Kingdom and to a lesser extent Canada, the United States of America and Ireland amongst others. Experts from Australia, the United Kingdom and United States of America provided invaluable assistance.’

The tax frameworks of New Zealand and Australia are also similar to that of the Republic. Based on the considerations above Australia and New Zealand were included in the comparative analysis.

5.3 China

According to PWC Hong Kong\textsuperscript{112}, major taxes in the People’s Republic of China include:

- ‘Tax on Income’, which includes Corporate Income Tax, at a standard rate of 25 percent; and progressive individual income tax ranging from 3 percent to 45 percent,
- ‘Tax on transactions’, which includes value-added tax, consumption tax and business tax on the provision of certain services, and
- Various other taxes including land appreciation, behaviour related taxes, real estate and customs taxes.

The Law of the People’s Republic of China on Tax Administration\textsuperscript{113} (the Chinese Act) is available in English. Article 2 of this act states that ‘This Law shall apply to the administration of tax collection in respect of all taxes collected by the tax authorities in accordance with laws.’ Provisions related to tax withholding agents have not been considered.


5.3.1 China: the failure to file tax returns on time

In terms of Article 62 of the Chinese Act:

‘Should a taxpayer fail to file tax returns and present the relevant information in connection with tax payments… the tax authorities shall order it to make rectification within the prescribed time limit and may impose a fine up to 2,000 yuan and in a grave case, impose a fine ranging from 2,000 yuan to 10,000 yuan.’

5.3.2 China: the failure to pay taxes on time

In terms of article 32 of the Chinese Act:

‘A taxpayer failing to pay tax… within the prescribed time limit shall be ordered by the tax authorities to pay or hand over the tax and imposed a daily surcharge on the overdue part at 0.5% of the overdue amount beginning from the day the deferral begins.’

5.3.3 China: the failure to correctly declare all tax liabilities

Article 52 of the Chinese Act provides for mistakes on the part of the Tax Authorities to be corrected within three years, with no surcharge (interest) or fine payable by the taxpayer. In the instance of ‘miscalculation or other mistakes’ which are identified within three years (or five years in special circumstances), the late payment surcharge will apply but no fine is payable. It seems that this would occur in the case of a voluntary disclosure of such mistake, although this is not stipulated in the wording of the Article. Articles 63, 64 and 66 of the Chinese Act state the following:

‘Article 63 It shall be deemed a case of tax evasion when a taxpayer forges, revises, conceals or destroys without official permission its account books or supporting vouchers for the accounts, or overstates the expenses or does not state or understates incomes in account books, or refuses to file tax returns despite notification by the tax authorities, or files fraudulent tax returns, or refuses to pay or underpays the amount of tax payable. To
a taxpayer who has dodged tax payment, the tax authorities shall order it to pay the amount of tax payable unpaid or underpaid and a surcharge for overdue tax payment and impose a fine ranging from 50% to 500% of the amount of the tax amount unpaid or underpaid; if the case constitutes a crime, criminal responsibilities shall be sought.114

Article 64 Should a taxpayer or withholding agent forge evidence for tax assessment, the tax authorities shall order it to make rectification with the prescribed time limit and impose a fine up to 50,000 yuan.

Article 66 Where a taxpayer obtains tax refund from the State with fraudulent reports of exports or by other deceptive means, the tax authorities shall order it to return the refund and impose a fine ranging from 100% to 500% of the refund; and if the case constitutes a crime, criminal responsibilities shall be sought.'

5.3.4 China: other general penalties

Article 60 of the Chinese Act stipulates a penalty of between 2000 and 10 000 yuan for various acts of non-compliance. Examples include failure to register, keeping and furnishing of records and failure to inform the tax authorities of all bank accounts.

5.3.5 China: objection and appeal

The general objection and appeal process appears to apply to penalties:

‘Article 33: A taxpayer may submit a written application for tax reduction or exemption to the tax authorities in accordance with the law or administrative regulations.’

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114 Article 52 stipulates that ‘There shall be no time limit as prescribed in the previous passage for the tax authorities to demand payment of unpaid, underpaid tax and surcharge for overdue tax payment resulting from tax evasion, resistance or fraud.’
5.4. Germany

The Fiscal Code of Germany\textsuperscript{115} (the German Code) is available in English on the website of the Federal Central Tax Office. German residents are taxed on their world-wide income. Non-residents are taxed on German-source income. Major taxes include Corporate Income Taxes, Personal Income Taxes and Value-Added Tax\textsuperscript{116}.

5.4.1 Germany: the failure to file tax returns on time

In terms of s152 of the German Code:

‘(1) A late-filing penalty may be set against anyone failing to meet his obligation to submit a tax return at all or on time. The late-filing penalty shall not be set where such failure appears excusable. Default by a legal representative or an aide shall be deemed equal to personal default.

(2) The late-filing penalty may not exceed 10 per cent of the assessed tax or of the assessed basic amount and shall be no more than 25,000 euros. In assessing the late-filing penalty, in addition to its purpose of obliging taxpayers to submit their tax returns on time, the length of time by which the deadline has been exceeded, the amount of the payment claim arising from the tax assessment, the benefits gained from the delayed submission of the tax return and the degree of fault and the economic position of the taxpayer shall be taken into consideration.’

5.4.2 Germany: the failure to pay taxes on time.

The so called late-payment penalties are contained in s 240 of the German Code:


\textsuperscript{116}Deloitte, \textit{International Tax, Germany Highlights} (2014).
‘(1) Where a tax is not paid by the end of the due date, a late-payment penalty of 1 per cent of the rounded tax amount in arrears shall be payable for each month of default; the amount shall be rounded down to the nearest amount divisible by 50 euros. . .

(3) No late-payment penalty shall be levied for defaults of up to three days.’

5.4.3 Germany: the failure to correctly declare all tax liabilities
Section 370 of the German code imposes a penalty of up to five years\textsuperscript{117} imprisonment or a monetary fine for various tax evasion acts of ‘substantial significance for taxation’. Section 371 exempts cases if voluntary disclosure occurs prior to notification of a tax audit or criminal proceedings. Understatement through gross negligence is punishable with a fine of up to 50 000 euros. Certain items of ‘general minor tax fraud’ may attract a penalty of up to 5 000 euros. However, other than deliberate tax evasion committed intentionally or through gross negligence, no penalty arises.\textsuperscript{118}

5.4.4 Germany: other general penalties
No other penalties were identified which were considered relevant to this comparative study.

5.4.5 Germany: objection and appeal
No specific objection and appeal provisions were identified. It appears that section 347 ‘Objection to administrative acts’ would apply.

5.5 United States of America
The tax laws of the United States of America (USA) are contained in the United States Code, Title 26: Internal Revenue Code.\textsuperscript{119} The laws related to income taxes are contained in subtitle A. Subtitle F – ‘Procedure and Administration’ contains the penalty provisions which

\textsuperscript{117} Or 10 years in certain serious cases.

\textsuperscript{118} Interest is charged under s 233a of the German Code.

are relevant to this comparative study. The tax system of the USA comprises progressive individual income tax and corporate income tax with a marginal rate of 39.6 percent and 35 percent respectively. Other taxes include payroll taxes on wages; estate, gift and generation skipping taxes and excise taxes on selected goods and services.\textsuperscript{120}

### 5.5.1 USA: the failure to file tax returns on time

The penalty for the failure to file a return is stipulated at 6651 as follows:

‘In case of failure—

(1) to file any return required…on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return 5 percent of the amount of such tax if the failure is for not more than 1 month, with an additional 5 percent for each additional month or fraction thereof during which such failure continues, not exceeding 25 percent in the aggregate.’

In a case where a failure to file is fraudulent, ‘5 percent’ is replaced with 15 percent and ‘25 percent’ is replaced with 75 percent in each of the places that they appear.\textsuperscript{121}

The penalty is based on the net amount of tax due at the beginning of the month in which it is calculated. If the return is not filed within 60 days of the prescribed date, the minimum penalty will be the lower of the tax due or USD135.

### 5.5.2 USA: the failure to pay taxes on time.

The penalty is an amount of 0.5 percent of the tax due per month to a maximum of 25 percent. This penalty of 0.5 percent is increased to 1 percent in the case where a taxpayer...

\textsuperscript{120} Joint Committee on Taxation, *Overview of the Federal Tax System as in Effect for 2013* (JCX-2-13R), (2013) at 1.

\textsuperscript{121} Op cit 26 U.S. Code § 6651 - Failure to file tax return or to pay tax: (f).
neglects or refuses to pay tax on demand. If a taxpayer files the return and an installment agreement is in place, then the penalty is reduced to 0.25 percent per month. A failure to file penalty (above) is reduced by this penalty, effectively preventing a duplicate penalty.

5.5.3 USA: the failure to correctly declare all tax liabilities

The US Code imposes accuracy related penalties on underpayments through §6662. Under this section a 20 percent penalty is imposed on any underpayment which arises under various circumstances, including:

1) Negligence\(^{122}\) or disregard of rules or regulations\(^{123}\), or

2) Any substantial underatement of income tax.

These penalties are not ‘stackable’, which means that the penalty can only be applied once if more than one of the behaviours listed occurs. There is no penalty if the taxpayer acted in good faith and it can be shown that there was reasonable cause for the position taken.\(^{124}\)

A substantial underatement of income tax is an underatement for the taxable year which exceeds the greater of 10 percent of the tax for the year and USD5 000.\(^{125}\) If the taxpayer has substantial authority for the tax treatment of an item or adequate disclosure has been made of an item for which there is a reasonable basis for the tax treatment, the amount will not attract an understatement penalty. According to the guidance provided by the IRS: ‘A reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. The position must be more than just merely arguable or

\(^{122}\) Under subpara (c) this ‘includes any failure to make a reasonable attempt to comply with the provisions of this title’.

\(^{123}\) Under subpara (c) ‘includes any careless, reckless, or intentional disregard’.

\(^{124}\) Op cit US Code §6664(c)(1).

\(^{125}\) For certain corporations the amount is the lessor of:

- The greater of 10 percent of the tax or USD10 000, or
- USD10 000 000.
merely a colorable claim. The position must be reasonably based on authority supporting the position.  

In the instance where a part of an understatement is due to fraud, the penalty is increased to 75 percent of the portion of the underpayment in terms of §6663. In court proceedings, the IRS bears the initial burden of proof regarding the accuracy-related penalty. The IRS must first present sufficient evidence to establish that the penalty is warranted. The burden of proof then shifts to the taxpayer to establish any exception to the penalty, such as reasonable cause.  

5.5.4 USA: other general penalties  

The so called frivolous tax return penalty is a sanction of USD5 000 ‘against persons who file what purports to be a return that does not contain information on which the correctness of the self-assessment may be judged, or contains information that on the face indicates the self-assessment is incorrect, and if either of the following apply:  

- The return is based on a frivolous position identified as frivolous under IRC 6702(c)  
  Listing of Frivolous Positions, or  
- The return reflects a desire to delay or impede the administration of federal tax laws.  

128 This penalty applies to any return required to be filed by the internal revenue code.  
5.5.5 USA: objection and appeal

In terms of the Internal Revenue Service Revenue Manual:130

‘Various administrative and legislative remedies are provided for taxpayers who disagree with the IRS’s determination that they are liable for a particular penalty. Generally, when a taxpayer disagrees with our determination regarding a penalty, he or she has the right to an administrative appeal.

5.6 Australia

The Australian tax system is broadly similar to the Republic of South Africa. A residence basis of taxation applies and individuals are progressively taxed with a marginal rate of 45 percent and are subject to a low income tax offset rebate. The Australian penalty provisions are contained Chapter 4 of Schedule 1 of the *Taxation Administration Act 1953*131 (Australian Act).132

According to the Australian Taxation Office website:

‘Uniform penalty provisions apply to most tax laws. Broadly this means that if you fail to meet a tax obligation under any tax law, you will be liable under the same penalty provision’133

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132 Special provisions in this section related to transfer pricing, partnerships and trusts are considered to be outside of the scope of this work and are not considered.

5.6.1 Australia: the failure to file tax returns on time

The so called failure to lodge penalty is contained in Division 286 of the Australian Act. The section applies an administrative penalty to the failure to render a return, statement, notice or other document by a particular time under all the taxation laws.\textsuperscript{134} The taxpayer will not be liable to this penalty if the relevant documentation has been provided to a tax agent who then did not submit within the timeframe.\textsuperscript{135} Penalty assessments can be issued prior to the provision of the relevant documentation by the taxpayer. The Commissioner is required to notify the taxpayer of an administrative penalty.

The method of calculating the penalty is contained in the Australian Act s286-80(2)-(5). Firstly a “base penalty” is calculated. The penalty commences when a document is due and ends on the day it is given and comprises 1 penalty unit\textsuperscript{136} for each period of 28 days or part thereof to a maximum of 5 penalty units.

If the entity’s assessable income for the relevant year of assessment is between $1 million and $20 million or greater than $20 million, then the penalty is multiplied by two and five respectively.\textsuperscript{137}

5.6.2 Australia: the failure to pay taxes on time.

There is no specific penalty provision for a late payment of taxes but interest charges apply.

\textsuperscript{134} This section applies to both the Commissioner and other various entities.

\textsuperscript{135} Under S286-75 the evidential burden to show that the information was provided to the tax agent is on the taxpayer for the purposes of this safe harbour. In addition, this section will not apply in the case of intentional disregard or recklessness on the part of the tax agent.

\textsuperscript{136} A penalty unit is $170.

\textsuperscript{137} Penalties in these sections related to GST submissions and employee withholding taxes are out of scope of the current study and have been ignored.
5.6.3 Australia: the failure to correctly declare all tax liabilities

Division 284 of the Australian Act, ‘Administrative penalties for statements, unarguable positions and schemes’ applies to:

‘(a) making false or misleading statements\(^{138}\), and
(b) taking a position that is not reasonably arguable; and
(c) entering into schemes’.\(^{139}\)

Division 284 groups these into two subdivisions, namely Subdivision 284-B Penalties relating to statements, and Subdivision 284 – C Penalties relating to schemes.\(^{140}\)

Section 284-80 defines the so-called “shortfall amount”. This

‘is the amount by which the relevant liability, or the payment or credit, is less than or more than it would otherwise have been.’

The method for calculating the penalty is given in s 284-85(2) and consists of identifying a base penalty amount (BPA) and then adjusting it in accordance with the formula:

‘BPA + [BPA x (Increase % - Reduction %)]’

The BPA is worked out using a table which has been summarised below. Miscellaneous Tax Ruling 2008/1 provides guidance on the various behaviours listed.

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\(^{138}\) Section 284-20 defines statements ‘to include those made orally, in a document or in any other way (including electronically)’. Section 284-25 includes statements made by a taxpayer’s agent on their behalf.

\(^{139}\) This is considered to be outside of the scope of the current study.

\(^{140}\) Under the South African Legislation, a tax benefit arising as the result of an impermissible tax avoidance arrangement in terms of ss 80A-L of the Income Tax Act or other anti-avoidance legislation would be subject to the general rules. This penalty is therefore not considered further.
False or misleading statement made to the Commissioner or an entity exercising powers or performing functions under a taxation law\textsuperscript{141}

<table>
<thead>
<tr>
<th>Shortfall Arises</th>
<th>Intentional disregard\textsuperscript{142}</th>
<th>75% of shortfall amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shortfall Arises</td>
<td>Recklessness by taxpayer\textsuperscript{143}</td>
<td>50% of shortfall amount</td>
</tr>
<tr>
<td>Shortfall Arises</td>
<td>Failure to take reasonable care\textsuperscript{144}</td>
<td>25% of shortfall amount</td>
</tr>
<tr>
<td>No Shortfall Arises</td>
<td>Intentional disregard, Recklessness by taxpayer, Failure to take reasonable care</td>
<td>60, 40 and 20 penalty units respectively.\textsuperscript{145}</td>
</tr>
</tbody>
</table>

The taxpayer has a shortfall amount, all or part of which resulted from a tax treatment that was not reasonably arguable and that amount is more than the taxpayer’s reasonably arguable threshold:

25\% of the shortfall amount

\textit{Figure 2 Summary of Australian understatement penalties}

This penalty only applies to certain tax types, including income tax. In addition this penalty type excludes errors of fact (for example a taxpayer accidentally reads the incorrect line of a reference table),\textsuperscript{146} which may be subject to the reasonable care test.

The term ‘reasonably arguable’ is defined in subsection 284-15(1) and (2) as follows:

\begin{itemize}
\item \textsuperscript{141} Subsection 284-75 (1) and (4).
\item \textsuperscript{142} Paragraph 112 of Miscellaneous Tax Ruling 2008/1 states that: ‘intentional disregard means that there must be actual knowledge that the statement made is false. To establish intentional disregard, the entity must understand the effect of the relevant legislation and how it operates in respect of the entity’s affairs and make a deliberate choice to ignore the law.’ This is can be compared to ‘Intentional Tax Evasion’ under the South African legislation.
\item \textsuperscript{143} Miscellaneous Tax Ruling 2008/1 explains ‘recklessness’ as follows in para 99: ‘The legislative context… indicates that ‘recklessness’ connotes conduct that is more culpable than a failure to take reasonable care to comply with a taxation law but less culpable than an intentional disregard of a taxation law.’ This can be seen as largely similar to the meaning of ‘gross negligence’ employed in the South African legislation.
\item \textsuperscript{144} Paragraphs 28 and 36 explain that ‘The reasonable care test requires an entity to take the same care in fulfilling their tax obligations that could be expected of a reasonable ordinary person in their position. This means that even though the standard of care is measured objectively, it takes into account the circumstances of the taxpayer… The reasonable care test is not intended to be overly onerous for taxpayers. For most taxpayers, an earnest effort to follow TaxPack instructions would usually be sufficient to pass the test.’
\item \textsuperscript{146} Australian Tax Office Miscellaneous Tax Ruling 2008/1 (MT 2008/1) at 71.
\end{itemize}
‘A matter is reasonably arguable if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.

To the extent that a matter involves an assumption about the way in which the Commissioner will exercise a discretion, the matter is only reasonably arguable if, had the Commissioner exercised the discretion in the way assumed, a court would be about as likely as not to decide that the exercise of the discretion was in accordance with law.’

MT2008/1\textsuperscript{147} par 36 further illustrates this application as follows:

‘The test does not require the taxpayer's position to be the 'better view'. . .. However, the reasonably arguable position standard would not be satisfied if a taxpayer takes a position which is not defensible, or that is fairly unlikely to prevail in court. On the contrary, the strength of the taxpayer's argument should be sufficient to support a reasonable expectation that the taxpayer could win in court. The taxpayer's argument should be cogent, well-grounded and considerable in its persuasiveness.’

The reasonably arguable threshold is the greater of $10 000 or 1 percent of the income tax payable for the income year.\textsuperscript{148} Therefore taxpayers do not need to prove reasonable grounds for the tax treatment of items below this threshold.

If the Commissioner determines the tax related liability without the assistance of a document which is necessary for the determination of a tax related liability and which the taxpayer fails to provide, a penalty of 75 percent of tax related liability concerned is levied.\textsuperscript{149} This matter is not separately dealt with under the South African penalty provisions. SARS is given wide discretion to assess

\textsuperscript{147}Op cit.
\textsuperscript{148}Section 284 – 90 (3)(i). The remaining provisions, which relate to the Petroleum resource rent tax, trusts and partnerships are excluded.
\textsuperscript{149}Subsection 284-75(3).
taxpayers under ss 91 to 95 of the Act. Under s 95, if a taxpayer fails to submit a return or submits a return or information that is incorrect or inadequate, SARS may assess the taxpayer based on an estimate. It seems that the general penalty provisions would apply in this case.

The base penalty is then adjusted based on the behaviour of the taxpayer.\textsuperscript{150} If a taxpayer is obstructive or becomes aware of either a shortfall amount or a false and misleading statement and does not disclose this in a reasonable time, the penalty is increased by 20 percent. This increase also applies for repeat offences.

The base penalty is reduced to the extent to which a tax treatment is based on advice, practice or an approved publication of the Commissioner (the law was applied in an accepted way). Voluntary Disclosure may also benefit the taxpayer. A voluntary disclosure after the announcement of an examination by the Commissioner will result in a 20 percent reduction.\textsuperscript{151} A voluntary disclosure before the announcement of an examination will result in a reduction of between 80 and 100 percent.

5.6.4 Australia: other general penalties

Division 288 contains a listing on non-compliance matters which attract an administrative penalty, for example a failure to retain records as required under tax law will attract a penalty of 20 penalty units.\textsuperscript{152} A review of the provisions of this section indicates that the penalty is attracted by the non-compliance event and is not amended based on the size of the entity (taxpayer).

\textsuperscript{150} In terms of par 42 of MT2008/1 The Australian legislation does not place the burden of proof regarding a taxpayer’s behaviour on the Commissioner. However the common law position indicates that ‘there is no presumption that the existence of a shortfall amount caused by a false or misleading statement necessarily or automatically points to a failure to take reasonable care.’

\textsuperscript{151} If it will save the Commissioner time and resources.

\textsuperscript{152} Op cit section 288-25.
5.6.5   **Australia: objection and appeal**

Taxpayers have 60 days from the date of penalty assessment to object. Certain conditions apply under which taxpayers may not object to penalties below certain thresholds. For example, a taxpayer cannot object to a decision not to remit (waive) a penalty if the amount is $340 or less.\(^{153}\)

5.7   **New Zealand**

The worldwide income of New Zealand residents is generally subject to income tax in New Zealand, and non-residents are taxed on New Zealand source income. Progressive personal income tax rates of 10.5 percent to 33 percent apply.\(^{154}\) The New Zealand company tax rate is 28 percent.\(^ {155}\) Other taxes include Goods and Services Tax, Customs Duty, Excise Duty, Gift Duty and Estate Duty. The New Zealand penalty provisions are contained Part 9 of the *Taxation Administration Act 1994*\(^ {156}\) (New Zealand Act).

5.7.1   **New Zealand: the failure to file tax returns on time**

A taxpayer is liable to pay a late filing penalty under s139A of the New Zealand Act in the event that certain returns, including the annual tax return are not completed and provided on time and the Commissioner notifies the taxpayer that the penalty is payable. The late filing penalty for an annual tax return is initially based on the taxpayer’s net income for the

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\(^{154}\) For the 2012/2013 year of assessment


previous year of assessment. Once the current year net income is known, the penalty is
adjusted to be based on the current year. This is a once off penalty.

5.7.2 New Zealand: the failure to pay taxes on time.

Late payment penalties are cumulative and are calculated as follows:

- An initial late payment penalty of 1 percent of the unpaid tax on the first day.
- An initial late payment penalty of 4 percent of the tax to pay at the end of the sixth
day.
- an incremental late payment penalty equal to 1 percent of the amount of tax to pay
determined on each day that falls 1 month after a day on which a penalty is
imposed.\(^{158}\)

The incremental penalty may cease when a tax payer contacts the Commissioner to seek
financial relief under s139BA.

5.7.3 New Zealand: the failure to correctly declare all tax liabilities

The tax shortfall penalty arises under s141 of the New Zealand Act. In terms of s141:

(3) A separate tax shortfall calculation is required—

(a) for each return period; and

(b) for each tax type; and

(c) for each tax position taken by a taxpayer.

The penalty is based on taxpayer behaviour and is summarised below:

\(^{157}\) This penalty amounts to $50 in the case of net income of less than $100 000, and $250 and $500 in the case
of net income of between $100 001 and $1 million and over $1 million respectively.

\(^{158}\) New Zealand Act s139B(2).
<table>
<thead>
<tr>
<th>Behaviour</th>
<th>Penalty</th>
<th>Exclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not taking reasonable care(^{159}) (this may include calculation and</td>
<td>20% of tax shortfall</td>
<td>Certain instances of bona fide reliance on a tax advisor</td>
</tr>
<tr>
<td>recording mistakes)</td>
<td></td>
<td>An acceptable tax position results in reasonable care</td>
</tr>
<tr>
<td>Unacceptable tax position(^{160}) and:</td>
<td>20% of tax shortfall</td>
<td>Mere calculation or recording mistake</td>
</tr>
<tr>
<td>income tax shortfall greater than both $50 000, and 1% of total tax</td>
<td></td>
<td>Tax position arises from appropriate IFRS disclosure</td>
</tr>
<tr>
<td>Gross carelessness(^{161})</td>
<td>40% of shortfall</td>
<td>Reliance on Commissioner’s opinion</td>
</tr>
<tr>
<td>Abusive tax position(^{162})</td>
<td>100% of shortfall(^{163})</td>
<td></td>
</tr>
<tr>
<td>Evasion or similar act or enables or attempts to enable another</td>
<td>150% of shortfall</td>
<td>Failure is due to accident, illness or cause beyond the taxpayer’s control</td>
</tr>
<tr>
<td>person to evade or similar</td>
<td></td>
<td>Excludes section 141ED</td>
</tr>
</tbody>
</table>

Figure 3.1 Summary of New Zealand understatement penalties part 1

Section 141FB of the New Zealand Act allows for a reduction of penalties for previous behaviour. The penalty is reduced by 50 percent in the instance where a taxpayer has not been liable for a similar shortfall penalty in the last four years (for certain taxes this is reduced to two years). In addition, section 141G of the New Zealand Act the shortfall penalty may be reduced as follows:

\(^{159}\)Op cit s 141A.

\(^{160}\)Op cit s 141B: ‘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.’

\(^{161}\)Section 141C(3): ‘gross carelessness 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.’

\(^{162}\)Section 141D Abusive tax position (1) The purpose of this section is to penalise those taxpayers who, having taken an unacceptable tax position, have entered into or acted in respect of arrangements or interpreted or applied tax laws with a dominant purpose of taking, or of supporting the taking of, tax positions that reduce or remove tax liabilities or give tax benefits.

\(^{163}\) ‘If an arrangement is offered, sold, issued or promoted to 10 or more people in a tax year and it involves an abusive tax position, the promoter will be liable for a promoter penalty. The penalty will be the sum of the tax shortfalls the investors could have obtained. This means that if the arrangement affects income tax, the promoter penalty is calculated on the maximum tax-related benefits of each investor at the rate of 39 cents in the dollar. If a promoter is penalised, the penalty on the investors is reduced from 100% to 20%.’ [Online] Available at: http://www.ird.govt.nz/how-to/debt/penalties/shortfall-penalties/sf-penalty-abusive.html (Accessed 5 December 2014).
<table>
<thead>
<tr>
<th>Behaviour</th>
<th>Consequence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-notification disclosure(^{164})</td>
<td>100%, if the shortfall penalty is for not taking reasonable care, for taking an unacceptable tax position, or for an unacceptable interpretation; or 75%</td>
</tr>
<tr>
<td>Post-notification disclosure(^{165})</td>
<td>40%</td>
</tr>
<tr>
<td>Adequate disclosure of an unacceptable tax position (^{166})</td>
<td>75%</td>
</tr>
<tr>
<td>Tax shortfall is temporary</td>
<td>75%(^{167})</td>
</tr>
</tbody>
</table>

**Figure 3.2 Summary New Zealand understatement penalties part 2**

A temporary shortfall on a tax position is effectively a tax position which will permanently reverse or correct within four tax years. A shortfall penalty may be increased by 25% ‘if the taxpayer obstructs the Commissioner in determining the correct tax position in respect of the taxpayer’s tax liabilities.’\(^{168}\)

5.7.4 **New Zealand: objection and appeal**

The penalties above appear to be subject to the general objection provisions contained in Part 8 of the New Zealand Act. Section 183A of the New Zealand Act grants the Commissioner discretion to remit the penalties referred to above in the instance of circumstances outside of the control of the taxpayer or if the taxpayer has a reasonable justification or excuse for the failure. Section 183ABA provides for remission of interest in certain events.

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\(^{164}\)Before the taxpayer is first notified of a pending tax audit or investigation, s 141G(1)(a).

\(^{165}\)After the taxpayer is notified of a pending tax audit or investigation, but before the Commissioner starts the audit or investigation, s 141G(1)(b).

\(^{166}\)At the time the position is taken s 141H(1).

\(^{167}\)This is reduced to 100% in the case of voluntary disclosure prior to notification of audit.

\(^{168}\)Section 141K(1).
5.8 Summary of findings

5.8.1 Failure to file

The South African failure to file penalty appears to be the most onerous of all of the countries analysed. The length of time over which the penalty accumulates is also the longest.

Since it is based on the taxable income of the previous year, the penalty does not take tax payable or tax owing for the relevant year of assessment into account. Therefore substantial penalties can be incurred even if the taxpayer does not have a tax liability or has paid the full liability through employee’s tax or provisional tax. Germany, the United States of America and New Zealand only sanction taxpayers for late filing if taxes remain due at filing date. In addition, the Chinese and Australian penalties, which are independent of due taxes, are relatively low.

The USA effectively does not charge a late filing penalty if a late payment penalty applies, which avoids double jeopardy.

Only South Africa links the penalty for non-compliance to the taxable income of the taxpayer for all penalty types. Although the current regime only applies to income tax returns, it is submitted that should the provisions be extended to other tax types such as donations tax, estate duty, provisional tax or value added tax, a penalty based on taxable income would be inappropriate.

5.8.2 Late payment of taxes

The approach to late payment of taxes appears to be relatively consistent across the countries analysed.
5.8.3 Penalty for failure to correctly declare all tax liabilities

With the exception of China, the penalties in this category are generally linked to behaviour of the taxpayer. South Africa, Australia, New Zealand and Germany provide substantial reductions in penalties in the instance of voluntary disclosure by the taxpayer, especially if this is prior to investigation, public notice or audit by the Commissioner. Therefore the framework applied by South Africa appears to be consistent with international practices.

However, the penalties imposed by South Africa appear to be higher than all countries except China (which is also difficult to compare to other jurisdictions). It is notable that the current South African penalty percentages have recently been lowered but they remain comparatively high.

New Zealand provides for a lower penalty in the instance of a so called temporary shortfall. It is submitted that this is an important provision and would address the shortcoming of the South African legislation as identified in Chapter 4, where the understatement will be reversed in a subsequent year of assessment.

The roles and responsibilities of tax intermediaries vary widely from country to country.

The behavioural terms used are similar but varied between countries. Australia and the USA provide extensive guidance and examples to assist taxpayers. It is submitted that given the importance and quantitative effect of differentiating between behavioural categories, extensive guidance and examples are necessary and should be binding on the revenue authority (as is the case in Australia). The Internal Revenue Manual, which contains detailed policy, guidance and examples, is published by the IRS for use by American taxpayers.
5.9 Conclusion

The legislation which has been analysed and compared in this chapter varies widely in nature, approach, volume and complexity. In certain instances, such as China, the legislation is very limited and appears to lend substantial discretion to the Commissioner. The Australian legislation appears to have the most detailed and extensive penalty provisions. There are also many exceptions and separate penalties to cater for a wide array of taxing matters outside of the scope of this study. However, in general the broad themes of the OECD research appear to be applied in most instances.

The regimes of Australia and New Zealand appear to most closely resemble that of the Republic. It is noteworthy, however, that the South African legislators appear to have taken a hard line by comparison to these countries, with less grace for first offences, and higher penalty amounts and percentages in almost all instances. The most striking departure from the other countries appears to be in the administrative non-compliance penalty, as discussed above.

The onerous nature of the penalties brings their fairness into question and whether it is appropriate for a developing country to impose penalties that exceed global practice. This also supports the concern expressed in the research into the efficacy of penalties which are overly complex and onerous, as discussed in Chapter 2. This indicates that the current penalties may not be fair by global standards and may be perceived by taxpayers to be unfair, which might in turn impact on the efficacy of these penalty provisions.
CHAPTER 6

A STUDY OF THE IMPACT OF THE PENALTY PROVISIONS IN LIGHT OF THE MOST RECENT TAX RELATED COURT CASES IN SOUTH AFRICA

6.1 Introduction

Each year, disputes between taxpayers and the South African Revenue Service must be adjudicated by the courts. Tax related court cases provide a window, albeit sometimes opaque, into the normally confidential relationship between taxpayer and fiscus. Therefore an analysis of these cases is considered relevant to provide an insight into the fairness of the relevant penalty provisions of the Act and their implementation by SARS. It is submitted that this analysis will not shed light on the efficacy of the penalty provisions as a deterrent to non-compliant behaviour, since the advent of a court case indicates that a dispute between the taxpayer and SARS has already arisen.

The purpose of this chapter is to consider the most recent tax cases in the Supreme Court of Appeal, High Courts, and Tax Courts in order to assess the extent to which penalties are considered by the courts and then to analyse whether they appear to be consistently and fairly applied to taxpayers.

6.2 Selection of court cases for analysis

A purposeful or judgemental sampling approach has been applied.\textsuperscript{169}

The court cases selected represent a cross section of the publicly available cases. Tax Board cases are not published. There are no recent tax disputes of relevance to the current study which have been heard by the Constitutional Court. Since the Act commenced on 1 October

\textsuperscript{169} See 5.2.
2012, recent tax cases are most likely to be subject to the provisions of this Act, although cases that deal with the historical provisions are also considered. A judgmental selection of the ten most recent cases was therefore made. Judgments delivered after 31 August 2015 are considered to be out of the scope of this study and have been excluded.\textsuperscript{170}

Section 132 of the Act requires that all tax court cases be published for general information. These are published on the SARS official website\textsuperscript{171} along with the High Court, Supreme Court of Appeal and Constitutional Court cases that pertain to SARS.

\textsuperscript{170} See 1.7.

\textsuperscript{171} www.sars.gov.
6.3 Supreme Court of Appeal

Of the ten most recent Supreme Court of Appeal cases published on the SARS website, the following four cases were of interest to the current study:

<table>
<thead>
<tr>
<th>Case</th>
<th>Note</th>
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</thead>
<tbody>
<tr>
<td>Miles Plant Hire v Commissioner SARS&lt;sup&gt;172&lt;/sup&gt;</td>
<td>1</td>
</tr>
<tr>
<td>The Commissioner for the South African Revenue Service v Candice-Jean van der Merwe&lt;sup&gt;173&lt;/sup&gt;</td>
<td>2</td>
</tr>
<tr>
<td>SARS v Pretoria East Motors (Pty) Ltd&lt;sup&gt;174&lt;/sup&gt;</td>
<td>3</td>
</tr>
<tr>
<td>GB Mining v Commissioner: SARS&lt;sup&gt;175&lt;/sup&gt;</td>
<td>3</td>
</tr>
</tbody>
</table>

Notes:

1. This case deals with an application for condonation in respect of a winding up order and did not specify the underlying taxes owed, although reference is made to the fact that the taxes owing of R37 209 060.51 included penalties and interest. Therefore the case does not cast light on the penalties themselves. It is interesting, however, that the representative taxpayer, who was guilty of tax evasion, including the provision of false documents and statements, was subjected to fines of R100 000 for each of the two contraventions (Income Tax and Value-Added Tax Acts respectively), which was suspended for five years. This highlights the fact that the non-criminal penalties appear to be more onerous than those that arise under criminal prosecution.

2. This case, as above, relates to a failed application for condonation. The matter of interest to this study seems to be the level of non-compliance on the part of the taxpayer’s father. The case points to his total tax debt including penalties and interest of R66 206 256.53.

3. This case is significant to the current study and is considered further below.

*Figure 4 Supreme Court of Appeal Cases*

In the *Pretoria East Motors<sup>176</sup>* case, the Supreme Court of Appeal handed down judgment in respect of fifteen disputed items remaining out of an original twenty-one in relation to an

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<sup>172</sup> (20430/2014) [2015] ZASCA 98 (1 June 2015).


<sup>174</sup> (291/12) [2014] ZASCA 91 (12 June 2014).

<sup>175</sup> (903/2012) [2014] ZASCA 29 (28 March 2014).

<sup>176</sup> *Op cit.*
audit conducted in the 2014 year of assessment by SARS officials. In this audit additional assessments and penalties of two hundred percent of the additional tax were raised in terms of s76 of the Income Tax Act and s60(1) of the VAT Act respectively. It is not possible to fully quantify the original assessments, however it is clear that the additional taxes imposed on the taxpayer were in excess of twenty million rand. This means that the taxpayer would have been forced to pay at least sixty million rand including the penalties and interest, and would have not have had the use of this money for almost ten years.

In handing down judgment the learned judge Ponnan JA stated:177

‘The approach adopted by Ms Victor was to examine the accounts and, where she found a discrepancy that she did not understand and for which in her view no adequate explanation was furnished, she raised an assessment to additional tax – either income tax or VAT or, in some instances, both…her approach was fallacious.’

The judge emphasised that SARS is obliged to engage with taxpayers in a manner which is administratively fair, and pointed out that the SARS official had not been clear in terms of the explanations that were required and did not give the taxpayer adequate opportunity to provide support or explanations.

In many instances the provisions of the relevant Acts were simply not applied, for example internal transfers of vehicles within the business were treated by the SARS official as though they should be subject to output VAT.

In respect of the 200 percent penalty raised on both the VAT and income tax assessments, the judge stated that:178

177 Op cit 9 and 11.
178 Op cit 54.
‘It bears noting, however, that in this instance the Tax Court simply rubber stamped this decision.’

The learned judge then determined that in both the instance of the income tax as well as the VAT penalties, the requirement of the relevant provisions that the taxpayer must have had the intent to evade taxation were not met and therefore the penalties could not stand.

It seems that the current penalty regime under s223 of the Act as analysed in Chapter 4 would have inevitably led to a smaller penalty being applied. However, given that the SARS official inappropriately judged the behaviour to be intentional tax evasion, the maximum penalty may also have been imposed under the current regime, pending the objection and appeal process.

It is concerning that the Tax Court seems to have ‘rubber stamped’ the decision of SARS in respect of the penalties. It is submitted that in an instance in which a taxpayer is not contesting the underlying underpayment of tax, and therefore only the percentage to be applied to the penalty itself, it would be likely to be unduly expensive to be forced to carry an appeal through to the Supreme Court of Appeal, with the risk of losing with costs and that this may therefore not be an effective avenue for fairly resolving such disputes. In addition, the manner in which the SARS official simply assessed the taxpayer on any matter which she did not understand seems to have placed an undue onus on the taxpayer. This is considered relevant to the current study in several respects:

Firstly, such treatment might lead to a perception by taxpayers of not being treated with fairness and respect, as discussed in Chapter 2, and may erode taxpayer’s willingness to comply.

Secondly many taxpayers may not have the means or knowledge to object and appeal, resulting in individual taxpayers being prejudiced and eventually contributing disproportionately to the Fiscus.
Thirdly, in light of the size, nature and extent of the additional taxes and penalties raised in the example above and the length of time which passed before the resolution of the matter, it seems that this treatment would not promote the objectives of the Fiscus listed in Chapter 3 and could result in the closure of a small business which does not have access to the cash flow needed to carry a case of this sort to conclusion.

Fourthly there is no recourse available to taxpayers for the inconvenience, time and cost involved if a SARS official erroneously and even negligently raises inflated additional taxes and penalties.

In the *GB Mining*\(^\text{179}\) case, certain of the additional taxes raised under s 76 of the Income Tax Act in the amount of R352 911.44 were remitted in their entirety by the judge on the basis that the imposition of the additional tax was not justified. This again indicates that the penalty provisions may not be fairly and consistently imposed by SARS.

### 6.4 High Court

It is notable that the ten most recent High Court cases which have been reported on the SARS website did not relate to penalties or tax disputes. The only case of any interest to the current study is *Ackermans Limited v Commissioner for South African Revenue Service*\(^\text{180}\). In this case the appellant, Ackermans Limited, sought to set aside a decision by SARS in terms of the provisions of the Promotion of Administrative Justice Act \(^\text{181}(\text{PAJA})\) or to have the decision declared unconstitutional, unlawful and invalid, essentially on the basis of an undue delay by SARS of six years in issuing additional assessments. The case was referred back to the Tax

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179 *Op cit.*

180 77 SATC 191, 2015 (GP)

181 *Op cit.*
Court. This case highlights the difficulties that taxpayers may face in relying on provisions of the PAJA but does not add to this study and is therefore not considered further.

6.5 Tax Court

Of the ten most recent Tax Court cases published on the SARS website, the following eight cases were of interest to the current study:

<table>
<thead>
<tr>
<th>Case</th>
<th>Note</th>
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<tbody>
<tr>
<td>Case VAT 1129 (unreported)</td>
<td>1</td>
</tr>
<tr>
<td>Case VAT 867 (unreported)</td>
<td>2</td>
</tr>
<tr>
<td>ITC 1878(^{182})</td>
<td>3</td>
</tr>
<tr>
<td>ITC 1877(^{183})</td>
<td>4</td>
</tr>
<tr>
<td>Case VAT 969 (unreported)</td>
<td>5</td>
</tr>
<tr>
<td>Case VAT 1005 (unreported)</td>
<td>6</td>
</tr>
<tr>
<td>Case 13132 (unreported)</td>
<td>7</td>
</tr>
<tr>
<td>Case No 13472 (unreported)</td>
<td>3</td>
</tr>
</tbody>
</table>

Notes:

1. This case is subject to the provisions of the Tax Administration Act, and it is interesting that despite apparent non-compliance on the part of the taxpayer in respect of the VAT Act, no reference was made to penalties. It must be presumed that appropriate penalties were imposed.

2. In this case (to which the penalty provisions of the Tax Administration Act do not apply) the judge remitted penalties and interest charged prior to the judgment due to the ‘wrong point of departure by SARS’\(^{184}\). It does not appear that the taxpayer specifically objected to the penalties and interest of R30 720.04.\(^{185}\)

3. This case is considered relevant to the current study and is considered further below.

4. It is interesting that this unsuccessful appeal against the disallowance of substantial additional expenditure under s11D of the Act did not refer to penalties. A review of the case indicates

\(^{182}\) (2015) 77 SATC 349 (J)

\(^{183}\) (2015) 77 SATC 269 (WCTC)

\(^{184}\) At 39.

\(^{185}\) This amount of penalty and interest was derived by an explanation given by the learned judge at 2 and amounted to 13.5% of the disputed VAT.
that this dispute involved in interpretation of this section only and it is likely that penalties were not imposed on the basis that SARS appears to have had full knowledge of the relevant amounts and the intricacies of the particular case throughout the process.

5. In this case CSARS levied a penalty of 10 percent following a reassessment under a dispute over whether the supplies made by a taxpayer qualified for zero rating. However prior to the court case the penalties were remitted based on the objection of the taxpayer and were not in dispute in the court case. It seems that similarly to the case above, the matter related entirely to interpretation and that the taxpayer was transparent in their dealings with CSARS.

6. It seems that no penalties were levied in this case, which related to a disputed interpretation of the zero rating provisions of the VAT Act. In this instance SARS was recorded as approaching National Treasury for an interpretation of the relevant statute and the case was resolved through the invocation of the contra fiscum rule. The taxpayer seems to have been transparent in their dealings with SARS.

7. It is curious that no mention is made of penalties in this case in which the taxpayer omitted closing farming produce which had been included in previous years from his return of income. However it seems that no penalties were charged, as the judge made an order in respect of the levy of interest but made no mention of penalties.

**Figure 5 Tax Court Cases**

In *ITC1878* the taxpayer appealed unsuccessfully against taxes imposed based on an interpretation of the relevant double tax agreement with the United States of America. The taxpayer in this case had not submitted tax returns in South Africa and was subsequently assessed for the 2007, 2008 and 2009 years of assessment. SARS imposed additional taxes of 200 percent under s 76 of the Act. This was subsequently reduced to 100 percent without any reasons being furnished.

In considering the objection to the penalty imposed, the judge indicated that since the company in question had a presence in many countries, the failure to familiarise itself with

\[\text{Figure 5 Tax Court Cases}\]

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\[\text{186 Op cit.}\]
the South African tax laws would be ‘grossly negligent’. This indicates that it is likely that the penalty would be unchanged under s 223 of the Act.\textsuperscript{187}

Secondly it seems notable that the taxpayer had in fact declared this income in the United States of America and paid the relevant taxes and therefore was not escaping tax overall.\textsuperscript{188} It is submitted that this case represented a disagreement between the taxpayer and SARS and that the argument of Long and Swingen\textsuperscript{189} that forcing honest disagreements into a compliance framework does not achieve the purpose of the legislation.\textsuperscript{190}

In \textit{Case No. 13472}\textsuperscript{191} the taxpayer was unsuccessful in his appeal with respect to the increase of an amount of proceeds under the Eighth Schedule of the Act by R625 437 601 for the 2008 year of assessment. Having dismissed the appeal of the taxpayer, the learned judge Wepner J stated (with reference to \textit{CSARS v Foskor (Pty) Ltd})\textsuperscript{192} at 45:

> ‘When the correctness of a discretionary decision, which is subject to objection and appeal, is contested in the tax court, there is a re-hearing of the whole matter, including the question of penalties.’

In this case the penalty provisions of the Act were applied retrospectively\textsuperscript{193} to the 2008 year of assessment, a matter which was common cause between the appellant and SARS. The relevant understatement was in excess of R1 million, and therefore amounted to a ‘substantial understatement’ as defined in the Act. The Commissioner initially levied a 75 percent penalty

\textsuperscript{187} See Chapter 4. A Standard Case involving ‘Gross negligence’ would attract a penalty of 100 percent.

\textsuperscript{188} Whether or not the effective tax paid was less due to the rules of the different jurisdiction is unknown.

\textsuperscript{189} See Chapter 4.

\textsuperscript{190} It is conceded that given this company’s global footprint one may have anticipated that even in the absence of a tax return, there would have been some indication of the company formally considering this tax risk.

\textsuperscript{191} \textit{Op cit.}

\textsuperscript{192} [2010] 3 All SA 594 (SCA) at 51. It is noted that the \textit{Foskor} case did not specifically refer to penalties.

\textsuperscript{193} Presumably in accordance with the transitional provisions contained in s 270(6) of the Act.
on the basis of “reasonable care not taken”. The judge firstly noted that the table in the Act (which was being applied retrospectively) had changed and that the penalty was now 50 percent. The learned judge effectively changed the penalty based on a change to the Act which occurred after both the taxing event and the initial assessment by SARS. Although this favoured the taxpayer in the particular instance, it is clear that the converse could have applied if a more onerous table had been inserted into the section of the Act and that the final penalty was essentially decided based on the timing of the court decision. The learned judge then held that since the taxpayer had sought expert accounting and legal advice, that the taxpayer had ‘reasonable grounds’, resulting in the substantial understatement being a standard case, and the penalty was reduced to 10 percent of the understated tax. It is notable that the judge therefore interpreted the behaviour of the taxpayer two levels higher than SARS.

6.6 Conclusion

It appears from an analysis of the cases above that there is a clear distinction between taxpayers who disagree with SARS on an interpretation of the taxing acts, and those who wilfully disregard the requirements of the legislation or evade taxes completely. Therefore the current legislation appears to increase the fairness of the penalty framework by taking account the behaviour of the taxpayer. SARS also appears to take a lenient stance in instances where the taxpayer has not withheld information when submitting the relevant returns.

However, cases often take many years to reach resolution, and a regime of ‘pay now argue later’ applies, meaning that taxpayers may be out of pocket for extended periods of time,

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194 This advice would not have met the requirements of s 223(3)(b) of the Act, since the taxpayer was unable to show that a specific opinion was obtained in respect of the matter at hand.

195 In terms of s 164 of the Act, payment of taxes is not suspended pending objection and appeal, unless otherwise directed by a senior SARS official.
even if they eventually succeed in court. In addition, the charging and remittance of penalties by SARS does not seem to be transparent or consistent and even the Tax Courts have been accused of ‘rubber stamping’ the penalties imposed by SARS. It is also noted that none of the cases dealt with an objection to a penalty only. It is submitted that this may indicate that the normal objection and appeal process may not be an effective route for taxpayer disputes in relation to a penalty, in the absence of a dispute regarding the underlying tax matter.

There is also no mechanism for a taxpayer to seek recourse in the event of SARS imposing frivolous or negligent penalties. It seems imperative that additional taxes and penalties should be consistently and transparently applied from the outset.
7.1 Conclusion in respect of the fairness and efficacy of the penalty provisions

It appears that the stated intention of the Fiscus is to implement an internationally aligned, fair and effective penalty regime which is designed to form part of a multi-pronged approach for the promotion of broad based taxpayer compliance. It is submitted that since the Fiscus and SARS clearly provide for fairness as a stated intention, it is appropriate to consider both the fairness and the perceived fairness of the relevant penalty provisions.

The literature reviewed reveals that while penalties are widely used by taxing authorities to promote compliance, taxpayers tend in any event to comply at a higher rate than is expected of them. In addition, it appears that often non-compliance is due to inertia or indifference, as opposed to an intentional decision not to comply. The literature survey indicates that penalties have limited efficacy in achieving this objective, pointing to a wide set of factors which drive taxpayer behaviour.

The monitoring of the fixed amount administrative non-compliance penalty under the current regulation seems onerous given that the majority of registered individual taxpayers are not expected to submit returns.\(^\text{196}\) In addition it is not clear why individuals are penalised for not submitting returns, even though the decision to submit a return is not always easy or clear, while companies are not currently subject to penalties despite, the obligation to submit on all companies, as well as an on-time submission rate of 40.9 percent for company income tax returns.\(^\text{197}\) Therefore, while Chapter 15 seems to be designed to cast a wide net, the current

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\(^{196}\) See 4.4.1

\(^{197}\) See 1.4.
implementation is narrow, in contradiction with both the stated objectives of the Fiscus, as well as the Chapter of the Act in which it has been framed.\textsuperscript{198} The current application to individuals who already have at least two returns outstanding is compared to the postulate of Doran\textsuperscript{199} that penalties might define taxpayer behaviour. In this context, taxpayers who have only one or indeed no returns outstanding may not be motivated to submit on time on the basis that they have not yet fallen foul of the target which has been set. This could dilute the efficacy of the regime.

The penalties appear to be relatively onerous in monetary terms by comparison to the countries analysed.

The substantial and growing overdue tax debt in respect of penalties and additional tax and specifically administrative penalties noted in 1.4 also might call into question the effectiveness of the penalties as a deterrent as well as the ability to of SARS to effectively implement and collect these penalties. This might be considered with reference to the suggestion of Doran\textsuperscript{200} that penalties which are too harsh might indicate to taxpayers that non-compliance is widespread, reducing the sense of obligation and having the opposite effect to that intended.

The relative complexity of Chapter 15 of the Act is viewed in the light of the findings of Abrie and Doussy\textsuperscript{201} that tax complexity may influence the behaviour of taxpayers and present a stumbling block to compliance. This may indicate a dilutive effect on the efficacy of the penalties.

\textsuperscript{198} As stated in 4.6.
\textsuperscript{199} Op cit see 2.4.
\textsuperscript{200} See 2.3.2.
\textsuperscript{201} See 2.3.1.
In 4.5.4 it is noted that in the event that a taxpayer claims a deduction in the incorrect year of assessment, the entire amount is considered for the purposes of calculating the understatement. It has been proposed in 4.5.4 that in the instance of an underpayment penalty arising as a result of an omission or incorrect statement being included in the incorrect tax period, the penalty should be calculated based on the prejudice suffered by the Fiscus. Alternatively the approach taken by New Zealand\textsuperscript{202} of substantially reducing the penalty if the shortfall will reverse within four years could be implemented.

The study of recent tax cases, as performed in Chapter 6, indicates that penalties do not seem to be consistently applied. In almost all cases in which penalties were relevant, the initial penalty levied by SARS was later reduced, either by SARS or by one of the courts. It is submitted that this indicates that the initial levying of penalties may not be fairly and consistently implemented by SARS. This is considered in the light of the findings of Murphy\textsuperscript{203} that a penalty that is perceived to be unreasonable or unfair could result in active resistance against the relevant authority.

7.2 Recommendations for policy and implementation

7.2.1 Administrative non-compliance penalties: Chapter 15

An analysis of the provisions of Chapter 15 indicates that the wording might be considered to be vague. It also presents the risk of overlapping penalties as considered at 4.4.2. It is therefore proposed that the legislators consider clarifying the wording of the relevant sections in order to promote certainty and clarity. This is considered of particular relevance given that

\textsuperscript{202} See 5.7.3.

\textsuperscript{203} See 2.4.
the framework is designed to ensure wide compliance to the full spectrum of taxpayers in the Republic.

7.2.2 Understatement penalties: Chapter 16

In respect of Chapter 16, it is proposed that the term prejudice should be defined and that the reference to SARS be removed from the definition of the ‘understatement’. The wording of the definition of ‘understatement’ should be revisited to prevent an inadvertent circumvention of s210-211 as discussed in 4.5.3.

The understatement table should also take into account understatements which will reverse in future as discussed above.

It is recommended that SARS also publish an Interpretation Note which clearly explains the method of implementation of Chapter 16 of the Act and which defines the application of the five behaviours listed in the understatement penalty table.\(^\text{204}\) This would serve two key purposes, namely to provide clarity to taxpayers and to hold SARS accountable when penalties are levied. This would streamline compliance with the onus which rests on SARS to prove the facts on which such a penalty has been imposed.\(^\text{205}\)

A mechanism should be developed under which a taxpayer would have recourse against the time and cost of penalties which are imposed fallaciously or without merit as identified in the *Pretoria East Motors*\(^\text{206}\) case.

\(^{204}\) See 4.5.6

\(^{205}\) In terms of s102 of the Act.

\(^{206}\) *Op cit.*
7.3 Further research opportunities arising

In light of the above findings, it is proposed that a study of the understanding that South African taxpayers have of the penalty provisions might cast additional light on their efficacy. Gaining insight into the perceptions of taxpayers of the fairness and consistency with which the penalties are implemented and their impact on individual taxpayer behaviour would also be of value. In addition, the role of tax practitioners in understanding, implementing and communicating these matters to their clients might assist with a better understanding of the efficacy of the current regime. It is submitted that a questionnaire or interview based study would be fruitful in further analysing these questions.
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