

LEGAL UPDATE

Do you understand the understatement penalty behaviours?

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On 1 October 2012 the understatement penalty regime was introduced to replace the additional [tax](#) regime. An understatement penalty is determined by applying the highest applicable percentage in the understatement penalty table in section 223(1) of the Tax Administration Act, 28 of 2011 (“**TAA**”) to the shortfall. In terms of the understatement penalty table, the percentage of the understatement penalty depends on the circumstances under which the understatement event occurred (i.e. a standard case, if the taxpayer was obstructive or if it was a repeat offender, or cases where the taxpayer voluntarily disclosed the understatement) as well as the nature of the behaviour resulting in the understatement. The listed behaviours include the following (with percentages applying to a standard case):

- Substantial understatement – 10%;
- Reasonable care not taken in completing return – 25%;
- No reasonable grounds for tax position taken – 50%;
- Impermissible avoidance arrangement – 75%;
- Gross negligence – 100%; or
- Intentional tax avoidance – 150%.

It is important for taxpayers to understand the listed behaviours, especially where the taxpayer would like to object to the imposition by the South African Revenue Service (“SARS”) of an understatement penalty in terms of a specific behaviour. Taxpayers must understand how the standard of reasonableness is applied to the listed behaviours as most of the listed behaviours are determined thereby. To assist taxpayers in this regard SARS, on 29 March 2018, issued the Guide to Understatement Penalties and on 19 April 2018, issued Issue 2 thereof (“**the Guide**”). The statements set out in the Guide are discussed briefly below.

In terms of the Guide, what a reasonable person would have done is compared to what the taxpayer did. According to the Guide, the severity of the deviation from the standard of reasonableness, determines the listed behaviour that will apply. The further removed from that of a reasonable person, the less reasonable and more culpable the behaviour would be and will fall under either behaviour (ii) ‘reasonable care not taken in completing return’ or behaviour (iii) ‘no reasonable grounds for tax position taken’. According to the Guide, the taxpayer will be culpable if a reasonable person in the position of the taxpayer would have foreseen the possibility that the trigger would result in an understatement and had taken steps to prevent it from happening. In terms of the Guide, the steps that a reasonable person may take include enlisting the assistance of SARS or employing an accountant or tax practitioner. Even though reliance on professional advice is usually indicative that the taxpayer has acted reasonably, its use must be sensible and reliance on dubious advice will not be reasonable. The Guide continues to state that it is not reasonable to abdicate tax compliance in favour of professionals, as accountability lies with the taxpayer.

According to the Guide, the difference between behaviour (ii) ‘reasonable care not taken in completing return’ and behaviour (iii) ‘no reasonable grounds for tax position taken’ is that reasonable care might have been taken, i.e. advice may have been received from a professional, but without reasonable grounds, i.e. the content and the merits of the argument are not reasonable. In terms of the Guide, the question with regard to behaviour (iii) ‘no reasonable grounds for tax position taken’ is simply whether a reasonable person in the circumstances of the taxpayer would have concluded that within their understanding it was likely correct or have assumed a different position.

Further, as the level of care decreases, culpability increases to fall under behaviour (v) ‘gross negligence’ which, according to the Guide, is an “extreme departure from the standard of a reasonable person, which departure must demonstrate complete obtuseness of mind or total failure to take care”. In terms of the Guide, culpability can increase even further when, to reduce tax liability, the behaviour is intentionally contrary to how the reasonable person would have behaved, to fall under behaviour (vi) ‘intentional tax evasion’.

Although the Guide provides helpful insights on the standard of reasonableness and to determine the listed behaviours in respect thereof, the Guide is not binding on SARS and taxpayers should still seek guidance from other sources such as local case law and foreign case law (like that of Australia and the United States which have similar penalty regimes) in this regard. It is noteworthy that a reasoned opinion from a reputable tax practitioner, on which the treatment in the return is based, will, by definition, grant immunity from an understatement penalty under behaviours (iii), (v) and (vi) and even behaviour (ii) to the extent that the incorrect return was not due to carelessness in completion. If the opinion goes further to state that a court will more likely than not uphold the taxpayer’s position, even behaviour (i) will be avoided. Unfortunately, no matter how many opinions the taxpayer might have, the 75% penalty for behaviour (iv) ‘impermissible avoidance arrangement’, i.e. where the general anti-avoidance rule has been applied, can never be waived.



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