South African Institute of Tax Professionals

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The South African Revenue Service
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RE: COMMENTS ON SARS DRAFT GUIDE TO UNDERSTATEMENT PENALTIES

The comments of the SAIT Tax Administration Technical Work Group on the SARS Draft Guide to Understatement Penalties are enclosed in the Annexure. We trust that you will find our detailed comments and references to case law helpful in finalising the guide. We appreciate the opportunity to comment and would welcome further dialogue.

Yours sincerely

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ANNEXURE

1. **BACKGROUND**

1.1 Significant emphasis is placed throughout the Guide on the purpose of understatement penalties ("**USP**"), being to (i) encourage voluntary compliance and (ii) deter unwanted behaviour such as non-compliance and tax evasion. In our view, *fair and consistent application of the understatement penalty regime* is critical to achieving both the deterrence of unwanted behaviour, and voluntary compliance, which is significantly influenced by the actual and perceived fairness of the system.

1.2 We would also recommend that SARS officials are issued with comprehensive guidance in this regard, similar to that provided by the ATO in PS LA 2011/19, which is published on the ATO website and accessible to the public. If SARS issues a "Standard Operating Procedure" (SOP) in this respect, it is submitted that this should be accessible to the public.

2. **PARAGRAPH 3: TRANSITION FROM ADDITIONAL TAX**

2.1 The Guide provides (at page 5) that understatement penalties may be imposed for years of assessment which were finalized and in respect of which returns were submitted prior to the commencement of the Tax Administration Act 28 of 2011 ("**TAA**") where the verification, audit or investigation necessary to determine the understatement had not commenced or was not completed by 30 September 2012.

2.2 This issue is a highly contentious one, of which SARS is no doubt aware, given the numerous submissions that have been made in taxpayer matters to date. We understand that this issue is the subject of current appeals, to be heard by the courts soon. In the circumstances, the Guide putting forward one interpretation which is highly contentious, as if it is a statement of fact, is misleading and harmful to taxpayers.

2.3 If this statement in the Guide were correct, this is difficult to reconcile with section 270(6)(b) of the TAA. In this respect, why would there be a reference to additional taxes being imposed under the old provisions "if… an understatement penalty… cannot be imposed… in respect of an understatement… that occurred before the commencement date…", if the USP is indeed applicable?

2.4 There are strong Constitutional and administrative justice arguments against the retrospective application of the USP regime to pre-TAA acts or omissions; and section 270(6)(b) of the TAA clearly envisages that there would be circumstances where a USP cannot be imposed. The Guide should accordingly reflect this legal position, and not impose a simplistic interpretation that is misleading and detrimental to taxpayers.

3. PARAGRAPH 4: UNDERSTATEMENT – MEANING OF PREJUDICE

3.1 The Guide does not give adequate guidance on the meaning of "prejudice". In addition, this appears to incorrectly conflate the concept of "prejudice" with that of "shortfall".

3.2 For an understatement to occur, there must be "prejudice" to SARS or the fiscus, in terms of the definition of "understatement" in section 221 of the TAA. "Prejudice" is not a defined term in the TAA. Accordingly, the rules of interpretation require that one considers the ordinary meaning of the word, derived from dictionaries and potentially case law.

3.3 In contrast, the Guide fails to discuss the meaning of prejudice in dictionary or case law terms, and references "shortfall", which is used as a concept to quantify the USP. The TAA itself does not indicate that the shortfall comprises the prejudice. Rather, the TAA makes a direction regarding the calculation of the USP, which is based on the existence of prejudice (and absence of a *bona fide* inadvertent error).

3.4 While the Guide alleges that prejudice is not necessarily financial, within the context of the USP provisions this is questionable. In this respect, the definition of "substantial understatement" in section 221 of the TAA is "*a case where the prejudice to SARS or the fiscus exceeds the greater of…*". Since this definition refers to prejudice in Rand terms, this gives a contextual indication of the meaning of prejudice within the USP provisions.

3.5 One can look to one of the cases referenced in the Guide, for a description of "prejudice", being *Western Credit Bank Ltd v Kajee* [1967] 4 All SA 228 (N). Of course, one should consider the context of the term "prejudice" within the statute under consideration in this case, and that the relevant legislation also contained directions concerning how the Court should determine the extent of prejudice. In any event, the court found that (at page 237):

"The damages suffered by the plaintiff are not the sole criterion, for the operation of sec. 3 of the Act hinges on prejudice, which is wider in its connotation than damages. The full extent of this may be difficult to ascertain in any particular case, but Rex v. Dhlamini, 1943 T.P.D. 20 at p. 23, followed in Rex v. Williams, 1943 C.P.D. 206 at p. 208, indicates that prejudice includes "far more than pecuniary loss" and <u>may</u>, according to the circumstances, <u>include impairment of reputation or personal dignity and possibly cover any substantial inconvenience</u>. <u>If the plaintiff contends for any prejudice in a wider sense than damages suffered by it, it will be for it to produce evidence to establish this.</u>" (emphasis added)

3.6 The case also references the "balance of probabilities" standard, as being applicable in determining prejudice (at page 236).

3.7 These important components of the meaning of prejudice are not adequately highlighted in the Guide. Prejudice should be explained as the actual or likely (on a balance of probabilities) financial loss to be suffered by SARS or the fiscus, with the qualification that it may be possible for prejudice to be broader

than this, in which case SARS would have to prove the alleged other prejudice. Prejudice cannot be merely possible or remote, but must exist on a balance of probabilities.

3.8 The importance of defining of prejudice as actual or likely (on a balance of probabilities) financial loss suffered by SARS or the fiscus can be illustrated using the example of understatement penalties imposed in relation to an assessed loss. Whilst an overstatement of an assessed loss carried forward into a future tax period may represent potential prejudice to SARS where there is a reasonable prospect of the assessed loss being utilised in future years, this is sometimes not the case. For example, where taxpayers have significant long term historical losses or are winding down business, there is no prospect of utilising the assessed loss and in these circumstances, we submit that on a balance of probabilities, there is no prejudice to SARS which would warrant the levying of understatement penalties. Conversely, where a taxpayer is ordinarily profitable (in both the tax and accounting sense) but has an assessed loss in one particular year of assessment which is overstated, SARS would more than likely be able to justify the imposition of understatement penalties since, on a balance of probabilities, the taxpayer would be able to utilise the inflated assessed loss in the near future

3.9 Only once prejudice has been established, would "shortfall" become relevant, and a discussion of shortfall in its current location is confusing and misleading to taxpayers.

4. PARAGRAPH 5: *BONA FIDE* INADVERTENT ERROR

4.1 *Emphasis on doubtful grammatical interpretation*

4.1.1 The Guide states (at page 10): "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'." No grammatical explanation or citation for this conclusion is provided.

4.1.2 This is in contrast to the advice from linguistic experts that we have consulted, who express the rule that adjectives cannot modify other adjectives, but rather modify the relevant noun.

4.1.3 The example of "red floral dress" is particularly unhelpful as a method of conveying the point sought to be made (even if the point is correct, which we believe not to be the case).

4.1.4 We submit further that grammatical rules (correct or otherwise) ought not to be applied in isolation to interpret legislative phrases such as "*bona fide* inadvertent error". Regard should be had to the judgment in *Natal Joint Municipal Pension Fund v Endumeni Municipality ([2012]* 2 All SA 262 (SCA)) where it was held (at page 273) that:

"*Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document,*

consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production… The process is objective not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document."

4.1.5 We submit that regard should be had for the stated purpose of the understatement penalty legislation and the context in which it is to be applied (that is, that "*the regime is designed to sanction an understatement only when the act or omission that causes it springs from culpable or blameworthy behaviour")* when interpreting the phrase "*bona fide* inadvertent error", as opposed to analyzing the placement and meaning of the words with reference to arbitrary comparisons such as the one contained on page 10 of the Guide.

4.2 ***Contradiction with judicial precedent***

4.2.1 The doctrine of separation of powers provides for the allocation of specific functions and responsibilities amongst the three spheres of government. These powers are legislative authority, executive (or administrative) authority, and judicial authority.

4.2.2 SARS, as an executive body, should be applying the law as it stands, including the determination of the judiciary of the meaning of complex aspects that formed the subject of disputes before the court. We are concerned that the interpretation contained in the Guide explicitly contradicts existing judicial precedent (in ITC 1890) that "…*a bona fide inadvertent error had to be 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*".

4.2.3 We note that while the Guide purports to approve of the definitions of the words "*bona fide*" and "inadvertent" as defined in the abovementioned judgment, SARS does not accept the conclusion reached by the court based on those definitions.

4.3 ***Little guidance on "bona fide"***

4.3.1 Apart from referencing the court case where the dictionary definition of "*bona fide*" was provided, there is little guidance on the meaning, including what a taxpayer would be expected to demonstrate to SARS or a court in relation to its *bona fides*.

4.3.2 Taxpayers and SARS officials applying the relevant legal provisions need to understand that the legal test for good faith is a subjective one, which is tested through considering the surrounding factors and establishing whether or not the person is a credible witness.

4.3.3 While there may be various useful case law in this respect, we draw your attention to a criminal case *S v Rantsane* (1973 4 SA 380), where the court held that the *bona fide* belief of the accused was

subjective, and it was not necessary for this belief to be reasonable for it to comprise a *bona fide* belief. In this respect, the lower court had erred in applying an objective test or reasonableness to the accused's stated belief. Since there was no evidence to indicate that the accused's testimony was not credible, it had to be accepted.

4.4 ***Little guidance on "inadvertent"***

4.4.1 Apart from referencing the court case where the dictionary definition of "inadvertent" was provided, there is little guidance on the meaning of inadvertent, including specifically inadvertent as the adjective describing "error".

4.4.2 It is important to note the difference between "inadvertent" and "error". On the basis of the presumption against tautology, these two words must each bear a different meaning. It is submitted that "inadvertent" is a subjective concept, whereas in this context "error" must be something which is objectively incorrect.

4.4.3 While we do not have much tax case law on "inadvertent", we do have substantial tax (and other) case law on the meaning of "intent", from which guidance can be drawn.

4.4.4 Relevant principles include that "intent" requires not only the intent to take the relevant action, but to intend to do so with knowledge that it is wrong. This ties in to the term "inadvertent error", where inadvertent qualifies error. The taxpayer must accordingly not have intended the error (thing which is objectively incorrect).

4.4.5 In contrast, the Guide appears to conclude that if one has considered something ("due care and consideration" in the Example on page 12), there cannot be an inadvertent error. This contradicts existing case law on "intent", and fails to take into account the fact that "inadvertent" qualifies "error".

4.5 ***Absence of guidance on legal interpretative errors***

4.5.1 In the Draft Memorandum on the Objects of the Tax Administration Laws Amendment Bill, 2013, which introduced the "***bona fide* inadvertent error**" exclusion, there was a differentiation between factual errors and legal interpretative errors.

4.5.2 The Guide fails to provide guidance on legal interpretative errors.

4.6 ***Example used to illustrate SARS' definition of "bona fide inadvertent error"***

4.6.1 The example used on page 11 to demonstrate what SARS would consider to be a *bona fide* inadvertent error is unhelpful in several respects:

4.6.1.1 The detailed and specific nature of the conduct as set out in the example limits its usefulness as a demonstrative tool for tax practitioners, SARS officials, and taxpayers.

4.6.1.2 The conduct cited in the example provides a very narrow and restrictive example and seems to infer that an "*extraordinary effort*", combined with the error relating to something that does not form part of the taxpayer's "*normal activities*", would be required for an error or omission to be recognized and treated as a "*genuine oversight*" or *bona fide* inadvertent error by SARS.

4.6.1.3 Furthermore, it appears from the example that the oversight must be "*legitimately occasioned by the circumstances present at the time it was made*" in order to qualify as a *bona fide* inadvertent error by SARS. This appears to be conflation of the concept of "extenuating circumstances". In reality, "human error" has developed as a concept for a reason, and does not need to be as a result of exceptional circumstances, or in the presence of extenuating circumstances, to be a *bona fide* inadvertent error.

4.6.2 We submit that SARS should delete this example and incorporate several different examples taken from practice, which have practical significance, and would apply to a broad category of taxpayers.

5. PARAGRAPH 6: AN UNDERSTATEMENT PENALTY

5.1 *Example on page 12*

5.1.1 The example on page 12 seeks to demonstrate the concept of "reasonable care taken in completing the return". However, where this example fails is in its conclusion that "*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*".

5.1.2 The definition of "*bona fide* inadvertent error" does not specify or even imply that due care and consideration would exclude an error from being genuine and unintentional.

5.1.3 The example on page 12 is confusing when considered in conjunction with the example on page 11, where the taxpayer in fact takes extraordinary measures to comply with her tax obligations and nonetheless commits what SARS defines as a *bona fide* inadvertent error when she unintentionally omits an unusual receipt from her tax return.

5.1.4 It is incorrect to conflate care and consideration with a lack of genuineness and inadvertence. The degree of diligence exercised by the taxpayer does not affect whether the resultant omission was genuine and unintentional, since (as set out in detail in the example on page 11) it is entirely possible for a taxpayer to take great care and exercise unusual diligence in correctly completing her tax return and nonetheless accidentally omit an amount thereby occasioning an understatement

which would be subject to a penalty but for the *bona fide* and inadvertent nature of the error (i.e. the lack of culpability).

5.1.5 SARS' interpretation that due care and consideration results in no inadvertence is conceptually difficult to understand, and contrary to the purpose of the understatement penalties. If the amount cited in the example had been large enough to meet the definition of "substantial understatement", by SARS' interpretation this taxpayer would then be liable for a 10% penalty on something that was outside of his control, and where he was striving to make an accurate return. This cannot be a sustainable interpretation.

6. PARAGRAPH 8: THE LISTED BEHAVIOURS

6.1 *Definition of "reasonableness"*

6.1.1 The standard of reasonableness in South African law follows the test laid down in *Kruger v Coetzee* ([1966] (2) SA 428). Conduct will be reasonable if it is in accordance with what a reasonable person would do in the same circumstances. Conduct will be negligent where the reasonable person would have acted differently under the same circumstances, in that s/he would have reasonably foreseen the consequences of her/his actions, and taken steps to avoid such consequences. This definition should be included in the Guide. It is also submitted that it should be clarified that this is not a standard of perfection, that a person is not required to guard against every eventuality, and that the reasonable person test does not envisage a high level of conservatism (see Herschel v Mrupe 1954 3 SA 464 (A) 490).

6.2 *Reasonableness of consulting a professional*

6.2.1 We take exception to the statement on page 15 of the Draft Guide that taxpayers cannot always reasonably rely on the advice of professional advisors but can "*obtain advice from a SARS Contact Centre, branch, or Mobile Tax Unit; or other reputable sources such as official publications, interpretation notes, guides, and other information available on the SARS website*". The clear implication that it is reasonable to rely on SARS officials and documentation but not on the advice of qualified and reputable tax professionals affiliated with a recognized professional body is not only an unprofessional and prejudicial implication, it encourages taxpayers to have exclusive recourse to an already administratively over-burdened and under-resourced revenue service.

6.2.2 The statement on page 15 of the Draft Guide that "…the fact that such (being professional) services or advice is obtained is not definitive proof of reasonableness… even when advice is obtained its use must be sensible" needs to be appropriately explained and clarified.

6.2.3 In this respect, it is established judicial precedent both in South Africa and in various foreign comparative jurisdictions that a taxpayer who has taken professional advice from a reputable and

knowledgeable tax advisor having provided all material facts and information to the advisor will have acted reasonably, and cannot be expected to second-guess professional advice or there would be no purpose in obtaining it:

6.2.3.1 In *Z v Commissioner for the South African Revenue Service* ((13472) [2014] ZATC 2 (unreported)) the court held at para 40 that it is of the view that "*having received advice, there were reasonable grounds for the appellant to take the tax position which it did. Nor can it be said that he did not take reasonable care – he did so by consulting the experts*";

6.2.3.2 The Court referred to the decision of the Tax Court in the United States of America case of *Estate of Spruill v Commissioner*[1], which determined whether a fraud penalty was appropriately applied to an understatement of estate tax resulting from a significant under-valuation of property. The valuation had been determined with the advice of an attorney and an accountant and was based on an independent appraisal. The court held that: "*When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require a taxpayer to challenge the attorney, to seek a "second opinion", would nullify the very purpose of seeking the advice of a presumed expert in the first place.* . . ' (own emphasis)

6.2.4 *If SARS purports to diverge from the established case law on this point, this again raises issues in relation to the doctrine of separation of powers, and usurping the role of the judiciary. It also raises concerns that SARS, as an administrative body, would be reaching decisions by failing to take into account relevant considerations in the form of judicial precedent. This is not an approach that should be encouraged in the Guide.*

6.3 ***8.2.1 "Reasonable care not taken in completing return"***

6.3.1 We submit that the statement on page 16 of Guide, to the effect that "…*an eFiler who makes a mistake when completing a return could not be said to have exercised reasonable care*" is both incorrect and contradicts the example of reasonable care set out on page 15. Taxpayers submitting manual returns are just as able to check their declaration against source documentation, and utilizing a tax calculator does not ensure that there were no errors in completing a return.

6.3.2 Based on the example cited on page 15, a person who lacks financial knowledge and skill cannot be said to be unreasonable if they make an error in a return which is commensurate with their personal lack of skill and knowledge. It is difficult to understand how the mere use of the eFiling system renders the error described in the example automatically negligent. This statement also presupposes that all persons making use of the eFiling system have the requisite skills, knowledge

[1] 88 TC 1197 (1987).

and resources enabling them to use the application correctly, and that the eFiling system itself never encounters errors, which is an unreasonable assumption in and of itself.

6.3.3 In addition, the Guide should make it clear, in all relevant sections, that the burden of proof in relation to USPs is on SARS. The Guide alleges that "*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.*" This statement approaches the issue from the wrong direction. As opposed to the taxpayer having to try to argue "other" relevant factors to support its submission of reasonable care, SARS would have to identify the factors that comprise a deviation from the standard of reasonable care.

6.4 ***8.2.2 "No reasonable grounds for 'tax position' taken"***

6.4.1 It should be clarified in the Guide that this behaviour category is only potentially applicable when a taxpayer actively adopts a tax position. For example, in the case of the accidental omission of an amount as has been used in various examples in the Guide, this would not be a tax position taken, and this action should be judged in relation to other potentially relevant behaviour categories (such as gross negligence, reasonable care not taken in completing return, or substantial understatement, if found to not have arisen from a *bona fide* inadvertent error).

6.4.2 We submit (with reference to the submissions above) that a person will have reasonable grounds for the tax position taken where they have consulted and obtained advice from a reputable professional advisor, as this is the current judicial position in South Africa. Taxpayers cannot be expected to second-guess their advisors or obtain multiple sources of advice.

6.5 ***8.2. Gross Negligence***

6.5.1 The interpretation and guidance regarding "gross negligence" should be aligned with *XYZ CC v The Commissioner of SARS* (date: 20 November 2017). In other words, a 100% understatement penalty for gross negligence is applicable when a taxpayer's conduct constituted an extreme departure from the standard of conduct of the reasonable person, and not only misguided reliance on incorrect tax advice.

6.5.2 If SARS cannot prove this, a lower penalty must be imposed, which must be determined with reference to the facts of the matter.

6.5.3 All examples, except the last example, are vague and accordingly inaccurate. Each of these problematic examples could explain a situation of ordinary negligence, and not necessarily gross negligence. Examples should be more detailed, and make it clear what the "gross" aspect is, of the gross negligence.

6.6 ***8.3. Tax avoidance and evasion***

6.6.1 The quote contained in this paragraph ("Denis Healey said, The difference between tax avoidance and tax evasion is the thickness of a prison wall.") is an offensive and unnecessary statement. The Guide is not an appropriate platform for humour or anecdotal discussions. In South African law, tax avoidance is not a crime; and there is a very clear and distinct difference between tax evasion and tax avoidance, being criminal intent that must be established beyond a reasonable doubt.

6.7 ***Impermissible avoidance arrangement***

6.7.1 *The Guide should make it clear that subparagraph (e) of the definition of "understatement", which is titled "impermissible avoidance arrangement", was only introduced by the Taxation Laws Amendment Act of 2016 with effect from 19 January 2017. There was no specific effective date clause in this Act, and the general effective date clause therefore applied, to make the effective date the date of promulgation of the Amendment Act.*

6.7.2 *On the basis of the legal presumption against retrospective application (for example in Veldman v Director of Public Prosecutions, 2007 (9) BCLR 929 (CC) at paragraph 26), this penalty category is incapable of being applied to acts or omissions prior to 19 January 2017, and this should be specified in the Guide.*

6.8 ***Example 8.4.2***

6.8.1 The wording in example 8.4.2 is confusing, where it states "*provided that there is no evidence of culpability*". If there is no evidence of culpability, this appears to indicate that the understatement results from a *bona fide* inadvertent error, in which case no USP should be applied. We suggest that this wording is replaced with "provided that the understatement did not result from a *bona fide* inadvertent error, and provided further that the more severe behaviour categories such as gross negligence and intentional tax evasion are not applicable".

6.9 ***Apparent aggregation of different understatements – example 8.4.3***

6.9.1 In example 8.4.3, the Guide indicates that a shortfall of R896 000 for capital expenses claimed incorrectly would be subject to the "substantial understatement" penalty, even though the shortfall is patently below the R1 million threshold. In coming to this conclusion, it appears that SARS has concluded that the two separate understatements for different factual reasons, should be aggregated.

6.9.2 It is submitted that the correct test is on a case by case basis, or put differently, on an understatement by understatement basis. This is explained more fully below.

6.9.3 A "case" involving "income not declared", and a "case" involving "capital expenses claimed incorrectly", as set out in example 8.4.3, are entirely factually and legally discrete. It would make no commercial or legal sense for these different areas to be considered to be a single "case" for the purposes of imposition of penalties.

6.9.4 *"Substantial understatement" definition uses "singular" terminology*

6.9.4.1 Substantial understatement is defined under section 221 of the TAA as:

"***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****."* (emphasis added)

6.9.4.2 By the use of the words "a case" in the definition of 'substantial understatement' and not "cases" means that SARS has to look at each individual understatement in a return individually when ascertaining whether or not there has been a substantial understatement.

6.9.5 *"Understatement" definition uses "singular" terminology*

6.9.5.1 "Understatement" is likewise defined in section 221 of the TAA on a "singular" rather than a "plural" basis:

""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 not return is required, the failure to pay the right amount of 'tax'; or*
(e) an *'impermissible avoidance arrangement'." (emphasis added)*

6.9.5.2 The use of "a" and "an" in defining what would constitute an 'understatement' is used to connote the singular and not the plural. Accordingly, in interpreting this definition SARS must look at each "omission" or each "incorrect statement in a return" individually, in order to ascertain the understatement for that omission or that incorrect statement in a return.

6.9.5.3 It the intention was to group understatements in a tax period, the definition would read in the plural as opposed to the singular. For example, (b) would read "one or more omission**s** from a return" and (C) would read "one or more incorrect statement**s** in a return" which then clearly indicates the plural.

6.9.6 *Imposing provision uses "singular" terminology*

6.9.6.1 The section that imposes understatement penalties, section 222 of the TAA, states as follows:

*""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 subsection (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;*

*(c) the difference between the amount of 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)…" (emphasis added)*

6.9.6.2 Again, the use of "an understatement", "the understatement" and "to each understatement in a return" in defining what would constitute an understatement penalty is a clear indication of the singular and not plural.

6.9.6.3 The use of the wording "each", requires that each understatement is viewed individually. The understatement penalty must be applied on an individual basis, applying the highest applicable understatement penalty percentage in relation to the relevant shortfall in relation to the relevant understatement.

6.9.6.4 If there was the intention to aggregate the individual understatements, the legislature could and should have used wording such as "the aggregated shortfall", rather than "to each shortfall", and "the aggregated understatement" rather than "to each understatement". Similarly, if this were the intention of the legislature, "shortfall" should have been defined in relation to "the understatements", and not in relation to "understatement" (singular).

6.9.6.5 SARS' construction also gives rise to difficulties in relation to a tax period where there are understatements that relate to separate behaviour categories. It is generally accepted that, where understatements relate to separate behaviour categories, the penalty in relation to the relevant behaviour category should be applied to the tax loss suffered in relation to that behaviour category. This interpretation is, however, inconsistent with SARS' construction that aggregates the separate shortfalls resulting from the separate understatements, in order to "create" the behaviour category "substantial understatement". Having determined that the

'Income not declared' should be penalised at a higher rate based on the applicable behaviour category of 'no reasonable grounds for tax position taken' we submit that this amount should be disregarded for purposes of determining whether there is a 'substantial understatement' in relation to the remaining items.

6.9.7 *Contra fiscum interpretation*

6.9.7.1 If indeed it is possible to construe the understatement penalty provisions in the manner in which SARS has done (which is denied), then it is submitted that the legislation should be interpreted in favour of taxpayers, on the basis of the *contra fiscum* rule of interpretation.

6.10 ***Remittance***

6.10.1 On page 21, when dealing with criteria for remittance of USP imposed in relation to "substantial understatement", the Guide states "…*and the arrangement was based on an opinion by a registered tax practitioner*". It appears that this wording should rather be "…*and the tax treatment was based on an opinion by a registered tax practitioner*".

7. PARAGRAPH 11: OBJECTION AND APPEAL

7.1 The Guide should incorporate guidance in relation to the onus which is placed on SARS by section 102 of the TAA in relation to the imposition of understatement penalties.

7.2 A problem which is frequently experienced in practice is that letters of audit findings are issued indicating that understatement penalties will be imposed and inviting the taxpayer to respond, without any indication of (i) which percentage penalty and behaviour categor(ies) SARS believes to be applicable; and (ii) the reasons underlying this belief. This makes it impossible for the taxpayer to frame a precise response to SARS in relation to understatement penalties prior to the assessment, alternatively places an undue burden on taxpayers of having to make submissions in relation to multiple behaviour categories that are not applicable.

7.3 Given that the burden of proof is on SARS, it is submitted that SARS should make sufficient enquiries during the audit to establish the facts of the matter, in relation to potentially applicable behaviour categories. Then, SARS should include these findings as part of the letter of audit findings in terms of section 42 of the TAA. The relevant process to be applied by SARS should be set out in the Guide, to give both SARS and the taxpayer clarity.

8. VOLUNTARY DISCLOSURE

8.1 Clarity needs to be reached as to how a taxpayer who voluntarily discloses information to a SARS official/auditor without making a formal voluntary disclosure application would be treated.

8.2 The TAA is silent as to the definition of "Voluntary" therefore one needs to look at its ordinary meaning defined in the Oxford Dictionary. Voluntary is defined as follows;

"Done, given, or acting of one's own free will".

8.3 The TAA is also silent as to the definition of the word "Disclosure", therefore one will need to also look at the ordinary meaning defined in the Oxford Dictionary. "Disclosure" is defined as follows;

"The action of making new or secret information known."

8.4 If one applies the above definitions to a taxpayer, there can be a voluntary disclosure in accordance with the table contained under section 223 of the TAA without a Voluntary Disclosure application being made. Further to this, "voluntary disclosure" contained in the aforesaid table would therefore not apply exclusively to Part B of Chapter 16 that deals with the Voluntary Disclosure Programme and therefore can be considered for purposes of determining an imposition of an understatement penalty in the absence of an application. There is an issue of ambiguity in respect of the meaning of "Voluntary Disclosure", and SARS should consider clarifying this issue.