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Understatement penalties: what is a bona fide inadvertent error?

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INTRODUCTION

The Tax Administration Act No 28 of 2011 (TAA) introduced the understatement penalty regime with effect from 1 October 2012. Under this regime, penalties would be levied against taxpayers for an understatement, usually ranging from 10% – 150%. In terms of section 221 of the TAA, an "understatement" means any prejudice to SARS in respect of a tax period as a result of a default in rendering a return, an omission for a return, an incorrect statement in a return, failure to pay the correct amount of tax where no return is required or an impermissible avoidance arrangement. Section 222(1) provides, however, that such understatement penalty would not be payable if it arose due to a bona fide inadvertent error.

BONA FIDE INADVERTENT ERROR

The term "bona fide inadvertent error" is not defined in the legislation. The Draft Memorandum on the Objects of the Draft Tax Administration Laws Amendment Bill 2013 (TALAB 2013) set out several factors that SARS would have regard to in assessing if an error was a bona fide inadvertent error. However, the final Memorandum on the Objects of the TALAB 2013 did not include the list of factors and instead stated that *"due to the broad range of possible errors, the proposal to define the term "bona fide inadvertent error" has the potential to inadvertently exclude deserving cases and include undeserving cases. SARS will, however, develop guidance in this regard for the use of taxpayers and SARS officials."*

Such guidance has yet to be issued and in November 2016 it fell to the Tax Court to shed some light on when an error is regarded as bona fide and inadvertent. In the case of ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service (ITI13772), the court was tasked with determining, *inter alia*, whether the Commissioner was correct to levy an understatement penalty on a taxpayer which incorrectly claimed a deduction in terms of section 24C of the Income Tax Act, 1962. The taxpayer submitted that the incorrect deduction was a bona fide inadvertent error. In determining what constitutes a bona fide inadvertent error, the court looked to the ordinary meaning of the words:

"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'. Error is defined by the Oxford Dictionary as 'a mistake'. It also gives the following synonyms: 'the state or condition of being wrong in conduct or judgement'.

It follows from the above that the bona fide inadvertent error has 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."

The court noted that the taxpayer had relied on an opinion provided by a tax practitioner and the advice of its external accountant. These factors assisted the court in concluding that the taxpayer acted in good faith, with no intention to deceive. Accordingly, the court held that the understatement penalty must be remitted.

CONCLUSION

Section 102 of the TAA states that the burden of proving the facts on which SARS bases the imposition of an understatement penalty, is upon SARS. SARS is therefore obliged to prove the bad faith or intent to claim an undue tax benefit. In this regard, it is clear from the *ABC Holdings* case that showing one relied on professional advice goes a long way in evidencing acting in good faith and having no intention to deceive, once again highlighting the importance of always seeking professional tax advice.



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