
SOUTH AFRICAN REVENUE SERVICE

**DRAFT GUIDE TO
UNDERSTATEMENT
PENALTIES**

Another helpful guide brought to you by the
South African Revenue Service



DRAFT GUIDE TO UNDERSTATEMENT PENALTIES

Preface

This guide is a general guide on understatement penalties under [Chapter 16](#) of the Tax Administration Act, 2011 (Act No. 28 of 2011). It does not delve into the precise technical and legal detail that is often associated with tax, and should therefore not be used as a legal reference. It is not an 'official publication' as defined in section 1 of the Tax Administration Act and accordingly does not create a practice generally prevailing under section 5 of that Act. It is also not a binding general ruling under section 89 of the Tax Administration Act. Should an advance tax ruling be required, visit the SARS website for details of the application procedure.

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

For more information you may –

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

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

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GENERAL PRINCIPLES FOR THE INTERPRETATION OF THE TAX ADMINISTRATION ACT

The Tax Administration Act contains generic provisions that administers the tax imposed under the legislation listed in the definition of ‘tax Act’ in [section 1](#). ‘Tax’, in the same section, ‘for purposes of administration under this Act, includes a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act’. The definition of ‘tax Act’ includes the Tax Administration Act and the Value-Added Tax Act 1991 (Act No. 89 of 1991), but customs and excise legislation is specifically excluded.¹ This means that the principles discussed in any guide on the Tax Administration Act will find application in the customs and excise environment to the extent that customs and excise activities give rise to value-added tax obligations. Additionally, the Tax Administration Act does apply in the customs and excise environment in cases where it specifically incorporates customs and excise legislation,² and when the customs and excise legislation specifically makes the Tax Administration Act applicable.³ It follows that any guide on provisions of the Tax Administration Act that are applicable to the customs and excise environment in this way will assist users in this environment.

Tax is charged under various Acts, each one dealing with specific types of taxes – income tax under the Income Tax Act, 1962 (Act No. 58 of 1962), value-added tax under the Value-Added Tax Act, and so forth. These Acts, and, in some cases, other Acts that exclusively deal with the administration of certain tax types,⁴ (**‘taxation Acts’**)⁵ contain administrative provisions, but only those that are unique or additional to the tax type specified in each Act. On the other hand, to simplify and harmonise tax administration, the Tax Administration Act incorporates into one piece of legislation administrative provisions generic to all the tax types governed by the taxation Acts. It is the primary vehicle for and only deals with the administration of all the tax types.

EXAMPLE

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

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

¹ The Customs and Excise Act, 1964 (Act No. 91 of 1964) is presently in operation but will, at a future date, be replaced with the Customs Control Act, 2014 (Act No. 31 of 2014), the Customs Duty Act, 2014 (Act No 30 of 2014) and the Excise Duty Act, 1964 (Act No. 91 of 1964) (i.e. the Customs and Excise Act, 1964 as amended) – for more information click [here](#).

² E.g. section 68, 69, and 191.

³ E.g. sections 705, 862 and 900 of the Customs Control Act, 2014 (Act No. 31 of 2014).

⁴ E.g. the Securities Transfer Tax Administration Act, 2007 (Act No. 26 of 2007).

⁵ As explained in the paragraph above, ‘tax Act’ includes the Tax Administration Act. To avoid confusion in this guide, the term ‘taxation Act’ as opposed to ‘tax Act’ is used to indicate that in such instances reference to the Tax Administration Act is excluded.

EXAMPLE

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

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

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

EXAMPLE

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

In addition, when 'director' is used in the Tax Administration Act when referring to the National Director of Public Prosecutions or the Director-General of the National Treasury, the context indicates the exact meaning.

- In the Income Tax Act, the term 'dividend' is defined and used to refer to amounts paid by a company for the benefit of a shareholder.⁷ However, when the term is used in the Tax Administration Act, it is used in context of a liquidator or trustee paying creditors.⁸ The context where the term is used in the Tax Administration Act therefore indicates that, even when the provision is applied in respect of income tax, it will not have the meaning defined in the Income Tax Act.

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

⁶ [Section 1](#) of the Tax Administration Act.

⁷ In section 1.

⁸ Section 198.

⁹ Various sections of the taxation Acts such as section 1(2) of both the Income Tax and the Value-Added Tax Acts.

EXAMPLE

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

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

EXAMPLE

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

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

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

¹⁰ In accordance with [section 4\(3\)](#) of the Tax Administration Act.

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

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Glossary

For the purpose of this guide, unless the context indicates otherwise, the following terms have the following meanings –

- **‘Act’** means the Tax Administration Act;
- **‘anti-avoidance rules’** means the statutory prohibitions of the avoidance, reduction or postponement of tax liability contained in Part IIA of Chapter III of the Income Tax Act, section 73 of the Value-Added Tax Act and similar provisions of the taxation Acts;
- **‘Commissioner’** means the Commissioner of SARS;
- **‘Diamond Export Levy (Administration) Act’** means the Diamond Export Levy (Administration) Act, 2007 (Act No. 14 of 2007);
- **‘Estate Duty Act’** means the Estate Duty Act, 1955 (Act No. 45 of 1955);
- **‘Income Tax Act’** means the Income Tax Act, 1962 (Act No. 58 of 1962);
- **‘listed behaviours’** means the items listed in column 2 of rows (i) to (vi) of the understatement penalty table;
- **‘Mineral and Petroleum Resources Royalty (Administration) Act’** means the Mineral and Petroleum Resources Royalty (Administration) Act, 2008 (Act No. 29 of 2008);
- **‘penalty percentage’** means a percentage contained in the understatement penalty percentage table;
- **‘prescribed circumstances’** means the items listed in the second row of columns 3 to 6 of the understatement penalty table;¹²
- **‘prescribed rate’** means the rate fixed by the Minister of Finance under section 80(1)(b) of the Public Finance Management Act, 1999 (Act No. 1 of 1999), 10.5% per annum at date of publication in Notice No. 259 in *Government Gazette* 39960 on 29 April 2016;¹³
- **‘SARS’** means the South African Revenue Service established by section 2 of the South African Revenue Service Act, 1997 (Act No. 34 of 1997);
- **‘Securities Transfer Tax Administration Act’** means the Securities Transfer Tax Administration Act, 2007 (Act No. 26 of 2007);
- **‘Skills Development Levies Act’** means the Skills Development Levies Act, 1999 (Act No. 9 of 1999);
- **‘Tax Administration Act’** means the Tax Administration Act, 2011 (Act No. 28 of 2011);

¹² Referred to as conduct in the audit environment.

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

- **'taxation Act'** means an Act, or portion of an Act, referred to in section 4 of the South African Revenue Service Act, 1997 (Act No. 34 of 1997) excluding the Tax Administration Act and the customs and excise legislation;¹⁴
- **'Transfer Duty Act'** means the Transfer Duty Act, 1949 (Act No. 40 of 1949);
- **'understatement penalty'** means the penalty imposed under Chapter 16 of the Tax Administration Act;
- **'understatement penalty table'** means the understatement penalty percentage table contained in section 223(1) of the Act;
- **'Unemployment Insurance Contributions Act'** means the Unemployment Insurance Contributions Act, 2002 (Act No. 4 of 2002);
- **'Value-Added Tax Act'** means the Value-Added Tax Act, 1991 (Act No. 89 of 1991); and
- **'VAT'** means value-added tax.

¹⁴ In [section 1](#) of the Tax Administration Act, the definition of 'tax Acts' includes the Tax Administration Act but for the purpose of this guide, the term 'taxation Act' does not.

1. Purpose

The purpose of this guide is to assist people who use it to gain an understanding of the understatement penalties contained in [Part A of Chapter 16](#) of the Tax Administration Act.

2. Background

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

Administrative non-compliance penalties under the erstwhile section 75B of the Income Tax Act were deleted and are now imposed in accordance with Chapter 15 of the Act. They relate to failures to comply with tax administrative requirements imposed under taxation Acts and the Tax Administration Act. Fixed amount penalties (Part B) consist of reportable arrangement penalties and other penalties for failures, listed in public notices.¹⁶ To avoid administrative 'double jeopardy', these failures exclude those that incur penalties under Part C of Chapter 15, or incur penalties for understatements, or for reportable arrangements. Percentage-based penalties (Part C) predominantly deal with late payment. Although the provisions of Chapter 15 apply across taxes, Part C must be read together with the taxation Act to determine the applicable penalty percentage for each tax type.¹⁷

The discretion to impose 'additional tax' of up to 200% under sections of various taxation Acts¹⁸ was replaced with the more equitable and consistent understatement penalty regime in [Part A of Chapter 16](#). This Chapter contains terms with definitions that only apply when such terms are used in it in single quotation marks.¹⁹ Although these terms are discussed in appropriate places in this guide, the term 'tax' deserves a special mention. Throughout the Act, tax includes 'a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act'²⁰ so as to collectively refer to all amounts imposed under tax legislation. However, for the purpose of Chapter 16, penalties and interest are excluded from the definition of 'tax' as understatement penalties are only imposed on understated tax and not on penalties and interest.

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

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

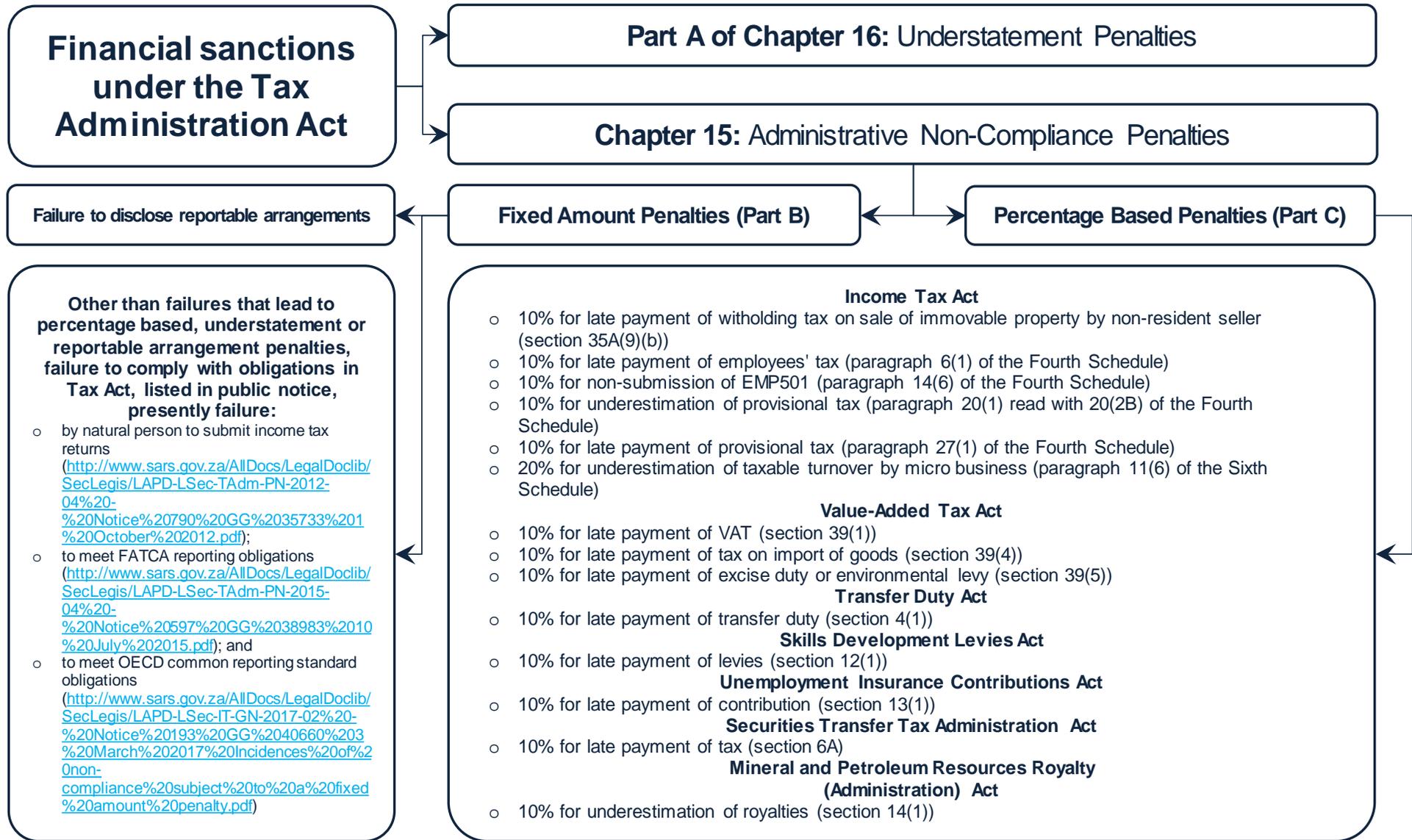
¹⁶ See visual representation below.

¹⁷ See discussion in the preamble to this guide for some general principles for the interpretation of the Tax Administration Act.

¹⁸ Most notably the repealed section 76 of the Income Tax Act but also sections 61(h) and 64B(11) of the same Act, and paragraph 6(2A) of the Fourth Schedule to it; section 60 of the Value-Added Tax Act; section 17A of the Transfer Duty Act; section 12(3) of the Skills Development Levies Act; and section 13(2) of the Unemployment Insurance Contributions Act.

¹⁹ In [section 221](#).

²⁰ As defined in [section 1](#) of the Act.



3. Transition from additional tax

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

The Tax Administration Act commenced on 1 October 2012. It contains provisions to ensure a smooth transition from the law applicable before that date to the law applicable after its commencement.²³ The general principle is that the provisions of the taxation Acts that were amended or repealed by the Act, applied as they read prior to amendment or repeal until 30 September 2012 and thereafter the Act applies.²⁴ This was done to facilitate the rapid implementation of the legislative reform intended by the Act and, by avoiding the need for different processes and systems, helps to reduce the cost of tax administration substantially.



In keeping with this principle, an understatement penalty is imposed if the return containing the understatement is *submitted* at any time from 1 October, *irrespective of the tax period to which it relates*. However, if the return was *submitted* up to 30 September, the situation is not so straightforward and, in the interest of equity, the Act makes exceptions to the principle illustrated above.

Such a return will attract an additional tax penalty if the verification, audit, or investigation necessary to determine the understatement was completed, and the assessment necessary to impose the penalty was issued by 30 September. If the verification, audit, or investigation was completed but the assessment not yet issued, an additional tax penalty will likewise be imposed.²⁵ On the other hand, if the verification, audit, or investigation was incomplete or had not yet commenced by 30 September, an understatement penalty will be imposed. However, certain concessions are made to equalise changes in the legislation that may negatively affect the taxpayer.²⁶ These concessions are discussed in appropriate places in

²¹ See footnote 18.

²² As held by the South African courts on more than one occasion in, for example, *Israelsohn v CIR* 1952(3) SA 529 (AD) at 539-540 and *CIR v McNeil* 1959(1) SA 481 (AD) at 487F

²³ Chapter 20.

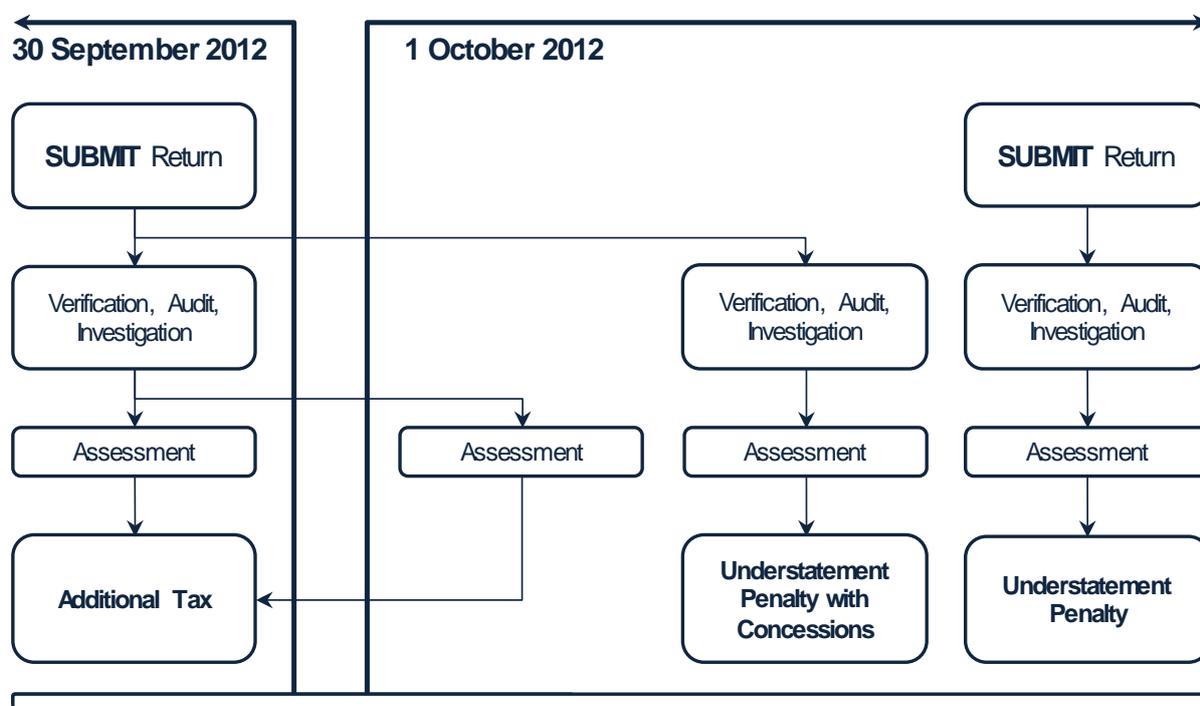
²⁴ [Section 270\(1\)](#)

²⁵ [Section 270\(6\)](#) read with [270\(6A\)](#).

²⁶ [Sections 270\(6B\) to \(6E\)](#).

this guide. They relate to the remittance of a penalty for substantial understatement, the reduction of the penalty percentage in the event of voluntary disclosure obtained under repealed provisions of the taxation Acts, the reduction or waiver of penalties under certain circumstances, and the date from which interest accrues.²⁷

The transition from the additional tax penalty system to the understatement penalty regime is illustrated below.



4. An understatement

The main purpose of the understatement penalty regime is to deter unwanted behaviour that causes non-compliant reporting. To reflect this purpose, all the actions or inactions that can trigger understatements are ones that negatively affect the submission or content of a return – a default in rendering, an omission from, or an incorrect statement in a return; the failure to pay the correct amount of tax when a return is not required; or an impermissible avoidance arrangement. In any given tax period there can be one or more of these actions or inactions and for each one that causes prejudice to SARS or the *fiscus*, the resultant prejudice will be an understatement.²⁸ It follows that a person who ‘fails to submit a return as required’ or ‘submits a return or information that is incorrect or inadequate’ will incur an understatement penalty²⁹ when SARS makes an assessment based on an estimate.³⁰

The ‘prejudice’ that the action or inaction causes need not be actual financial loss.³¹ If this were so, an understatement would not occur if it was discovered before the tax or refund was payable. A non-compliant or dishonest person would get off scot-free and not be deterred from engaging in similar unwanted behaviour in future. The purpose of the regime

²⁷ See paragraphs 8.4, 9, 11 and 10.

²⁸ See definition of ‘understatement’ in [section 221](#) of the Act.

²⁹ [Section 223\(2\)](#).

³⁰ In accordance with [section 95](#) of the Act.

³¹ *Western Credit Bank Ltd v Kajee* [1967] 4 All SA 228 (N) at page 237 and the case law referenced at page 237 and *Miele Et Cie GmbH & Co v Euro Electrical (Pty) Ltd* [1988] 2 All SA 244 (A) at page 253.

would not be achieved. On the other hand, applying too broad a meaning to ‘prejudice’ would blur the distinction between the various financial sanctions under the Act.

Administrative non-compliance penalties (Chapter 15) focus on the failure to comply with the administrative requirements of tax legislation. They address administrative prejudice – non-compliance in the case of fixed amount penalties (Part B) and late payment in the case of percentage-based penalties (Part C).³² The main emphasis of the understatement penalty regime is the deterrence of non-compliant reporting. It addresses the negative effect of reporting actions or inactions on the true amount of tax payable, i.e. not only the actual but also the potential financial prejudice caused. For each such action or inaction, the prejudice is consequently quantified by a shortfall to determine the existence of an understatement. The shortfall is essentially the difference between the correct amount of tax and the tax that was *reported*³³ in a tax period (by either the submission or non-submission of a return), i.e. the negative effect of the action or inaction expressed in monetary terms. For each understatement it is calculated as the sum of –

- the difference between the tax properly chargeable and the tax that was reported as chargeable ([section 222\(3\)\(a\)](#));
- the difference between the amount properly refundable and the amount that was reported as refundable ([section 222\(3\)\(b\)](#));³⁴ and
- the result of the maximum tax rate applied to the difference between the assessed loss or other benefit to the taxpayer properly carried forward from one tax period to the next and the assessed loss or benefit that was reported as carried forward ([section 222\(3\)\(c\)](#)). The tax rate is the maximum one applicable to the taxpayer, ignoring any assessed loss or other benefit to the taxpayer carried forward from one tax period to the next.³⁵ For illustrative purposes, a standard tax rate of 28% is used in all the examples in this guide.

EXAMPLE 4.1

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

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

EXAMPLE 4.2

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

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

³² See [section 210](#) and [213](#) of the Act.

³³ This would include not only direct reporting of actual tax chargeable, such as in the value-added tax environment (i.e. self-assessment), but also indirect reporting on matters that impact tax chargeable, such as in an income tax environment (i.e. SARS assessment).

³⁴ This could be a refund because of an assessment, e.g. where input exceeded output VAT or because of a payment, e.g. where more pay-as-you-earn or provisional tax was paid during the year than was required.

³⁵ [Section 222\(5\)](#).

EXAMPLE 4.3

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

Assessed loss reported	R	1 000	
Actual assessed loss	- R	300	
Difference		<u>R</u>	700
Tax rate	x	28	%
Paragraph (c) shortfall		<u>R</u>	196

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

EXAMPLE 4.4

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

VAT properly chargeable	R	400	
VAT reported as chargeable	- R	0	
Difference under paragraph (a)		<u>R</u>	400
VAT reported as refundable	R	100	
VAT properly refundable	- R	0	
Difference under paragraph (b)		<u>R</u>	100
Sum of paragraph (a) + (b)		R	400
	+	<u>R</u>	<u>100</u>
Shortfall		<u>R</u>	500

EXAMPLE 4.5

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

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

However, the differences in paragraphs (a) and (b) could be as a result of a duplication and therefore, in the interest of equity, the Act allows for the reduction of the resultant shortfall by the amount of this duplication.³⁶

³⁶ [Section 222\(4\)](#).

EXAMPLE 4.6

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

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

EXAMPLE 4.7

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

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

Take Note

A return could contain a number of actions or inactions (i.e. defaults, omissions, etc.) that negatively affect the true amount of tax payable. The prejudice is quantified by the shortfall (the sum of (a) + (b) + (c)) for each action or inaction to determine whether it has caused an understatement. There can consequently be a number of understatements in one return.

EXAMPLE 4.8

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

Taxable income not declared

Tax properly chargeable	R	392	28% of R1 400
Tax reported as chargeable	- R	280	
Shortfall	R	112	

Capital expenses claimed incorrectly

Tax properly chargeable	R	308	28% of R1 100
Tax reported as chargeable	- R	280	
Shortfall	R	28	

Take Note

The examples in this paragraph, particularly those that involve assessed losses, illustrate that the prejudice to SARS or the *fiscus* need not be actual financial loss. Although shortfalls mostly represent the actual adjustment to the tax payable, this is not always the case.

In short, an 'understatement' is the prejudice, quantified as a shortfall, to SARS or the *fiscus* caused by a non-compliant or dishonest reporting action or inaction. In such an event, the taxpayer must pay a penalty 'unless the 'understatement' results from a *bona fide* inadvertent error.'³⁷

5. *Bona fide* inadvertent error

The understatement penalty regime is designed to sanction undesirable behaviour, not to punish involuntary mistakes. It consequently exempts an understatement from a penalty if it is caused by a *bona fide* inadvertent error.

According to the Oxford Dictionary the origin of the word '*bona fide*' is Latin and literally means 'with good faith'. The word is also defined as 'genuine'; 'real'; 'without intention to deceive'. 'Inadvertent' is defined as 'not resulting from' or 'achieved through deliberate planning'. The Merriam-Webster online dictionary gives the following as some of the synonyms for the word inadvertent: 'accidental' 'unintentional', 'unintended', 'unpremeditated', 'unplanned' and 'unwitting'.³⁸

Notwithstanding views to the contrary, in the phrase '*bona fide* inadvertent error', '*bona fide*' does not describe the word 'error', it describes the word 'inadvertent'. If both described the error, there would be a comma after '*bona fide*'. The significance of this differentiation is illustrated below.

EXAMPLE

- A red floral dress – a dress of unspecified colour with a red floral pattern
- A floral red dress – a red dress with a floral pattern of unspecified colour
- A floral, red dress – a red dress with a red floral pattern

³⁷ The definition of understatement in [section 221](#) read with [section 222\(1\)](#) of the Act.

³⁸ TCIT 13772 WC at paragraph 44.

It follows from the above that a *bona fide* inadvertent error is not ‘an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive.’³⁹ It is a misstatement that genuinely is not achieved through or does not result from deliberate planning; or a misstatement that is genuinely, sincerely, and honestly unintentional, unintended, unpremeditated, unplanned and unwitting. The focus is not the *bona fides* of the error; it is the *bona fides* of its accidental nature. A *bona fide* inadvertent error is simply a real or genuinely accidental mistake, an honest momentary lapse of reason if you will. What constitutes such an error would depend on the circumstances of the taxpayer and the circumstances under which it was made.

EXAMPLE

Employees’ tax is deducted from the monthly salary of a provisional taxpayer. She earns investment income, has a unit trust and tax-free savings account, and contributes to a retirement annuity fund and medical aid scheme. In March one year, she provided services outside of her employment, something she had never done before, and received R1 000. As no employees’ tax was deducted from this payment, she researched the tax implications and ensured that she separately accounted for it in her provisional tax returns.

During the latter part of the year, she changed her post box address, occasioning the non-receipt of tax certificates when the final return was due. It took a great deal of effort to obtain the required documentation. However, after numerous telephone calls and lengthy periods in queues during lunchtime, she eventually managed to obtain the required certificates. Based on the information in these certificates and her IRP5, she completed her final return. However, she completely forgot about the R1 000 for services rendered.

Although there has undoubtedly been an understatement, if the taxpayer had deliberately planned to hide the additional income, she would have omitted it, not only from the final return but also from her provisional ones. The error was merely a genuine oversight, legitimately occasioned by the circumstances present at the time it was made – the extraordinary effort required to obtain the tax certificates and the fact that the provision of services did not form part of her normal activities. All things being equal, she has likely made a *bona fide* inadvertent error.

Although it might at first glance seem as if, in the absence of a *bona fide* inadvertent error, an understatement will always incur a penalty, this is not necessarily the case.

6. An understatement penalty

The primary aim of the understatement penalty regime is to deter the unwanted reporting behaviours specifically listed in rows (i) to (vi) of the understatement penalty table.⁴⁰ Albeit in negative form, these listed behaviours emphasise the standard expected from taxpayers when fulfilling tax obligations, and barring ‘substantial understatement’ (item (i)), illustrate that the regime is designed to sanction an understatement only when the act or omission that causes it springs from culpable or blameworthy behaviour. It consequently not only exempts understatements from a penalty if they result from a genuinely involuntary mistake, but also precludes by operation, the imposition of a penalty when the understatement arises from behaviour that meets the expected standard.

³⁹ TCIT 13772 WC at paragraph 45 – this definition additionally does not incorporate ‘inadvertent’.

⁴⁰ In [section223\(1\)](#).

Each understatement in a tax period is investigated to determine which, if any, of the listed behaviours applies. The amount of the penalty is calculated as a percentage of the shortfall occasioned by each and this percentage is dictated by two sets of criteria: the listed behaviours and the prescribed circumstances of the case listed in columns 3 to 6 of the understatement penalty table.⁴¹ If the act or omission of the taxpayer is not encapsulated in any of the listed behaviours, there is no basis for the determination of a penalty and consequently there can be no penalty.

EXAMPLE

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

7. Criteria for the determination of the penalty percentage

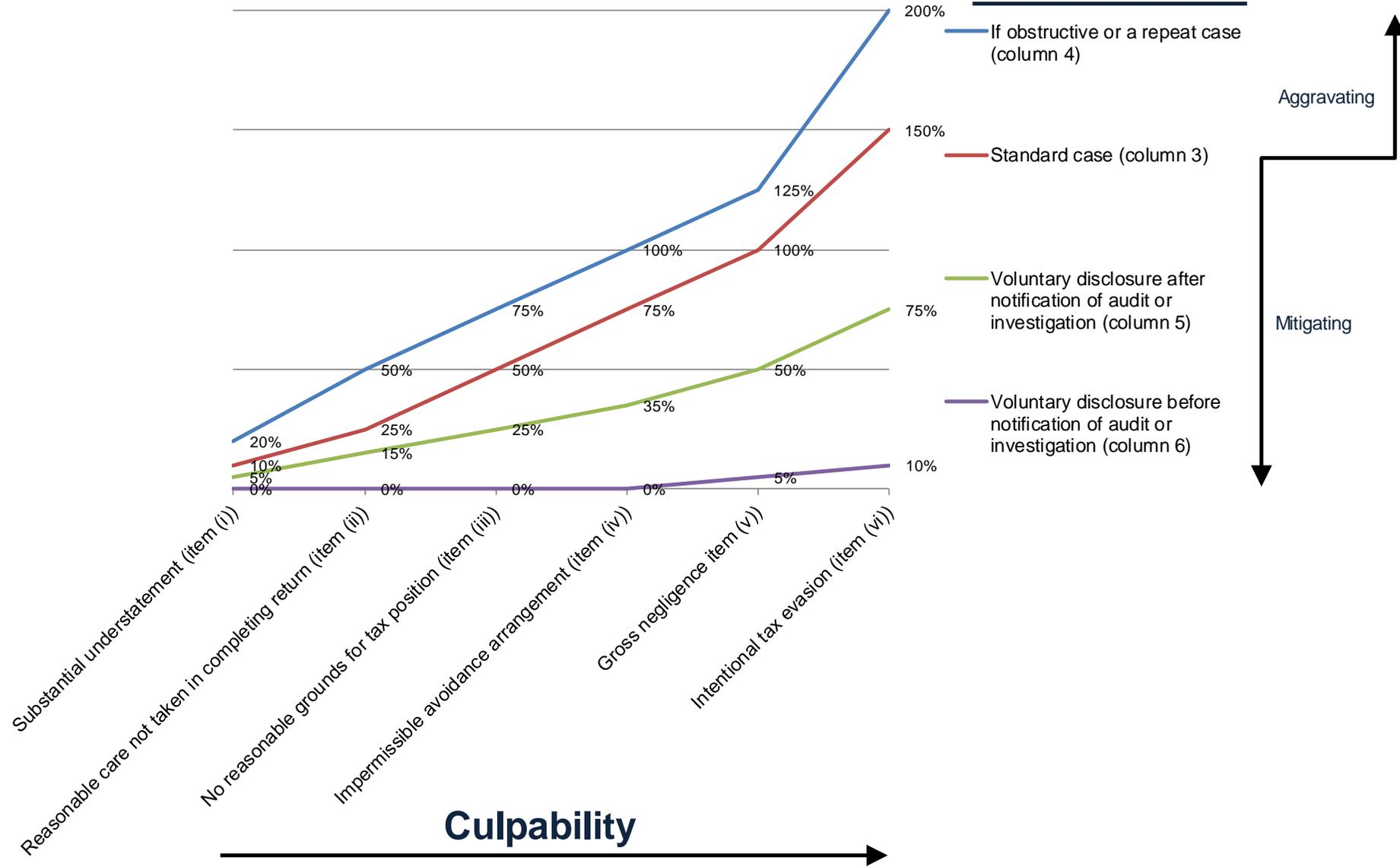
The criteria that determine the penalty percentage appropriate to each understatement were derived by considering those used under the additional tax penalty system, how these were shaped by case law, and the criteria used internationally in comparable circumstances. The understatement penalty regime sanctions the listed behaviours progressively: the higher the degree of culpability, the more severe the penalty. They are listed in ascending order of culpability from item (i) (substantial understatement), where culpability is absent, to item (vi) (intentional tax evasion), where culpability is highest. If any one of these behaviours is responsible for the understatement, the appropriate percentage in the row of that behaviour is determined by the prescribed circumstances of the case. Although other circumstances play a role in identifying the behaviour that led to the understatement,⁴² the prescribed ones – aimed at encouraging voluntary compliance – mitigate or aggravate the severity of the penalty in all cases. 'Substantial understatement' is unique in that, although it is listed with and treated like the behaviours (i.e. the penalty percentage is mitigated or aggravated by the presence of the prescribed circumstances), it is not behaviour at all. It is also a circumstance of the case, the existence of which is sanctioned. It is included as behaviour in recognition of the severity of the prejudice that SARS and the *fiscus* suffer because of acts or omissions that culminate in the substantial understatement of tax.

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

⁴¹ [Section222\(2\)](#) and [section223\(1\)](#).

⁴² See discussion in paragraph 8.

Circumstances



8. The listed behaviours

Taxpayers generally make a first assessment of their tax liabilities, in many cases the last word on the subject. They are held responsible for their own tax affairs; must keep complete and accurate information and records to substantiate these; and, when required, timeously provide such information and records to SARS. These obligations remain with taxpayers regardless of whether they engage a third party to structure their tax affairs or prepare their tax returns. The listed behaviours, in negative form, emphasise the standard of behaviour expected from taxpayers when fulfilling these obligations.⁴³

8.1. The standard

The standard that is expected is that of a reasonable person: a hypothetical juristic or natural person of ordinary intelligence, knowledge, care, and good judgement in circumstances comparable to that of the taxpayer. What would such a person have done in the circumstances that caused the understatement? To determine the reasonableness of the taxpayer's act or omission, the answer to this question is compared to what the taxpayer did. The further it is removed from how a reasonable person in comparable circumstances would have behaved, the less reasonable the error. The behaviour will be culpable if it lacks the care that a reasonable person in the position of the taxpayer would have employed. As the level of care decreases, culpability increases and increases even further when, to reduce tax liability, the behaviour of the taxpayer is intentionally contrary to how the specific reasonable person would have behaved. Although the test to determine reasonableness is objective (i.e. what was the correct course of action), it takes the circumstances of both the taxpayer and the case into account.⁴⁴ The examples that follow are not exhaustive and the facts of each case will dictate what is relevant.

EXAMPLES

- Circumstances of individual taxpayers – Level of education and knowledge about tax; the effort made to understand tax liabilities; age, experience, skill, health, social, and cultural background; previous history of compliance
- Circumstances of businesses – Characteristics and complexity (size, nature, taxable activities); the manner in which the affairs of the business are conducted (including the appropriateness of records, procedures, practices, and systems); the diligence with which the business guards against the risk of errors occurring (including the effort to understand the tax liabilities)
- Circumstances of the case – Size, quantum, nature, and frequency of the error (from either one transaction or a number of similar ones);⁴⁵ the significance of the error (made in a single or various similar transactions viewed together); the period of time between errors and subsequent ones; the complexity of the law and the transaction; the effort employed to understand obligations; the period of time between the failure to report on the error and its discovery; previous interaction between the taxpayer and SARS on similar issues

⁴³ In section 223(1).

⁴⁴ *Philotex (Pty) Ltd and others and Braitex and others v Snyman and others* [1998] JOL 1881 (A) at page 8.

⁴⁵ In this regard see discussion on substantial understatement in paragraph 8.2 below.

8.2. Reasonableness

All taxpayers are expected to act as reasonably as a reasonable person in comparable circumstances would, particularly in the care that they employ when completing returns (item (ii)) and the grounds they rely on for the adoption of a particular tax position (item (iii)).⁴⁶ If the reasonableness appropriate to a reasonable person was not used, a penalty may be appropriate. It is not a question of whether the taxpayer knew or anticipated the risk that their behaviour would cause an understatement, but whether a reasonable person would have foreseen it as a possibility and taken steps to prevent it.

Such steps may include employing an accountant, tax practitioner, or other tax professional to complete returns, or from whom to obtain advice before completing a return with entries that are not understood or before adopting a position with tax implications. However, the fact that such services or advice is obtained is not definitive proof of reasonableness. Appropriate services and advice can only be provided if all the relevant information and material facts pertinent to the tax liabilities are supplied to the professional. Additionally, even when advice is obtained, its use must be sensible – reliance on dubious advice will not be reasonable. It will likewise not be reasonable to abdicate tax compliance in favour of such a professional, the accountability, in the final analysis, lying with the taxpayer.

Take Note

Taxpayers can obtain advice from a SARS Contact Centre, branch, or Mobile Tax Unit; or consult reputable sources, such as official publications, interpretation notes, guides, and other information available on the SARS website.⁴⁷

8.2.1. Reasonable care not taken in completing return

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

EXAMPLE

An aged pensioner without any commercial training or experience invests money in a savings account. Transaction codes identify the interest payments on her bank statements and she carefully extracts the amounts reflected against these codes for inclusion in her income tax return. She however omits one amount, which was marked with the wrong code. In these circumstances, the failure to report the interest was not because the taxpayer did not take reasonable care. She carefully gathered and examined the relevant records and information, and completed the tax return with due diligence. A reasonable person of a similar age, with a concomitant lack of experience in financial matters, would not have foreseen that reliance on the codes would have resulted in an underpayment of tax. Much like the taxpayer in paragraph 6, she has acted reasonably.

⁴⁶ An assumption underlying one or more aspect of a tax return ([section 221](#) of the Act) such as whether a transaction is taxable or not, including assumptions regarding whether or not an amount, transaction, event, or item is taxable; an amount or item is deductible or may be set-off; a lower rate of tax than the maximum applicable to that class of taxpayer, transaction, event or item applies; or whether an amount qualifies as a reduction of tax payable.

⁴⁷ Available [here](#).

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

Although the appropriate standard is determined in context of the circumstances of the taxpayer, the circumstances of the case do play a role. For instance, when completing a return, eFilers can check their declaration against source documentation to ensure accuracy and can utilise the tax calculator provided on eFiling to verify that the recorded declarations match the disclosures made. Considering the resources at their disposal, in the absence of other relevant factors, an eFiler who makes a mistake when completing a return could not be said to have exercised reasonable care. Moreover, because tax is an integral part of trade, a reasonable person whose affairs become more complex as their business expands, will exert more effort to understand their reporting obligations and take the necessary steps to ensure that they accurately report to SARS. On the face of it, a taxpayer who inaccurately completes a return because of unsuitable systems to record the tax consequences of their transactions, has not employed reasonable care or may even be considered more culpable.

8.2.2. No reasonable grounds for ‘tax position’ taken

On the other hand, although relevant, the circumstances of the taxpayer are less important when determining the standard of reasonableness that must underscore the grounds for the adoption of a particular ‘tax position’.⁴⁸ Whether the law applies in a particular way is judged mainly on an analysis of the relevant provisions of the tax legislation, seen in context of other relevant provisions that may affect the position,⁴⁹ and the application of these to the circumstances of the case. Relevant circumstances are, for example, the steps taken to understand the risks associated with the tax position, the reasoning for its adoption, the complexity, and financial implications of the underlying transaction, as well as the resources at the disposal of the taxpayer. However, the investigation focuses on the merits of an argument in support of a particular tax position, rather than the effort in reaching it. It is not a question of whether a person thinks or believes that their position is reasonable or for that matter, whether SARS disagrees with the application of the law – the fact that a person adopted an interpretation that differs from that of a ruling will not necessarily mean that an unreasonable tax position has been adopted. The question is simply whether a reasonable person would have concluded that it was likely correct or have assumed a different position. The answer lies in having regard to appropriate authorities available at the time that the position was taken (such as court decisions, academic writing, and rulings issued by SARS). Although subsequent development in case law or rulings may clarify the position, should such clarification not support the one adopted, it will not necessarily mean that the position was unacceptable. Reliance may for instance, have been placed on a court case that was later overturned. The position is judged on the information available at the time of taking it and there can be no sanction for relying on law that supported the position at the time. Additionally, even if there are no authorities to support a position, there may still be an acceptable interpretation. In such cases, as in the case where the interpretation differs from a ruling by SARS, the interpretation must be a sensible and well-reasoned one.

⁴⁸ For an explanation of what a ‘tax position’ is see footnote 46.

⁴⁹ Such as legislated anti-avoidance rules.

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

8.2.3. Gross negligence

Whether completing a return or taking a tax position, the further taxpayers move away from the appropriate standard of reasonableness, the more culpable their behaviour. Gross negligence (item (v)) is the above-discussed behaviours to 'so extreme a degree as to merit the epithet of 'gross' '.⁵⁰ It displays an 'extreme departure from the standard of a reasonable person which departure must demonstrate complete obtuseness of mind or total failure to take care'.⁵¹ This includes not only a failure to take care but also to give appropriate thought or be indifferent to the consequences of a risk. Much like the concept of gross carelessness in the New Zealand Tax Administration Act 1994, it means, 'doing or not doing something in a way that, in all the circumstances, suggests or implies a complete or high level of disregard for the consequences.'⁵² It has been described as similar to recklessness.⁵³

The test is not whether the person had actual knowledge of wrongdoing but whether a reasonable person would have foreseen the dangers that such behaviour could result in an understatement and considered it unjustifiable and taken legitimate steps to mitigate the risk.

EXAMPLES

- Negligence in making enquiries when a reasonable person would have done so
- Drawing unreasonable inferences from the known facts
- The absence of reasonable grounds for a belief in information provided, such as reliance on dubious tax advice
- Making declarations based on insufficient grounds
- Being indifferent to whether declarations are correct⁵⁴

⁵⁰ Rex v Myers [1948] 1 All SA 354 (A) at page 360.

⁵¹ Claassen RD, Dictionary of Legal Words and Phrases, LexisNexis South Africa.

⁵² Section 141C of this Act deals with gross carelessness penalties, conceptually comparable to understatement penalties for gross negligence. For a general discussion on gross carelessness see Case W4 (2003) 21 NZTC 11,034 particularly paragraphs 44 to 49.

⁵³ Rosenthal v Marks 1944 TPD 172 at page 180, S v Smith en Andere [1973] 1 All SA 176 (T) where reckless driving was deemed grossly negligent, S v Dhlamini [1988] 2 All SA 106 (A) at page 111, Case W4 (2003) 21 NZTC 11,034, Philotex (Pty) Ltd and others and Braitex and others v Snyman and others [1998] JOL 1881 (A) at page 7 to 9 and the other case law referenced there.

⁵⁴ Rex v Myers [1948] 1 All SA 354 (A) at page 358 to 363.

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

8.3. Tax avoidance and evasion

Denis Healey said,

The difference between tax avoidance and tax evasion is the thickness of a prison wall.

In addition to conducting their tax affairs reasonably, all taxpayers are expected to do so within the confines of the law. This does not mean that they are barred from arranging their financial affairs in ways that minimise their tax burden.⁵⁵ However, if they employ illicit means to reduce or eradicate their tax liability, a penalty may be appropriate.

8.3.1. Impermissible avoidance arrangement

Avoidance arrangements (item (iv)) fall somewhere between legitimate tax planning and tax evasion. However, when their sole or main purpose is to obtain a tax benefit, they are prohibited by the anti-avoidance rules. SARS can rectify the effects of such arrangements by applying these rules and if appropriate, issue an assessment. If it does, an understatement penalty for impermissible avoidance arrangement must be imposed.⁵⁶ That is unless the behaviour is found to amount to gross negligence or intentional tax evasion, in which case the highest penalty percentage appropriate to the understatement will apply.⁵⁷

8.3.2. Intentional tax evasion

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

... itself the outcome of fraudulent diligence in ignorance – that is, of a wilful abstention from all sources of information which might lead to suspicion, and a sedulous avoidance of all possible avenues to the truth, for the express purpose of not having any doubt thrown on what he desires and is determined to, and afterwards does (in a sense) believe.⁵⁸

⁵⁵ Commissioner for Inland Revenue v Estate Kohler and Others [1953] 3 All SA 7 (A) at page 8 to 9, Secretary for Inland Revenue v Hartzenberg [1966] 1 All SA 626 (A) at page 628, Hicklin v Secretary for Inland Revenue [1980] 1 All SA 301 (A) at page 311, Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd [1999] JOL 5363 (A) at paragraph 1 and CSARS v NWK Ltd [2011] 2 All SA 347 (SCA) at paragraph 42.

⁵⁶ Definition of 'impermissible avoidance arrangement' in [section 221](#) of the Act.

⁵⁷ In accordance with [section 222\(2\)](#) of the Act.

⁵⁸ Halsbury quoted in Rex v Myers [1948] 1 All SA 354 (A) at page 360 and Milne, NO v Singh, NO, and Others [1960] 3 All SA 295 (D) at page 312.

When a taxpayer displays 'conduct which shows that the representor does not know what the truth is in regard to the statements which he makes and is indifferent whether his representations are true or not, or, not knowing, wilfully omits to make any enquiries', such conduct could amount to intentional tax evasion. Such a person may be 'wilfully false'⁵⁹ or be engaging in 'wilful blindness'.⁶⁰

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

EXAMPLES

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

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

Take Note

Administrative double jeopardy is avoided, in that a fixed amount penalty⁶¹ may not be imposed for non-compliance in respect of which an understatement penalty has been imposed.⁶² However, the existence of the penalty regime does not preclude the possibility of criminal prosecution for tax evasion.⁶³

In criminal prosecutions, tax evasion must be proven beyond a reasonable doubt and for the imposition of an understatement penalty proof need only be on a balance of probabilities. In both instances, should SARS meet the required onus of proof; the onus will devolve upon the taxpayer to present proof to the contrary.

⁵⁹ Rex v Myers [1948] 1 All SA 354 (A) at page 362 to 363.

⁶⁰ Attorney General of Canada v Villeneuve and others, 2004 FCA 20 at paragraphs 6 and 8 – although the Court ruled the behaviour to be gross negligence, it found that the taxpayer possessed wrongful intent and imposed a penalty for misrepresentation under section 163(2) of the Canadian Income Tax Act.

⁶¹ The administrative non-compliance penalties imposed under Part B of Chapter 15 of the Act.

⁶² [Section 210\(2\)\(b\)](#) of the Act.

⁶³ Under the common law or Chapter 17 of the Act.

8.4. Substantial understatement

'substantial understatement' means a **case** where the **prejudice to SARS or the fiscus** exceeds the greater of five percent of the amount of the 'tax' properly chargeable or refundable under a tax Act for the **relevant tax period**, or R1 000 000⁶⁴

Substantial understatement is not an understatement, and neither is it behaviour although it is listed with and treated as such. It is a **case**; in point of fact, a factual circumstance of a case the presence of which, along with the other listed behaviours, contributes to determining the appropriate penalty percentage to apply to individual understatements. When the **prejudice to SARS or the fiscus** (P) exceeds the greater of 5% of the tax properly chargeable or refundable (5%), or R1 000 000 (R1m), substantial understatement exists. Since (P) must exceed the greater of the other two, (P) of less than R1 000 000 cannot result in a substantial understatement. A substantial understatement = R1m < P always and if (5% > R1m) < P

EXAMPLE 8.4.1	Not a substantial understatement	Not a substantial understatement	A substantial understatement
Tax properly chargeable	R 30 000 000	R 30 000 000	R 30 000 000
5%	R 1 500 000	R 1 500 000	R 1 500 000
Tax reported as chargeable	R 29 100 000	R 28 900 000	R 28 400 000
Prejudice (P)	R 900 000	R 1 100 000	R 1 600 000
	R1m > P and (5% > R1m) > P	R1m < P and (5% > R1m) > P	R1m < P and (5% > R1m) < P

Prejudice (P) is measured for a **relevant tax period**. Although shortfalls are also calculated for the same period, they represent the prejudicial effect of individual understatements. Their cumulative effect represents the prejudicial circumstance prevailing at the time that one or multiple understatements are made. Where this prejudice exceeds the threshold amount as discussed above, substantial understatement is present. A taxpayer will then incur a penalty for substantial understatement, mitigated or aggravated by the prescribed circumstances, for understatements where only this circumstance prevails. If one or more understatements are found to additionally result from any of the other listed behaviours, these will incur a penalty appropriate to the level of culpability as the understatement penalty regime requires that the highest penalty percentage be applied to the shortfall associated with each understatement and the percentages in relation to substantial understatements are the lowest.⁶⁵ The following examples serve to illustrate.

EXAMPLE 8.4.2	VAT reported refundable	VAT properly refundable	Shortfall	Listed behaviour
VAT return reflects refund	R 2 000 000	R 2 000 000		
Output VAT excluded	R 1 200 000	R 800 000	R 1 200 000	> R1m

Assuming a standard case (column 3 of the understatement penalty table), the understatement will attract a penalty of 10% of R1 200 000 for substantial understatement provided there is no evidence of culpability on the part of the taxpayer. However, if it is found that the output VAT was excluded due to gross negligence, the penalty will be 100% of the shortfall.

⁶⁴ Definition of 'substantial understatement' in [section 221](#) of the Act with own emphasis added.

⁶⁵ [Section 222\(2\)](#).

EXAMPLE 8.4.3		Tax reported chargeable	Tax properly chargeable	Shortfall	Listed behaviour
Taxable income declared	R 100 000 000	R 28 000 000			
Income not declared	R 50 000 000		R 42 000 000	R 14 000 000	No reasonable ground for tax position
Capital expenses claimed incorrectly	R 3 200 000		R 42 896 000	R 896 000	
Total		R 28 000 000	R 42 896 000	R 14 896 000	> 5%

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

'Substantial understatement' highlights the fact that the standard of care expected from the reasonable person is raised exponentially in circumstances where large amounts of money are involved. This is evident from the fact that a taxpayer can incur a penalty for substantial understatement even if they have met the required standard of reasonableness expected from all taxpayers. On the other hand, the only one of the penalties that can be remitted is the one for substantial understatement. The circumstances of remittance both illustrate the level of care expected and acknowledge when it has been attained. SARS must remit a penalty imposed for substantial understatement if it is satisfied that the prejudice to SARS or the *fiscus* was due to an arrangement⁶⁶ that was fully disclosed to SARS by the date that the relevant return was due, and the arrangement was based on an opinion by a registered tax practitioner.⁶⁷ The opinion must have been issued and in the possession of the taxpayer when the return was due. It must be based on full disclosure of the facts and circumstances specific to the arrangement; and confirm that the taxpayer's position is 'more likely than not to be upheld if the matter proceeds to court'. In other words, the position should be sufficiently substantiated to support the expectation that, should it be challenged, a Court could rule in favour of such a position being taken. In the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance rules, all of the steps in or parts of the arrangement must be fully disclosed to the tax practitioner, regardless of whether the taxpayer was a direct party to the steps or parts in question.⁶⁸ It is evident that the mere existence of such an opinion does not establish compliance with these requirements; only the content does.

Take Note

A substantial understatement in a return submitted before the commencement of the Tax Administration Act on 1 October 2012 will attract an understatement penalty (as opposed to an additional tax penalty) if the verification, audit, or investigation necessary to determine the penalty was not complete or had not commenced before this date. However, because the

⁶⁶ Defined in section 34 of the Act as 'any transaction, operation, scheme, agreement or understanding (whether enforceable or not)'.

⁶⁷ See Chapter 18 of the Act for details about registered tax practitioners.

⁶⁸ [Section 223\(3\)](#).

previously applicable legislation did not require it, taxpayers are granted the concession of being able to obtain the opinion described above after the return was due.⁶⁹

9. The prescribed circumstances

The circumstances of a case, prescribed in columns 3 to 6 of the understatement penalty table, influence the amount of the penalty by mitigating or aggravating the penalty percentage. A standard case (column 3) is the mean that applies if none of the other circumstances is present. In order to give taxpayers the opportunity to correct undesirable behaviour, this classification is applied to all understatements discovered during an initial verification, audit, or investigation, whether they arise from the same or other listed behaviours and even if they occur in more than one tax period. This is of course so unless the taxpayer is obstructive, in which case column 4 will apply. However, within a five-year cycle of this initial encounter, a subsequent understatement, even if ascribable to other listed behaviours, will become a repeat case.⁷⁰

EXAMPLE

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

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

Along with obstructiveness, a repeat case (column 4) aggravates the penalty – the penalty percentage is most severe under such circumstances. Conversely, to promote voluntary compliance in the interest of the good management of the tax system and the best use of the resources of SARS, participation in the voluntary disclosure programme (columns 5 and 6) mitigates the penalty. The programme allows taxpayers to come forward if they have been non-compliant in order to avoid criminal prosecution and to reduce or avoid penalties.⁷¹ For understatements, the penalty percentage is substantially reduced when a taxpayer qualifies for voluntary disclosure relief (column 5) and reduced even further should they do so before SARS commences an audit or investigation (column 6). For more information about the voluntary disclosure programme click [here](#).

Take Note

Although under certain circumstances, understatements in returns submitted before the commencement of the Tax Administration Act incur understatement penalties (as opposed to additional tax penalties), taxpayers who qualified for voluntary disclosure relief under repealed provisions of the taxation Acts also qualify for the reduction of the penalty percentage in accordance with columns 5 and 6.⁷²

⁶⁹ See [section 270\(6B\)](#).

⁷⁰ See definition of 'repeat case' in [section 221](#) of the Act.

⁷¹ [Section 229](#) of the Act.

⁷² See [section 270\(6C\)](#) and discussion in paragraph 3.

10. Interest

As with other administrative provisions generic to all taxes, when the Tax Administration Act came into operation on 1 October 2012, it amended or repealed provisions regulating interest in the taxation Acts and replaced these with a consolidated interest regime in [Chapter 12](#). However, notwithstanding being enacted, the provisions of Chapter 12 that regulate interest have not yet commenced,⁷³ and the concomitant changes to the taxation Acts have, to the extent that they relate to interest, not yet been put into effect. Until the interest regime under Chapter 12 is fully operational, interest on outstanding tax is levied and remitted in terms of the provisions of the taxation Acts that dealt with interest,⁷⁴ and in the case of interest on understatement penalties, those that dealt with additional tax penalties, before they were amended or deleted by the Tax Administration Act.⁷⁵ Although this guide does not discuss such provisions, they are, for convenience, summarised in [Annexure B](#).

Take Note

Understatements in a return submitted by 30 September 2012 where the verification, audit, or investigation necessary to determine the amount of the penalties was incomplete or had not yet commenced by this date, will incur understatement penalties but interest on such penalties will only accrue from 1 October 2012.⁷⁶

From the date that Chapter 12 and the changes to the interest provisions of the taxation Acts are promulgated, the accrual, payment, and remittance of interest on tax and understatement penalties will be governed by Chapter 12. Interest will then accrue on understatement penalties imposed after such date, at the prescribed rate from the date from when interest accrues on the understated tax⁷⁷ and a senior SARS official will be able to direct that interest on understatement penalties is not payable if the accrual of this interest is attributable to circumstances beyond the taxpayer's control. These circumstances are however limited to natural or human-made disasters, civil disturbances or disruptions in services, or serious illness or accident.⁷⁸

11. Objection and appeal

Any 'potential adjustments of a material nature' identified upon conclusion of an audit, will likely be caused by understatements and, should these result from listed behaviours and not *bona fide* inadvertent errors, SARS will be obliged to impose an understatement penalty. Under such circumstances, SARS must inform the taxpayer accordingly and provide grounds for the proposed assessment, including the grounds for the imposition of the penalty.⁷⁹ Other than where the remittance process for substantial understatements has

⁷³ Sections 187(2), (3)(a) to (e) and (4), 188(2) and (3) and 189(2) and (5).

⁷⁴ Date to be determined by the President by proclamation – [section 272\(1\) and \(2\)](#) of the Act read with Proclamation No. 51 of 14 September 2012 published in Government Gazette No. 35687.

⁷⁵ [Section 270\(6E\)](#).

⁷⁶ See [section 270\(6E\)](#) and discussion in paragraph 3.

⁷⁷ [Section 187\(1\)](#) read with [section 187\(3\)\(f\)](#).

⁷⁸ [Section 187\(6\)](#) and [187\(7\)](#) read with [section 187\(1\)](#).

⁷⁹ For more information on the meaning and content of 'grounds for assessment', consult paragraph 5.1 of the Dispute Resolution Guide available [here](#).

been utilised,⁸⁰ the taxpayer is then provided with a first opportunity to respond to both the existence of an understatement and the penalty.⁸¹

Upon conclusion of this process and in cases other than an audit, an assessment will be made. As such an assessment will not fully be based on a return submitted by the taxpayer,⁸² SARS must here too, in the notice of assessment, provide 'a statement of the grounds for the assessment', including the grounds for the imposition of the penalty.⁸³ These should enable the taxpayer to object or appeal against the assessment, including the penalty, in the normal course. The Dispute Resolution Guide⁸⁴ and the guide on 'What to do if you dispute your tax assessment'⁸⁵ will provide guidance in this regard. The taxpayer can also object or appeal against a decision not to remit a substantial understatement penalty, in which case the taxpayer bears the onus of proving that this decision is incorrect.⁸⁶

If the assessment of the understated tax is overturned, it follows that the penalty will likewise be reversed. Excepting for a penalty imposed for an impermissible avoidance arrangement, a penalty may be reduced, or its imposition overturned if SARS cannot prove the facts upon which the penalty is based on a balance of probability.⁸⁷ In the event of a penalty for an impermissible avoidance arrangement, the correlation between the assessment and the penalty means that such a penalty stands or falls on the application of the anti-avoidance rules.⁸⁸ In other words, the only way to successfully object to or appeal against such a penalty is to prove that the arrangement underlying the understated tax did not contravene the anti-avoidance rules.

Take Note

Understatements in a return submitted before the commencement of the Tax Administration Act will attract understatement penalties (as opposed to additional tax penalties) if the verification, audit, or investigation necessary to determine the penalty was incomplete or had not yet commenced by 30 September 2012. However, if such a return was submitted under the Income Tax Act (excluding returns required under the Fourth Schedule), a senior SARS official must reduce, and may even waive the penalty if satisfied that there were extenuating circumstances. For such returns under the Fourth Schedule or the Value-Added Tax Act, a senior SARS official must waive the penalty unless it was based on intentional tax evasion (item (vi) in the understatement penalty table).⁸⁹

⁸⁰ See discussion in paragraph 8.4

⁸¹ [Sections 42\(2\)\(b\) and \(3\)](#) – both SARS and the taxpayer have 21 business days which may be extended by SARS if the audit is complex.

⁸² Because of the penalty but also possibly because of the additional assessment.

⁸³ [Section 96\(2\)](#).

⁸⁴ See footnote 79.

⁸⁵ Available [here](#).

⁸⁶ [Section 224](#) and [section102\(1\)](#).

⁸⁷ [Section129\(3\)](#).

⁸⁸ See paragraph 8.3.1.

⁸⁹ See [section 270\(6D\)](#) and discussion in paragraph 3.

Annexure A – Relevant sections of the Tax Administration Act

Chapter 1 – Definitions

Section 1 – Definitions

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

...

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

...

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

...

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

...

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

...

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

Chapter 2 – General Administration Provisions Part A – In General

...

Section 4

...

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

Chapter 5 – Information Gathering

Part A – General Rules for Inspection, Verification, Audit and Criminal Investigation

...

Section 42 – Keeping taxpayer informed

...

- (2) Upon conclusion of the audit or a criminal investigation, and where—
 - (a) the audit or investigation was inconclusive, SARS must inform the taxpayer accordingly within 21 business days; or
 - (b) the audit identified potential adjustments of a material nature, SARS must within 21 business days, or the further period that may be required based on the complexities of the audit, provide the taxpayer with a document containing the outcome of the audit, including the grounds for the proposed assessment or decision referred to in section 104(2).
- (3) Upon receipt of the document described in subsection (2)(b), the taxpayer must within 21 business days of delivery of the document, or the further period requested by the taxpayer that may be allowed by SARS based on the complexities of the audit, respond in writing to the facts and conclusions set out in the document.

Chapter 8 – Assessments

...

Section 95 – Estimation of assessments

- (1) SARS may make an original, additional, reduced or jeopardy assessment based in whole or in part on an estimate if the taxpayer—
 - (a) fails to submit a return as required; or
 - (b) submits a return or information that is incorrect or inadequate.
- (2) SARS must make the estimate based on information readily available to it.
- (3) If the taxpayer is unable to submit an accurate return, a senior SARS official may agree in writing with the taxpayer as to the amount of tax chargeable and issue an assessment accordingly, which assessment is not subject to objection or appeal.

Section 96 – Notice of assessment

...

- (2) In addition to the information provided in terms of subsection (1) SARS must give the person assessed—
 - (a) in the case of an assessment described in section 95 or an assessment that is not fully based on a return submitted by the taxpayer, a statement of the grounds for the assessment; and

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

Chapter 9 – Dispute Resolution

Part A – General

...

Section 102 – Burden of proof

- (1) A taxpayer bears the burden of proving—
 - (a) that an amount, transaction, event or item is exempt or otherwise not taxable;
 - (b) that an amount or item is deductible or may be setoff;
 - (c) the rate of tax applicable to a transaction, event, item or class of taxpayer;
 - (d) that an amount qualifies as a reduction of tax payable;
 - (e) that a valuation is correct; or
 - (f) whether a ‘decision’ that is subject to objection and appeal under a tax Act, is incorrect.

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

...

Part D – Tax Court

...

Section 129 – Decision by tax court

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

Chapter 12 – Interest

Section 187 – General interest rules

- (1) If a tax debt or refund payable by SARS is not paid in full by the effective date, interest accrues, and is payable, on the amount of the outstanding balance of the tax debt or refund—
 - (a) at the rate provided under section 189; and
 - (b) for the period provided under section 188.

- (2) Interest payable under a tax Act is calculated on—
 - (a) the daily balance owing; or

- (b) the daily balance owing and compounded monthly, which method of determining interest will apply to a tax type from the date the Commissioner prescribes it by public notice.
- (3) The effective date for purposes of the calculation of interest in relation to—
 - (a) tax other than income tax or estate duty for any tax period, is the date by which tax for the tax period is due and payable under a tax Act;
 - (b) income tax for any year of assessment, is the date falling seven months after the last day of that year in the case of a taxpayer that has a year of assessment ending on the last day of February, and six months in any other case;
 - (c) estate duty for any period, is the earlier of the date of assessment or 12 months after the date of death;
 - (d) a fixed amount penalty referred to in section 210, is the date of assessment of the penalty, and in relation to an increment of the penalty under section 211 (2), the date of the increment.
 - (e) a percentage based penalty referred to in section 214, is the date by which tax for the tax period should have been paid;
 - (f) an understatement penalty, is the effective date for the tax understated;
 - (g) an outstanding tax debt referred to in section 190 (5), is the date of payment of a refund which is not properly payable under a tax Act.
- (4) The effective date in relation to an additional assessment or reduced assessment is the effective date in relation to the tax payable under the original assessment.
- (5) The effective date in relation to a jeopardy assessment is the date for payment specified in the jeopardy assessment.
- (6) If a senior SARS official is satisfied that interest payable by a taxpayer under subsection (1) is payable as a result of circumstances beyond the taxpayer's control, the official may, unless prohibited by a tax Act, direct that so much of the interest as is attributable to the circumstances is not payable by the taxpayer.
 - (7) The circumstances referred to in subsection (6) are limited to—
 - (a) a natural or human-made disaster;
 - (b) a civil disturbance or disruption in services; or
 - (c) a serious illness or accident.
 - (8) SARS may not make a direction that interest is not payable under subsection (6) after the expiry of three years, in the case of an assessment by SARS, or five years, in the case of self-assessment, from the date of assessment of the tax in respect of which the interest accrued.

188. Period over which interest accrues

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

- (2) Interest payable in respect of the—
 - (a) first payment of provisional tax, is imposed from the effective date for the first payment of provisional tax until the earlier of the date on which the payment is made or the effective date for the second payment of provisional tax; and
 - (b) second payment of provisional tax, is imposed from the effective date for the second payment of provisional tax until the earlier of the date on which the payment is made or the effective date for income tax for the relevant year of assessment.
- (3) Unless otherwise provided under a tax Act—
 - (a) interest on an amount refundable under section 190 is calculated from the later of the effective date or the date that the excess was received by SARS to the date the refunded tax is paid; and
 - (b) for this purpose, if a refund is offset against a liability of the taxpayer under section 191, the date on which the offset is effected is considered to be the date of payment of the refund.

Section 189 – Rate at which interest is charged

- (1) The rate at which interest is payable under section 187 is the prescribed rate.
- (2) In the case of interest payable with respect to refunds on assessment of provisional tax and employees' tax paid for the relevant year of assessment, the rate payable by SARS is four percentage points below the prescribed rate.
- (3) The prescribed rate is the interest rate that the Minister may from time to time fix by notice in the Gazette under section 80(1)(b) of the Public Finance Management Act, 1999 (Act No. 1 of 1999).
- (4) If the Minister fixes a different interest rate referred to in subsection (3) the new rate comes into operation on the first day of the second month following the month in which the new rate becomes effective for purposes of the Public Finance Management Act, 1999.
- (5) If interest is payable under this Chapter and the rate at which the interest is payable has with effect from any date been altered, and the interest is payable in respect of any period or portion thereof which commenced before the said date, the interest to be determined in respect of—
 - (a) the period or portion thereof which ended immediately before the said date; or
 - (b) the portion of the period which was completed before the said date, must be calculated as if the rate had not been altered.

Chapter 15 – Administrative Non-Compliance Penalties

Part B – Fixed Amount Penalties

...

Section 210 – Non-compliance subject to penalty

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

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

- (a) the failure to pay tax subject to a percentage based penalty under Part C;
- (b) non-compliance in respect of which an understatement penalty under Chapter 16 has been imposed; or
- (c) the failure to disclose information subject to a reportable arrangement penalty under section 212.

...

Part C – Percentage Based Penalty

Section 213 – Imposition of percentage based penalty

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

Chapter 16 – Understatement Penalty

Part A – Imposition of Understatement Penalty

Section 221 – Definitions

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

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

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

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

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

'tax position' means an assumption underlying one or more aspects of a tax return, including whether or not—

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

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

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

Section 222 – Understatement penalty

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

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

(3) The shortfall is the sum of—

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

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

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

Section 223 – Understatement penalty percentage table

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

1	2	3	4	5	6
Item	Behaviour	Standard case	If obstructive, or if it is a repeat case	Voluntary disclosure after notification of audit or investigation	Voluntary disclosure before notification of audit or investigation
(i)	Substantial understatement	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for tax position taken	50%	75%	25%	0%
(iv)	'Impermissible avoidance arrangement'	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

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

- (a) an assessment based on an estimation under section 95 is made; or
- (b) an assessment agreed upon with the taxpayer under section 95(3) is issued.

(3) SARS must remit a 'penalty' imposed for a 'substantial understatement' if SARS is satisfied that the taxpayer—

- (a) made full disclosure of the arrangement, as defined in section 34, that gave rise to the prejudice to SARS or the fiscus by no later than the date that the relevant return was due; and
- (b) was in possession of an opinion by an independent registered tax practitioner that—
 - (i) was issued by no later than the date that the relevant return was due;
 - (ii) was based upon full disclosure of the specific facts and circumstances of the arrangement and, in the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance provisions of a tax Act, this requirement cannot be met unless the taxpayer is able to demonstrate that all of the steps in or parts of the arrangement were fully disclosed to the tax practitioner, whether or not the taxpayer was a direct party to the steps or parts in question; and
 - (iii) confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court.

Section 224 – Objection and appeal against imposition of understatement penalty

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

Part B – Voluntary Disclosure Programme

...

Section 229 – Voluntary disclosure relief

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

- (a) not pursue criminal prosecution for a tax offence arising from the 'default';
- (b) grant the relief in respect of any understatement penalty to the extent referred to in column 5 or 6 of the understatement penalty percentage table in section 223; and
- (c) grant 100 per cent relief in respect of an administrative noncompliance penalty that was or may be imposed under Chapter 15 or a penalty imposed under a tax Act, excluding a penalty imposed under that Chapter or in terms of a tax Act for the late submission of a return.

Chapter 20 – Transitional Provisions

...

Section 270 – Application of Act to prior or continuing action

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

...

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

- (a) additional tax, penalty or interest which but for the repeal would have been capable of being imposed, levied, assessed or recovered by the commencement date of this Act, has not been imposed, levied, assessed or recovered by the commencement date of this Act; or
- (b) an understatement penalty, administrative noncompliance penalty or interest under this Act cannot be imposed, levied, assessed or recovered in respect of an understatement as defined in section 221, noncompliance or failure to pay that occurred before the commencement date of this Act.

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

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

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

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

- (a) the Income Tax Act, excluding returns required under the Fourth Schedule to that Act, a senior SARS official must, in considering the objection, reduce the penalty in whole or in part if satisfied that there were extenuating circumstances; or
- (b) the Value-Added Tax Act or the Fourth Schedule to the Income Tax Act, a senior SARS official must reduce the penalty in whole if the penalty was imposed under circumstances other than the circumstances referred to in item (vi) of the understatement penalty table in section 223(1).

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

- (a) the accrual and payment of interest on an understatement penalty imposed under section 222 must be calculated in the manner that interest upon additional tax is calculated in terms of the interest provisions of the relevant tax Act; and
- (b) the effective date referred to in section 187(3)(f) for tax understated before 1 October 2012 must be regarded as the commencement date of this Act.

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

- (7) Interest arising before the commencement date of this Act must be—
 - (a) calculated in accordance with the relevant tax Act until the commencement date; and
 - (b) regarded as interest payable under this Act from the commencement date of the comparable provisions of this Act.

...

Section 272 – Short title and commencement

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

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

Annexure B – Interest accrual provisions of the taxation Acts

Tax type	Section	Effective date for interest	Interest rate	Remittance or other relief
Income Tax Act				
Withholding tax – sale of immovable property by non-resident seller and penalties	Section 35A(9)(a) read with subsection (4) and section 89(2)	15 days, where the purchaser is a resident, or 29 days, where the purchaser is not a resident, after the date that the amount is withheld	Prescribed rate	Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest
Dividends tax and penalties	Section 64K(6) read with subsection (1) and section 89(2)	The day after the last day of the month following the month in which the dividend is paid	Prescribed rate	Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest
Income tax and penalties	Section 89(2)	The day after the date of payment prescribed in either – <ul style="list-style-type: none"> • the notice of assessment; or • the Income Tax Act 	Prescribed rate	Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest
Employees' tax and penalties	Section 89bis(2) read with subsection (3) and paragraph 2(1) of the Fourth Schedule	<ul style="list-style-type: none"> • 8 days after – <ul style="list-style-type: none"> ○ the end of the month during which the tax was deducted or withheld; ○ the date on which a person ceases to be an employer; or • the day after a further period approved by the Commissioner 	Prescribed rate	Commissioner may, having regard to circumstances of case, direct otherwise

Tax type	Section	Effective date for interest	Interest rate	Remittance or other relief
Provisional tax and penalties	Section 89 <i>bis</i> (2) read with subsection (3) and paragraphs 21 and 23 of the Fourth Schedule	The day after – <ul style="list-style-type: none"> • 6 months from the first day of the year of assessment; and • the last day of the year of assessment 	Prescribed rate	Commissioner may, having regard to circumstances of case, direct otherwise
Provisional tax and penalties after increase of estimate	Section 89 <i>bis</i> (2) read with paragraph 25(1) of the Fourth Schedule	The day after the date of payment prescribed in the notice of assessment	Prescribed rate	Commissioner may, having regard to circumstances of case, direct otherwise
Underpayment of and penalties for understatement of provisional tax	Section 89 <i>quat</i>	<ul style="list-style-type: none"> • If the year of assessment ends on the last day of February, 1 October • If the year of assessment ends on another day, the day after 6 months from the last day of the year of assessment 	Prescribed rate	Commissioner may remit interest, in whole or in part under certain circumstances
Turnover tax of micro businesses and penalties	Paragraph 11 of the Sixth Schedule read with section 89(2)	The day after – <ul style="list-style-type: none"> • 6 months from the first day of the year of assessment; and • the last day of the year of assessment 	Prescribed rate	Commissioner may, under certain circumstances, extend the time within which the tax is payable without interest
Value-Added Tax Act				
Value-added tax	Section 39(1)(a)(ii) read with sections 28(1) and 39(7)(a)	The first day of the month following the month in which payment should have been made	Prescribed rate	Commissioner may remit interest, in whole or in part under certain circumstances

Tax type	Section	Effective date for interest	Interest rate	Remittance or other relief
Tax on goods supplied in the course of an enterprise	Section 39(2)(b) read with sections 29(1) and 39(7)(a)	The first day of the month following the month in which the period of 30 days from the date that the sale was made expires	Prescribed rate	Commissioner may remit interest, in whole or in part under certain circumstances
Tax on the importation of goods	Section 39(4) read with section 39(7)(a)	The later of the first day of the month following the month in which – <ul style="list-style-type: none"> the goods are entered for home consumption under the Customs and Excise Act⁹⁰; or the customs duty is payable or would have been payable under the Customs and Excise Act 	Prescribed rate	Commissioner may remit interest, in whole or in part under certain circumstances
Excise duty and environmental levy	Section 39(5) read with section 39(7)(a)	The first day of the month following the month in which the liability for payment arises for excise duty or environmental levy under the Customs and Excise Act	Prescribed rate	Commissioner may remit interest, in whole or in part under certain circumstances
Additional tax	Section 39(6A) read with section 39(7)(a)	The first day of the month following the month in which payment should have been made	Prescribed rate	Commissioner may remit interest, in whole or in part under certain circumstances
Transfer Duty Act				
Transfer duty	Section 4(1A) and 4(3) read with section 3	The day after 6 months from the date of acquisition	10% per annum	Commissioner may, under certain circumstances, extend the time within which the duty is payable without interest

⁹⁰ Customs and Excise Act, 1964 (Act No. 91 of 1964).

Tax type	Section	Effective date for interest	Interest rate	Remittance or other relief
Estate Duty Act				
Estate duty	Section 10	<ul style="list-style-type: none"> • 31 days after the date of payment prescribed in the notice of assessment; or • if no assessment has been made within 12 months from the date of death, the day after such 12 months period 	6% per annum	Commissioner may, under certain circumstances, extend the time within which the duty is payable without interest
Skills Development Levies Act				
Skills development levy and penalties	Section 11 read with sections 6, 7, and 12(3) and (4)	<ul style="list-style-type: none"> • 8 days after the end of the month in respect of which the levy is payable • In case of micro businesses, 8 days after – <ul style="list-style-type: none"> ○ 6 months from the first day of the year of assessment; and ○ the end of the year of assessment 	Prescribed rate	N/A
Unemployment Insurance Contributions Act				
Unemployment insurance contribution	Section 12 read with sections 8 and 9	<ul style="list-style-type: none"> • 8 days after the end of the month in respect of which the contribution is payable • In case of micro businesses, 8 days after – <ul style="list-style-type: none"> ○ 6 months from the first day of the year of assessment; and ○ the end of the year of assessment 	Prescribed rate	N/A
Additional penalties	Section 13(2) read with subsection (3) and section 11	The day after the date of payment prescribed in the notice of assessment	Prescribed rate	N/A

Tax type	Section	Effective date for interest	Interest rate	Remittance or other relief
Diamond Export Levy (Administration) Act				
Diamond export levy	Section 15(2) and (3) read with section 1 and 4(2)	31 days after – <ul style="list-style-type: none"> • in the case of a natural person, 31 August and the last day of February; and • in the case of any other person – <ul style="list-style-type: none"> ○ 6 months from the first day of the financial year; and ○ the end of the financial year 	Prescribed rate	N/A
Securities Transfer Tax Administration Act				
Securities transfer tax	Section 5 read with section 3	<ul style="list-style-type: none"> • In the case of listed securities, the 15th day of the month following the month in which the security is transferred • In the case of unlisted securities, the first day of the third month following the month in which the security is transferred 	Prescribed rate	N/A
Mineral and Petroleum Resources Royalty (Administration) Act				
Mineral and petroleum resources royalties	Section 16(2) read with sections 5(1), (2), 5A and 6 as well as Chapter 12 of the Tax Administration Act	<ul style="list-style-type: none"> • In the case of a first payment, the day after 6 months from the first day of the year of assessment • In the case of a second payment, the day after the last day of the year or assessment • In the case of a SARS assessment, the day after the period specified in the notice of assessment • In the case of an excess payment, the day after 6 months from the last day of the year of assessment 	Prescribed rate	Interest can be remitted in the same way as the understatement penalty. See discussion in paragraph 10 above