Refining the understatement penalty in terms of the Tax Administration Act

J.A. Feuth

Student number: 23242736

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Supervisor: Miss M Lubbe

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ABSTRACT

The Tax Administration Act (28 of 2011) (TA Act), which was promulgated on 4 July 2012 and came into effect on 1 October 2012, was enacted with the purpose of aligning all the administrative provisions dealt with under the various sections of the Income Tax Act (58 of 1962) (IT Act) and the Value-Added Tax Act (89 of 1991) (VAT Act) under one piece of legislation. The TA Act (28 of 2011) provides guidance on various matters of tax administration, including a very controversial penalty levying regime. Prior to the TA Act (28 of 2011), section 76 of the IT Act (58 of 1962) and section 60 the VAT Act (89 of 1991) (hereafter referred to as the pre-TA Act (28 of 2011) penalty provisions) dealt with the levying of additional taxes in cases of understated tax returns. Sections 76 and 60 of the respective acts unfortunately did not provide proper guidelines on the assessment and calculation of these additional taxes or on how the levying of these additional taxes could conform to matters of administrative justice. These matters have been included under sections 221 to 223 of the TA Act (28 of 2011) (hereafter referred to as the understatement penalty percentage provisions under the TA Act (28 of 2011)) and have been welcomed by most taxpayers.

This research study focused on the critical evaluation of the understatement penalty percentage provisions under the TA Act (28 of 2011) as well as the provisions which were repealed and replaced by the TA Act (28 of 2011) and which were previously applied in terms of the pre-TA Act (28 of 2011) penalty provisions. A comparison between the latter provisions, the understatement penalty percentage provisions under the TA Act (28 of 2011) and foreign legislation is made with the purpose of addressing how effective and fair the TA Act (28 of 2011) will prove to be. The study also includes brief advice on any possible improvements or practical approaches regarding the understatement penalty percentage provisions under the TA Act (28 of 2011). It is also seen as necessary to evaluate the effectiveness of the regulations promulgated in terms of sections 221 to 223 of the TA Act (28 of 2011), and to identify possible problems with the application and interpretation of the relevant understatement penalty percentage provisions under the TA Act (28 of 2011) by the Commissioner.

A literature review was used to critically analyse and compare various pieces of legislation and precedents, including South African and foreign laws and legislation, with possible practical illustrative examples. The objective with the literature review was to clarify issues such as the fairness of the understatement penalty percentage provisions under the TA Act (28 of 2011) and the pre-TA Act (28 of 2011) penalty provisions.

The findings of the research study revealed that the enactment of the understatement penalty percentage provisions under the TA Act (28 of 2011) on 1 October 2012 partially achieves the objective of providing taxpayers with a penalty levying system that is more reasonable and fair in comparison with the pre-TA Act (28 of 2011) penalty provisions. Despite a more favourable outcome achieved by the TA Act (28 of 2011), the research concludes that proper guidance and measures for levying a penalty are still lacking and that the legislation is unfortunately still failing in this regard. Harsh penalty percentages based on certain behavioural criteria that are not defined create the need for obvious improvements. That said, the TA Act (28 of 2011) is still young and creates a basis on which further amendments and improvements can take place.

KEYWORDS

Additional Tax, Behaviours, Discretion, Income Tax Act, Tax Administration Act, Tax Penalties, Understatement penalty percentage, Value-Added Tax Act

OPSOMMING

Die Wet op Belastingadministrasie (28 van 2011) (BA-wet), wat op 4 Julie 2012 afgekondig is en op 1 Oktober 2012 van krag geword het, is uitgevaardig met die doel om al die administratiewe bepalings wat ooreenkomstig die onderskeie artikels van die Inkomstebelastingwet (58 van 1962) (IB-wet) en die Wet op Belasting op Toegevoegde Waarde (89 van 1991) (BTW-wet) hanteer is, onder een stuk wetgewing te belyn. Die BA-wet (28 van 2011) voorsien leiding oor verskeie aangeleenthede betreffende belastingadministrasie, insluitende 'n uiters kontroversiële boeteheffingstelsel. Voor die BA-wet (28 van 2011) het artikel 76 van die IB-wet (58 van 1962) en artikel 60 van die BTW-wet (89 van 1991) (hierna die voor-BA-wet- (28 van 2011) boetebepalings genoem) die heffing van bykomende belasting in die geval van onderverklaarde belastingopgawes hanteer. Artikel 76 en 60 van die onderskeie wette het ongelukkig nie behoorlike riglyne oor die evaluering en berekening van hierdie addisionele belasting voorsien nie, en ook nie oor hoe die heffing van hierdie bykomende belasting aan aangeleenthede betreffende administratiewe geregtigheid kon voldoen nie. Hierdie kwessies is ingesluit in artikel 221 tot 223 van die BA-wet (28 van 2011) (hierna genoem die onderverklaring-boetebepalings ingevolge die BA-wet (28 van 2011) en is deur die meeste belastingpligtiges verwelkom.

Hierdie navorsingstudie het gefokus op die kritiese evaluering van die onderverklaring-boetebepalings ingevolge die BA-wet (28 van 2011), sowel as die bepalings wat deur die BA-wet (28 van 2011) vervang is en wat voorheen ingevolge die voor-BA-wet- (28 van 2011) boetebepalings toegepas is. 'n Vergelyking tussen die laasgenoemde bepalings, die onderverklaring-boetebepalings ingevolge die BA-wet (28 van 2011) en buitelandse wetgewing word getref met die doel om die doeltreffendheid en billikheid van die BA-wet (28 van 2011) vas te stel. Die studie sluit ook bondige advies in oor enige moontlike verbeterings aan of praktiese benaderings tot die onderverklaring-boetebepalings ingevolge die BA-wet (28 van 2011). Dit word ook nodig geag om die doeltreffendheid/effektiwiteit van die regulasies wat ingevolge artikel 221 tot 223 van die BA-wet (28 van 2011) afgekondig is te evalueer, en om moontlike probleme met die toepassing en vertolking van die toepaslike onderverklaring-boetebepalings ingevolge die BA-wet (28 van 2011) deur die Kommissaris te identifiseer.

'n Literatuurstudie is gebruik om verskeie stukke wetgewing en presedente krities te ontleed, insluitende Suid-Afrikaanse en buitelandse wette en wetgewing, met moontlike praktiese illustrerende voorbeelde. Die oogmerk van die literatuurstudie was om kwessies soos die

billikheid van die onderverklaring-boetebepalings ingevolge die BA-wet (28 van 2011) en die voor-BA-wet- (28 van 2011) boetebepalings op te klaar.

Die bevindinge van die navorsingstudie het aan die lig gebring dat die inwerkingtrede van die onderverklaring-boetebepalings ingevolge die BA-wet (28 van 2011) op 1 Oktober 2012 gedeeltelik sy oogmerk nakom deur aan belastingpligtiges 'n boeteheffingstelsel te voorsien wat redeliker en billiker is in vergelyking met die voor-BA-wet- (28 van 2011) boetebepalings. Ten spyte daarvan dat die BA-wet (28 van 2011) 'n veel gunstiger uitkoms bewerkstellig het, kom die navorsing tot die slotsom dat behoorlike leiding en maatstawwe vir die heffing van 'n boete steeds ontbreek en dat die wetgewing in hierdie opsig ongelukkig steeds tekort skiet. Strawwe boetepersentasies gebaseer op sekere gedragskriteria wat nie omskryf word nie, skep die behoefte aan voor die hand liggende verbeterings. Hoewel die BA-wet (28 van 2011) nog nuut is, skep dit nogtans 'n grondslag waarop verdere wysigings en verbeterings geskoei kan word.

SLEUTELWOORDE

Addisionele belasting, Gedrag, Diskresie, Inkomste Belasting Wet, Belastingadministrasie Wet, Belasting boetes, Onderverklaring-boete persentasie, Belasting op Toegevoegde Waarde Wet

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LIST OF ABBREVIATIONS

ATO	Australia Tax Office
AU TAA	Australia Tax Administration Act
AU	Australia
C.R.	Commercial Restitution
CIR	Commissioner for Inland Revenue
EM	Explanatory Memorandum
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
IRO	Inland Revenue Ordinance
IT Act	Income Tax Act
ITAA	Income Tax Assessments Act
ITC	Income Tax Case
JCPAA	Joint Committee on Public Accounts and Audit
NZ TA Act	New Zealand Tax Administration Act
NZ	New Zealand
NZIR	New Zealand Inland Revenue
OECD	Organization for Economic Cooperation and Development
PAJA	Promotion of Administrative Justice Act
PLR	Potential Lost Revenue

SARS	South African Revenue Services
SCOF	Standing Committee on Finance
TA Act	Tax Administration Act
TAB	Tax Administration Bill
UK	the United Kingdom
VAT Act	Value-Added Tax Act
VDP	Voluntary Disclosure Programme

CHAPTER 1

INTRODUCTION

1.1 Background

When the South African Revenue Services (SARS) recently introduced their Strategic Plan for 2012 and 2013 to 2016 and 2017 (2012:6), it became clear that a strong need exists to focus on tax compliance within various sectors that the relevant taxation and related legislation covers. These sectors include for example the large businesses and their very relevant issue of transfer pricing, high net worth individuals encompassing trust entities and small businesses, and their cost of compliance, tax practitioners and various others.

As our economy and business sectors evolve to adapt to the ever changing and somewhat straining economic environment, taxation laws are greatly challenged and debated between the opposing poles of the tax authority and entities bound by compliance therewith.

With the Tax Administration Act (TA Act) (28 of 2011) recently coming into effect, provision is made for the treatment of the so called "understatement penalty" or currently better known as "additional taxes". These understatement penalty percentage provisions under the TA Act (28 of 2011) and the treatment of levying a penalty is covered under section 221 to section 223 of the TA Act (28 of 2011), and as can be seen from the words of the Tax Court in Commissioner for Inland Revenue (CIR) v De Ciccio (1985) and Income Tax Case (ITC) no. 1351 (1981), the levying of penalties or additional taxes is aimed at acting as a deterrent to the taxpayer and a warning to prospective wrongdoers. It is designed to ensure that accurate and honest returns are filed by taxpayers (ITC no. 1331 (1980)), therefore optimising the revenue compliance in terms of the TA Act (28 of 2011). Although the penalty is collected by SARS, it is a penal provision (Israelsohn v Commissioner for Inland Revenue (1952); ITC no. 1295 (1979); ITC no. 1351 (1981) and ITC no. 1430 (1987)).

Prior to the TA Act (28 of 2011) penalty provisions, penalties were levied on taxpayers' assessments in terms of section 76 of the Income Tax Act (IT Act) (58 of 1962) which, together with section 60 of the Value-Added Tax Act (VAT Act) (89 of 1991), has been replaced by the relevant amendments in the TA Act (28 of 2011). Section 76(1) of the IT Act (58 of 1962) determined that a penalty should be calculated as an amount equal to twice the difference between the tax amount calculated in respect of the taxable income returned by a taxpayer, and the tax properly chargeable in respect of his taxable income as determined after the inclusion of the omitted amount. Section 60 of the VAT Act (89 of 1991) levied penalties different to the IT Act (58 of 1962), but on similar grounds. In terms of section 60 of the VAT Act (89 of 1991), when a vendor failed to perform, or omitted to perform with the intention of evading the payment of tax payable by him or to obtain a refund in excess of the amount refundable to him, the amount of the additional tax penalty may not be more than double the amount of the tax amount that he was seeking to evade or the refund improperly claimed.

Under the pre-TA Act (28 of 2011) penalty provisions, no set guideline or rules existed to regulate the levying of additional taxes and penalties. This was seen as a matter of great concern, obviously controversial and greatly criticised. As a result, attempts were made to have certain problems addressed, and possibly eliminated, by the understatement penalty percentage provisions under the TA Act (28 of 2011).

Compliance is clearly a priority, and with that, a topic that cannot be ignored. It is inevitable that a critical evaluation of both the understatement penalty percentage provisions under the TA Act (28 of 2011) and the pre-TA Act (28 of 2011) penalty provisions will have to be done and that these provisions will have to be compared to the penal provisions and law under foreign legislation in order to address how effective and fair the TA Act (28 of 2011) will prove to be. Focusing on the above-mentioned information, the problem statement and research objectives are presented below.

1.2 Problem statement

The understatement penalty percentage provisions under the TA Act (28 of 2011) are new and only came into effect on 1 October 2012. From the background provided above, it is clear that the penalty regime in South Africa has always been a controversial matter, referring to the fairness of penalty levying as well as the accompanying administrative justice. It has also been identified that the problem statement below has not yet been addressed.

The purpose of this study is therefore to refine the understatement penalty percentage provisions under the TA Act (28 of 2011) and to clarify certain issues relating to the treatment of tax penalties.

1.3 Research objectives

The TA Act (28 of 2011) is still young and the effectiveness thereof will only be proven to be effective on the one hand, once it is legitimised by public belief in the effectiveness and fairness thereof and on the other hand once it has been proven by the level of administrative justice it creates. Thus, the following objectives follow:

(i) To critically analyse various legislative provisions prior to the TA Act (28 of 2011) relating to the penalty levying under section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991), including the use of the adapted Hong Kong penalty table that had been adopted to assist the Commissioner in its decision-making. This is addressed in Chapter 2.

(ii) To evaluate the effectiveness of the regulations of the understatement penalty percentage provisions under the TA Act (28 of 2011), and to identify possible problems with the application and interpretation thereof by the Commissioner. This is addressed in Chapter 3.

(iii) To compare the understatement penalty percentage provisions under the TA Act (28 of 2011) and pre-TA Act (28 of 2011) penalty provisions to foreign legislation and penalty provisions. The countries referred to for purposes of comparison include Australia, the United Kingdom and New Zealand, as well as the Hong Kong Special Administrative Region of China, in order to find alternatives and possible improvements to the TA Act (28 of 2011). It also addresses changes that were made to the Hong Kong penalty table since its adoption and how it compares to the penalty provisions in the TA Act (28 of 2011), in order to find alternatives and possible improvements to the penalty provisions in the TA Act (28 of 2011). The penalty tables in Australia, the United Kingdom and New Zealand were also compared to the South African understatement penalty percentage under the TA Act (28 of 2011). This is addressed in Chapter 4 and Chapter 5.

1.4 Research methodology

1.4.1 Research approach

According to Bayat & Fox (2007:35) a literature review is conducted by obtaining an understanding and providing a summary of the range of past and contemporary literature.

The study uses historic research to analyse and obtain an in-depth understanding of the pre-TA Act (28 of 2011) penalty provisions and the current understatement penalty percentage provisions under the TA Act (28 of 2011). Historical research, which is largely a qualitative endeavour, is used to describe past events and to present a factually supported rationale to suggest how and why they may have happened (Leedy & Ormrod, 2013:170). According to Henning *et al.* (2004:3) the purpose of selecting this approach is to understand, and also explain in argument, using evidence from the data and literature, what the study is about. The approach involves obtaining an understanding of pre-TA Act (28 of 2011) penalty provisions and the current understatement penalty percentage provisions under the TA Act (28 of 2011).

A comparative study according to Denscombe (2007:254) is conducted by examining the similarities and differences between data. The data used in this study was in the form of penalty tables, foreign legislation and pre-TA Act (28 of 2011) legislation. According to Mouton (2013:155) a comparative study is performed by using data mainly from primary sources of information, which in this study was the legislation of the respective countries.

1.4.2 Research design

The study was focused around a literature review, which is a selection of available documents on the topic and contain information, ideas, data and evidence written from a particular standpoint to express certain views on the nature of the topic and how it is to be investigated, and the effective evaluation of these documents in relation to the research (Hart, 1998:13). Data, primarily in the form of words, sentences and paragraphs, were collected and examined, and hence a largely historical research approach was applied (Leedy & Ormrod, 2013:170). The review included sources such as books, journal articles, internet articles and electronic newsletters, articles by organisations dedicated to this field and government publications, which included South African income tax legislation, explanatory memoranda, foreign case law, South African case law and reports of commissions of inquiry.

The study used a historic literature review to analyse and obtain an understanding of the understatement penalty percentage provisions under the TA Act (28 of 2011). The approach also involved obtaining an understanding of the pre-TA Act (28 of 2011) penalty provisions, and the penalty provisions in comparable foreign countries.

The study then uses a literature review to understand and discuss the reasons and motivation for the introduction of the current understatement penalty percentage provisions under the TA Act (28 of 2011). The review was performed by also investigating the background to the understatement penalty percentage provisions, and the reasons for the introduction of the understatement penalty percentage provisions under the TA Act (28 of 2011).

The study then proceeded using a literature review to provide a background of the tax systems, more specifically on penalty provisions in developed countries. Focus areas were the penalty tables, which included the behaviours and conducts of taxpayers, together with the different penalty percentages implemented by developed countries. A review on the penalty tables was conducted to ensure that equitable comparisons can be made between the countries selected.

A comparison of the results obtained during the literature review was then performed between South Africa and the developed countries, namely Hong Kong Special Administrative Region of China, Australia, the United Kingdom and New Zealand. The focus was on the penalty tables, which included defining some of the behaviours and conducts of taxpayer, together with the relevant penalty percentages.

According to the approach of De Vos *et al.* (2011:447) the final step of this study entailed making inferences to answer the objectives by doing interpretations, drawing conclusions and making recommendations on the basis of the data collected. The interpretations, conclusions and recommendations enable objectives (i) to (iii) to be addressed, as well as the problem statement on refining the understatement penalty percentage provisions under the TA Act (28 of 2011), and to clarify certain issues relating to the treatment of tax penalties.

1.4.3 Countries that were considered

Hong Kong (although not a country but rather a Chinese Special Administrative Region) was selected for consideration due to the fact that certain SARS offices had opted to use the adapted Hong Kong penalty table prior to the TA Act (28 of 2011) in deciding which penalty percentage to levy (Lombard, 2008). The Hong Kong penalty table played a pivotal role in determining the current understatement penalty percentage provisions under the TA Act (28 of 2011), and therefore will be considered as a comparative country.

Australia, the United Kingdom and New Zealand were selected based on the fact that they are part of the Organization for Economic Cooperation and Development (OECD) English-speaking countries, and in addition to the latter, it is widely known that South African law is partly based on English law (Zimmermann & Visser, 1996:14) due to the great degree of colonial influence on the Roman-Dutch law from which South African Law originated. Countries like Australia (Brink & Viviers, 2012: 439) and New Zealand (Ministry of Justice, 2010) have legal systems also largely based on English law, and as a result were useful comparative countries to study.

1.5 Delineations and inherent research limitations of the study

1.5.1 Delineations

The following delineations applied to this study:

- The study is South African-specific in that it only addresses the understatement penalty percentage provisions under the TA Act (28 of 2011) in a South African context and thus provides limited use to other jurisdictions or countries. Foreign countries selected for the study were limited to Australia, the United Kingdom and New Zealand, as well as the Hong Kong Special Administrative Region. This study therefore did not deal with penalty provisions of other foreign countries. Should a more detailed and extensive list of countries have had to be selected, the possibility exists that a different conclusion could have been arrived at.
- The penalty tables of the countries referred to in Chapters 2 to 5 were obtained while conducting the study on 13 March 2013.
- The penalty provisions in relation to Income Tax and Value-Added Tax were considered, but not the penalty provisions on other types of taxes (*e.g.* Pay As You Earn, Donations Tax, Dividends Tax, Customs and Excise and Estate Duty).

1.5.2 Inherent research limitations

The following inherent limitation applies to this study:

- The use of interpretation of the provisions of the TA Act (28 of 2011) legislation has been identified as a limitation, specifically, in defining and interpreting some of the behaviours set out in the understatement penalty percentage table in section 223 of the TA Act (28 of 2011). However, measures were instituted to limit the impact that this may have had. These measures included: a phased literature study, which included a selection of research material that was obtained from impartial sources (i.e. the South African Tax Cases Reports, Hong Kong Inland Revenue Department penalty provisions, Australian Tax Office (ATO) interpretation and rulings on penalty provisions, Her Majesty's Revenue & Customs (HMRC) penalty provisions and New Zealand Inland Revenue (NZIR) penalty provisions); and the South African case law documentation, foreign penalty provisions, foreign behavioural interpretations and rulings contained the full facts and details from objective sources. A purposive approach was also used when interpreting the TA Act (28 of 2011) provisions.

1.6 Assumptions

The following assumption is applicable to this study:

- It is assumed in this study that in all the foreign countries used in the study, the internal penalty levying procedures (i.e. the use of penalty committees) followed by the different revenue departments are more or less the same as in South Africa.

1.7 Overview of each chapter

The layout of this research is as follows:

Chapter 1 introduces the background to the research, provides the problem statement to be investigated, the research objectives, as well as the research method followed.

Chapter 2 provides an overview of the pre-TA Act (28 of 2011) penalty provisions, which include the use of the Hong Kong penalty table as a guideline to levy pre-TA Act (28 of 2011) additional tax (hereafter referred to as penalty) in terms of section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991).

Chapter 3 provides an overview of the understatement penalty percentage provisions under the TA Act (28 of 2011), with specific focus on the behaviours and the conducts of taxpayers covered in the understatement penalty percentage table. The Chapter focuses on refining some of the behavioural definitions not covered in the TA Act (28 of 2011). Chapter 3 also investigates the procedures followed by SARS in order to levy an understatement penalty percentage in terms of sections 221 to 223 of the TA Act (28 of 2011).

Chapter 4 provides an overview of the Hong Kong penalty table implemented as a guideline for penalty levying pre-TA Act (28 of 2011), which set the path to a more structured and guided method of penalty levying. However, Hong Kong has in the meantime revised the Hong Kong penalty table during 2012, i.e. since the enactment of the South African understatement penalty percentage table on 1 October 2012. The understatement penalty percentage table will therefore be compared to the older and to the revised Hong Kong penalty tables.

Chapter 5 provides a literature review and comparative study of the understatement penalty percentage provisions under the TA Act (28 of 2011), mainly emphasising penalty provisions in Australia, the United Kingdom and New Zealand. These countries have a similar treatment of understatement penalties as South Africa. Countries like Australia and New Zealand have legal systems also largely based on English law like South Africa, and as a result are regarded as meaningful comparative countries to study. Chapter 5 further investigates the tax legislation and policies of Australia, the United Kingdom and New Zealand. The investigation includes principles and procedures regarding the levying of penalties that have already been tested and thought through by these countries and although not without fault, seems to be successful and accessible by the general public.

Chapter 6 highlights the key findings and conclusions from the research objectives under the achievement of research objectives and provides recommendations relating to issues identified in conducting this research. Suggestions for future research are also offered. Finally, the conclusion on the problem statement is arrived at the end of this chapter.

CHAPTER 2

THE PRE-TA ACT (28 of 2011) LEVYING OF ADDITIONAL TAX

2.1 Introduction

Before the enactment of the TA Act (28 of 2011) on 1 October 2012, no legislative or regulatory guidelines existed on which to base the levying of additional tax percentages in cases of understatement or non-compliance. Additional taxes and penalties relating to taxpayers were being levied on assessments in terms of section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991). However, due to the wide discretion granted to SARS officials under these sections, each SARS office treated the levying of penalties differently and as a result no consistency existed regarding levying of additional taxes and penalties. The Commissioner was vested with powers to levy additional taxes, but no limitations to these powers existed, opening up not only constitutional concerns, but also concerns relating to equitable administrative justice (CSARS v NWK, 2011 and Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS, 2005).

This chapter provides a critical analysis of various legislative provisions under the pre-TA Act (28 of 2011) relating to the penalty levying in terms of section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991), including the use of the adapted Hong Kong penalty table which were adopted to assist in the decision-making and penalty process under the pre-TA Act (28 of 2011) (Lombard, 2008) (refer to objective (i), paragraph 1.3.2).

2.2 Levying of additional tax in terms of the IT Act and VAT Act

It is SARS' practice in general, when deciding on an appropriate additional tax penalty to levy in cases of understatement or non-disclosure, to grant a taxpayer the opportunity to submit mitigating factors in writing as to why a lesser penalty should rather be imposed on the taxpayer. A penalty committee at each SARS office advises the SARS assessor or auditor on whether or not the factors submitted by the taxpayer will justify the imposition of a lower penalty (Olivier, 2004). The taxpayer, on the other hand, has the right to request reasons for the imposition of such a penalty in terms of rule 3 of the alternative dispute resolution rules promulgated under the now repealed section 107A of the IT Act (58 of 1962). This right of taxpayers is also entrenched in section 33 of the Constitution of the Republic of South Africa (1996) and enacted under the

Promotion of Administrative Justice Act (the PAJA Act) (3 of 2000). The taxpayer may also use section 5(3) of the PAJA Act (3 of 2000) to compel SARS to provide adequate reasons why a certain percentage penalty was levied.

In the Tax Court Case of Commissioner for Inland Revenue v De Ciccio (1985) and ITC no. 1351 (1981) the court explained that the penalty provisions of the IT Act (58 of 1962) and the treatment of the levying of a penalty was aimed at acting as a deterrent to the taxpayer, and a warning to prospective wrongdoers not to evade tax. It was designed to ensure that accurate and honest returns were filed by taxpayers and vendors, thereby optimising revenue compliance (ITC no. 1331 (1980)). In Israelsohn v Commissioner for Inland Revenue (1952); ITC no. 1295 (1979); ITC no. 1351 (1981) and ITC no. 1430 (1987), the court explained that although the penalty is collected by SARS, it is a penal provision that carries a penalty.

Prior to the enactment of the TA Act (28 of 2011), an "additional tax" charge had to be levied in terms of section 76 of the IT Act (58 of 1962), determined according to a basic calculation as indicated therein.

Section 76(1) of the IT Act (58 of 1962) stipulated that a penalty should be calculated as an amount equal to twice the difference between the tax amount calculated in respect of the taxable income returned by a taxpayer, and the tax properly chargeable in respect of a taxpayer's taxable income as determined after the inclusion of the omitted amount. In the event that the taxpayer made an incorrect statement in any return rendered by him which resulted in the assessment of the normal tax at an amount which is less than the tax properly chargeable, the penalty was calculated as an amount equal to twice the difference between the tax as assessed in accordance with the return made by him and the tax which would have been properly chargeable.

Section 60 of the VAT Act (89 of 1991) levied penalties different to the IT Act (58 of 1962), but on similar grounds. Section 60(1) of the VAT Act (89 of 1991) states that when a vendor fails to perform or omits to perform as required in terms of the said act with the intention of evading the payment of tax payable by him or to obtain a refund in excess of the amount refundable to him, the amount of the additional tax penalty may not be more than double the amount of the tax amount that he was seeking to evade or the refund improperly claimed.

At a first glance of the above sections, it is clear that in considering the additional tax levied under section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991), additional tax charges had to be levied according to a basic calculation clearly set out in the legislation. However, in considering the wording of the pre-TA Act (28 of 2011) provisions, the main issue of concern that arose from that was the extent to which the Commissioner had discretion to exercise powers on penalty levying stipulated in the said acts, as well as the circumstances and factors that could be taken into consideration and could have constituted mitigating factors to reduce penalties when the need arose due to the circumstances of the case. Under the legislation existing at the time, no guidelines existed defining the Commissioner's powers or even indicating any possible factors that could influence his decision-making.

In Olivier's (2004:284) opinion, the wording of section 76 of the IT Act (58 of 1962) was somewhat unfortunate. A careful reading of section 76 indicated that SARS was obliged to impose a 200 per cent penalty in cases of understatement. Due to no set guideline or rules to regulate the levying of additional taxes, in some cases inadequate or even no reasons at all were provided by the Commissioner when penalties were levied (Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS, 2005).

Section 76(2)(*a*) provides that the Commissioner may remit an imposed additional charge or any part thereof as he may deem fit. However, if he were satisfied that any act or omission of a taxpayer was done with any intent on his part to evade taxation and unless there were extenuating circumstances according to section 76(2)(*a*), the Commissioner was not allowed to remit any additional charge levied by him. The crux of the decision and assessment on whether or not to remit any additional tax lay with the test for intent. The test for intent is a subjective one in which the issue concerned relates to establishing what actually went on in the mind of an accused (S v Sigwala, 1967).

For the Commissioner to conclude that intent was indeed present, he must have concluded that certain circumstances were present at the time the alleged wrongdoing took place. These circumstances included *inter alia* whether the taxpayer intended the result that he caused while being aware of the wrongfulness of his non-compliance. If the taxpayer was consciously wrongful and actually foresaw the damages that he could cause (being loss to the *fiscus*), he met the criteria for intent. Implicit in the above is the requirement that the intent must be that of the taxpayer. The unauthorised, accidental or negligent actions of an employee could not in itself be attributed to the control of the taxpayer.

SARS has the practice of using penalty committees at each SARS office in order to advise SARS assessors on whether the factors submitted by the taxpayer could assist the imposition of a lower penalty or not (Olivier, 2004). However, under the VAT Act (89 of 1991) and IT Act (58 of 1962), a taxpayer had no access to any penalty committees or even access to communication with all of the penalty committee members irrespective of his intent (Olivier, 2004). As a result he could not present his case to the Commissioner. Croome (2003:88) mentions that this fact in itself constituted unfair administrative action. However, in the case of Administrator Transvaal v Traud (1989), it was found that the *audi alteram partem* rule does not mean that a taxpayer has to be given the opportunity to state his or her case before the decision is taken. In exceptional cases, the rules of natural justice are still complied with if the taxpayer gets sufficient opportunity to state his or her case after the decision has been taken. It is submitted that this is incorrect and borders on unfairness.

In terms of section 60 of the VAT Act (89 of 1991), additional taxes were dealt with differently than in terms of the IT Act (58 of 1962), but this in essence was just as unfortunate, if not more. The wording of section 60 of the VAT Act (89 of 1991) is very clear and uses mandatory language by stating that the vendor shall be chargeable with additional tax. In addition, penalty percentages in terms of the VAT Act (89 of 1991) were not capped at 200 per cent, as was the case under the IT Act (58 of 1962).

However, under section 60(1), the failure to perform any duty or omission by a vendor to do anything in terms of the VAT Act (89 of 1991) must have been with intent from the vendor before the Commissioner could impose additional taxes on him. It can therefore be said that if the Commissioner could prove that in relation to VAT the payment of tax or the receiving of an undue refund was due to the intention of the vendor, additional tax could be imposed. It is important to note that when imposing additional tax, the Commissioner must also take into account the circumstances of the case at hand in order to arrive at a fair and equitable penalty to be imposed. However, no guidelines were enacted or even provided by the legislature to guide officials to arrive at such a penalty.

In the matter of Weybro Boerdery BK v Kommissaris Van Binnelandse Inkomste (1996), the court held that in regard to the application of section 60 of the VAT Act (89 of 1991), having regard to the evidence that was given and the manner in which the transaction was structured, it was clear that the parties intentionally decided upon the unusual and abnormal terms just to remain within the requirements for a repayment claim which was requested. The court stated that if all the relevant factors were taken into account, the necessary intent for the purposes of section 60 was indeed present and that it made no difference whether or not the transaction was void. In the court's eyes it was clear that section 76 was also applicable to a transaction that was not enforceable and that the provisions of section 60 were consequently also applicable.

Section 10 of the Interpretation Act (33 of 1957) grants the exercising of a power as the occasion requires in cases where a law confers a power or imposes a duty on someone based on his intention, unless a contrary intention is apparent. The provision in section 10 of the Interpretation Act (33 of 1957) therefore states that even though section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991) are not discretionary, a power may be exercised and the duty shall be performed from time to time as the occasion requires. From this it seems clear that the imposition of "additional tax" under the pre-TA Act (28 of 2011) provisions could be imposed as and when the Commissioner could prove that imposing such a penalty would be fair and equitable. The reason behind the levying of addition tax was not only to ensure accuracy on returns, but also to avoid loss to the *fiscus* (ITC no. 1489, 1990). When determining the loss to the *fiscus,* interest paid on amounts that were outstanding by the taxpayer could be taken into account (CIR v BP Miller, 1993). However, what would be fair and equitable remained a question that had to be addressed by the relevant SARS official in every case without guidance from any provision on the factors to be taken into account or the circumstances of the taxpayer.

It is doubtful whether the Commissioner could truly objectively and fairly interpret a penalty without any set rules or at least some judicial guidelines. In many cases unfair additional tax charges inevitably may have caused diverse effects on the taxpayers as can be seen from numerous case studies and in particular in the published case of CSARS v NWK (2011). In its decision, the Supreme Court of Appeal recognised the diverse implication that the *status quo* at the time could hold and indeed had had. In this case SARS persisted with the standard 200 per cent penalty charge, because it felt that there were no extenuating circumstances to charge any other penalty. On appeal the Court reduced this penalty to 100 per cent, indicating that 200 per cent was, in the words of the Court, severe and out of proportion to the wrong committed by the taxpayer (CSARS v NWK, 2011).

It is clear that under the pre-TA Act (28 of 2011) provisions, the Commissioner could not claim to be able to interpret the fairness and justifiability behind a penalty without any set of rules or at least some judicial guidelines. Certain SARS offices has recognised the problem and prior to the enactment of the TA Act (28 of 2011) had opted to use an adapted additional tax guideline table adopted from the Hong Kong Special Administrative Region Inland Revenue Department, to assist it in its decision-making and penalty process (Lombard, 2008).

This Hong Kong penalty table gave some SARS officials more of an idea of what percentage to levy penalties, taking into account the different groups of non-compliance, mitigating and aggravating factors and the degree of cooperation received, as well as the level or category of disclosure made and the nature thereof.

2.3 The Hong Kong Special Administrative Region Inland Revenue penalty guideline

The Inland Revenue Department of the Hong Kong Special Administrative Region provides for a penalty policy for the assessment of additional taxes under section 82A of Policies: Penalty Policies (2003). This penalty policy gives clear general guidelines on mitigating and aggravating factors to be considered when deciding on the percentage additional tax to be levied in Hong Kong.

Prior to the enactment of the TA Act (28 of 2011) and as a result of the criticisms received due to the levying of penalties under section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991), certain SARS offices recognised the problem of over- and undercharging of penalties and opted to make use of this non-legislated adapted additional tax guideline table from Hong Kong. This additional tax guideline table was adopted from the Inland Revenue Department of the Hong Kong Special Administrative Region tax guideline table, and this adoption was aimed at assisting some SARS offices and their officials in the penalty-levying process (Lombard, 2008). This additional tax guideline table (hereafter referred to as the Hong Kong penalty table) was never enacted in South Africa, and as a result could not assist SARS officials more than by merely acting as a reference guide when dealing with penalties for understatement.

Notwithstanding this, the Hong Kong penalty table inevitably provided some SARS officials with some really needed assistance by guiding their decisions on the levying of penalties. The levying of penalties was now done through a process of taking into account categories of non-compliance, mitigating and aggravating factors as well as the degree of co-operation received from the taxpayer and the level and nature of disclosure made by him.

However, the implementation of the use of the Hong Kong penalty table was not without flaws, as on the one hand it gave some SARS officials the discretion in deciding on what tax percentage of additional tax to levy, but without having to give adequate reasons for arriving at the percentage of the penalty levied (Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS, 2005). On the other hand, the guidelines of the Hong Kong penalty table were not set in stone, as they were never enacted or made policy. It can be argued that some SARS officials, when using their own discretion and not providing reasons for their decisions, raised eyebrows with regard to the independence and care taken when a decision on an additional tax percentage was taken.

In the case of Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS (2005), SARS relying on certain *dicta* such as in the Alliance Cash and Carry (Pty) Ltd v CSARS (2002), the Commissioner argued a taxpayer's *onus* to prove its VAT return, from documents in its own possession. In the case in question, the taxpayer had to prove that it had exported certain goods in question, to which a VAT return pertained. The court did not accept the Commissioner's argument, and stated that SARS had not provided adequate reasons to support its decision to override the taxpayer's calculation of the VAT that was due. It also did not provide reasons as to how the overriding VAT amount was determined, of the basis of its decision that tax evasion had been committed, nor of the manner in which the amount of additional tax payable had been determined. The court found that the Commissioner had failed to answer the specific questions that the taxpayer had asked in its request for reasons and merely referred the taxpayer to its own documents to ascertain for itself the answers to those questions. In its finding, the Tax Court held that the taxpayer was entitled to answers to the questions it had posed to SARS in regard to the assessment.

It is difficult to lay down a general rule as to what will constitute adequate reasons. Determining if reasons are adequate will be dependent on the guidelines in case law and the facts of each matter. In the case of Minister of Environmental Affairs and Tourism v Phambili Fisheries (2003), the court referred to the Australian case of Ansett Transport Industries (Operations) (Pty) Ltd & Another v Wraith & Others (1983) and stated that adequate reasons must enable an aggrieved person to say that even though he may not be in agreement with it, he understood why the decision had gone against him. The taxpayer should be placed in a position to decide whether the Commissioner's decision involved an unwarranted finding of fact, or an error of law, which is worth challenging.

Despite the flaws that there may have been with the above Hong Kong penalty table, some good came from it, in that it set the pathway to a new tax era and to the way SARS approached the levying of additional tax, now known as an "understatement penalty" in the TA Act (28 of 2011).

In terms of the Inland Revenue Department of the Hong Kong Special Administrative Region Policy for cases involving field audit & investigation under section 82A, Part D, paragraph 2, the policy stipulates that the degree of penalty to be imposed on a taxpayer is in essence a function of the nature of omission or understatement of income or profit, the degree of his co-operation or disclosure and the length of the offence period. In order to maintain consistency in penalty calculations, the penalty loading table was used by certain SARS offices in deciding on what additional tax to be levied (refer to Table 2.1).

The Hong Kong penalty table dealt with cases where a field audit or investigation has been conducted in terms of section 82A, Part D, paragraph 1 of the Hong Kong penalty table. To determine the additional tax percentage to be levied after an audit has been conducted, certain conducts and offences (behaviours) had to be determined. According to the Hong Kong penalty table one of the tabled taxpayer's conducts had to be present when the audit was performed. The nature of the offences was divided in three groups: Group (a) dealt with cases where the taxpayer showed behaviours of "serious intent", group (b) consisted of cases where the taxpayer showed behaviours of "intent and gross negligence", and lastly group (c) dealt with cases where the taxpayer showed behaviours of "negligence and inadvertence". All of these behaviours were defined under note 1 of section 82A, part D, paragraph 2 of the Hong Kong penalty table.

An extract of the Hong Kong penalty table can be seen hereunder as Table 2.1.

Table 2.1: Extract of the adapted Hong Kong penalty table

Category of Disclosure and Co-operation								
Nature of Offence *(See Note Below)*	Full Voluntary Disclosure / Fully Co-operative		Disclosure with FULL Information Promptly on Challenge		Incomplete or Delayed Disclosures / Partially Co-operative		Disclosure or Omission is Denied and Uncooperative	
	Percentage to be / remain imposed							
	Normal	Max.	Normal	Max.	Normal	Max.	Normal	Max.
Group A	20	60	25	75	30	90	50	200
Group B	10	40	15	50	20	60	25	100
Group C	5	20	10	25	15	30	20	50

Group A SERIOUS INTENT: Cases where the taxpayer shows intentional disregard of the law and adopts deliberate cover-up tactics involving the preparation of false sets of books, fictitious entries or multiple omissions over a long period of time.
Group B INTENT AND GROSS NEGLIGENCE: Cases with slightly less serious acts of omission or intentional overstatement, resulting from recklessness or gross negligence.
Group C NEGLIGENCE AND INADVERTENCE: Cases where the taxpayer fails to exercise reasonable care, is ignorant of the law, has made inadvertent errors or is at most merely negligent (and NO finding of intentional conduct can be proven).

Source: Hong Kong penalty table in terms of section 82A of the Hong Kong Special Administrative Region Inland Revenue Department Policies: Penalty Policy (2003).

The Hong Kong Special Administrative Region Inland Revenue Department made an effort to provide clear guidance not only to their administrative personnel but also to the taxpayer on what percentage of additional tax can be levied and what the taxpayer can expect when additional taxes are levied. The Hong Kong penalty table does not merely base the levying of penalties on the nature of the omission or understatement of income or profit, degree of co-operation or disclosure and the length of the offence period, but also include mitigating and aggravating factors to be considered when evaluating the case at hand. An extract of the mitigating and aggravating factors to be considered as per the Hong Kong Special Administrative Region Inland Revenue Department Policies: Penalty Policy is contained under table 2.2 below.

Table 2.2: Extract of mitigating and aggravating factors to consider before levying additional tax under the Hong Kong penalty table.

Factors for Consideration	**Mitigating**	**Aggravating**
1. Background of the Taxpayer and Sophistication of the Business	• being illiterate or having a low standard of education	• sophisticated taxpayers
	• simple and unsophisticated business	• established and sophisticated business

2. Attitude of the Taxpayer	• genuine concern, seriousness, responsiveness and co-operation	• undue delay or obstruction to the progress of audit and investigation
	• sincerity and willingness to compromise	• passiveness and unwillingness to compromise
	• readiness to accept the discrepancy when quantified	• evasiveness and belated acceptance of the discrepancy quantified
3. Time Span	• casual or one-off understatement	• multiple or repeated evasion acts over a consecutive number of years (e.g. persistent default in rendering returns and making of incorrect returns when pressed with estimated assessments)
4. Scale of Business and Quantum of the Understatements	• relatively small cases	• cases with substantial quantum of understatements having regard to the operating scale of the business
	• accepted discrepancy includes substantial contentious items	• discrepancy consisting of specific fictitious items with cover-up tactics

Source: Hong Kong penalty table in terms of section 82A of the Hong Kong Special Administrative Region Inland Revenue Department Policies: Penalty Policy (2003).

It is submitted that having regard to the guidance provided by the penalty policy table provided for by the Hong Kong Special Administrative Region Inland Revenue Department, the process followed in levying additional taxes in Hong Kong, as well as unofficially in South Africa prior to the TA Act (28 of 2011), was a fair process for both the taxpayer and certain SARS offices. The procedures were clear and understandable and due to the non-existence of any penalty policy or general guideline on exactly how a proper penalty percentage would be levied in South Africa, the utilisation of the Hong Kong penalty table procedures were clearly a move in the right direction.

2.4 Conclusion

It is clear that the Hong Kong penalty table played an important role in the years following its informal introduction in South Africa, when the South African government embarked on the journey to provide a single piece of legislation that covered the tax administration of South Africa. The wording of the pre-TA Act (28 of 2011) penalty provisions was somewhat unfortunate. A careful reading of the pre-TA Act (28 of 2011) penalty provisions indicated that SARS was obliged to impose a 200 per cent penalty in cases of understatement (Olivier, 2004:284). As there was no set guideline or rules to regulate the levying of additional taxes, in some cases inadequate or even no reasons were provided by the Commissioner when penalties were levied (Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS, 2005).

The Hong Kong penalty table was therefore a stepping stone in the right direction for South Africa with regard to penalty levying in terms of the pre-TA Act (28 of 2011), serving as a "blueprint" for a personalised understatement penalty percentage table under the TA Act (28 of 2011).

CHAPTER 3

ANALYSING THE UNDERSTATEMENT PENALTY PERCENTAGE PROVISIONS UNDER SECTIONS 221 TO 223 OF THE TAX ADMINISTRATION ACT (28 of 2011)

3.1 Introduction

Understatement penalties under the TA Act (28 of 2011) predominantly targets serious non-compliance, such as conduct that includes elements of tax evasion. An understatement penalty percentage is triggered by an "understatement" as defined in section 221 of the TA Act (28 of 2011). In addition to a shift in the *onus* of proof from a taxpayer who must have discharged the *onus* of proof for his wrongdoings, it was now up to SARS to prove the reasons for levying an understatement penalty percentage and intent on the side of the taxpayer. The TA Act (28 of 2011) also includes a table of understatement penalty percentage percentages based on specified and defined (where required) behaviours to guide officials in their decision-making.

In order to address the issues of uncertainty, non-compliance and disregard of taxpayers' rights as discussed in Chapter 2, serious action had to be taken by the legislature not only to resolve the issues experienced under the pre-TA Act (28 of 2011) provisions, but also to provide for taxpayer certainty through the enactment of legislation. An attempt was made with the enactment of the TA Act (28 of 2011).

This chapter evaluates the effectiveness of the regulations under the TA Act (28 of 2011), and identifies possible problems with the application and interpretation by the Commissioner of the penal provisions under section 221 to section 223 of the TA Act (28 of 2011) (refer to objective (ii), part 1.3).

The Draft Explanatory Memorandum on the Draft Tax Administration Bill (National Treasury, 2009:17) indicated that the open-ended discretion to impose additional taxes up to 200 per cent under the pre-TA Act (28 of 2011) penalty provisions was fettered as it conferred a too broad discretion on SARS officials who may not have had the required expertise or guidance for the necessary discretion. Fettering a too wide discretion is not only permitted, but is mandated by the Constitution, mostly in order to give effect to the right to equality and the right to administrative justice (National Treasury, 2009:17). By ensuring consistent treatment of taxpayers in comparable circumstances, administrative justice is achieved.

The provisions under the TA Act (28 of 2011) will be discussed below in greater detail, including references to possible case studies and the resultant effect of these scenarios.

3.2 Imposing understatement penalties

Understatement penalty percentage provisions under the TA Act (28 of 2011) are to be levied in accordance with the provisions of Chapter 16 of Part A and is specifically covered under sections 221, 222, 223 and 224 of Chapter 16 of the TA Act (28 of 2011).

Section 222 of the TA Act (28 of 2011) covers the methods and calculations used in determining the levying of an understatement penalty percentage and reads as follows:

> *"(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 percentage determined under subsection (2).*
>
> *(2) The understatement penalty percentage is the amount resulting from applying the highest applicable understatement penalty percentage percentage in accordance with the table in section 223 to the shortfall determined under subsections (3) and (4).*
>
> *(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 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 an 'understatement' results in 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 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."

SARS will include an understatement penalty percentage in an assessment of a taxpayer if there is a difference between the correct amount of tax that should have been reported by the taxpayer and the amount that was reported by the taxpayer on his return. According to the SARS Short Guide to the Tax Administration Act (SARS, 2012:62), an understatement penalty percentage may only be imposed by SARS in instances where it can be seen that the *fiscus* will be prejudiced by the taxpayer's reporting in his return due to a shortfall.

What constitutes prejudice can in simple terms be explained as a shortfall that was caused because a taxpayer did not file a return, filed a return but omitted an item from that return or filed a return in which an incorrect statement was made (SARS, 2012:63).

According to the SARS Short Guide to the Tax Administration Act (SARS, 2012:63):

"the shortfall on which the applicable percentage is applied, is the sum of the difference between—

(a) the tax properly chargeable and what would have been charged if the taxpayer's reporting had been accepted;

(b) the amount properly refundable and what was refundable according to what the taxpayer reported; and

(c) the notional amount of tax applied to the loss or other benefit properly carried forward, and what the loss or benefit was according to what the taxpayer reported."

If an understatement results in a difference under both paragraphs (a) and (b), the shortfall must be reduced by the amount of any duplication between the paragraphs. The tax rate 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 (SARS, 2012:63).

If a taxpayer for example did not file a VAT return despite trading as a VAT vendor and should have paid VAT to an amount of for example R120 000, a shortfall will be calculated. This calculation is done on the difference between R120 000 (being the amount of VAT payable) and nil (being the tax position that the taxpayer reported). The shortfall is calculated as an expression of the prejudice that the understatement caused to the *fiscus*. To calculate the understatement penalty percentage to be levied by SARS, the understatement penalty percentage table will be used to identify the highest applicable percentage that best describes the facts of the case in conjunction with the taxpayer's behaviour or the degree of culpability in reporting an incorrect tax position.

The following table is an extract from the understatement penalty percentage table included under section 223(1) of the TA Act (28 of 2011). As can be seen hereunder, column one lists each relevant subsection under section 223(1) and corresponds it to column two, providing the SARS official with guidance under what behavioural term the taxpayer's behaviour can be categorised when an offence was committed. Column three to six will then give the SARS official the relevant guidance on the case type that he is dealing with in relation to the taxpayer's conduct and as a result determine a penalty percentage for the SARS official.

Table 3.1: Understatement penalty percentage table

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

Source: Understatement penalty percentage table in section 223 of TA Act (28 of 2011).

Once an applicable "behaviour" is identified, SARS must determine whether the taxpayer made a voluntary disclosure before or after being notified of the audit, whether the taxpayer was obstructive when engaging with SARS officials, whether it is a repeat case, or whether the case is a standard case. This is referred to as the taxpayer's conduct.

An understatement penalty percentage will be levied upon taxpayers in a percentage range from 0 per cent up to 200 per cent. This scale of penalties is similar to those in Australia, New Zealand and the United Kingdom. However, South Africa has a higher ceiling percentage, being 200 per cent compared to the lower maximum penalties used in the foreign countries mentioned above, ranging from between 20 per cent and 25 per cent penalties on a shortfall for failing to take "reasonable care" (refer to Tables 5.1 to 5.3). In South African, a penalty of 50 per cent of the shortfall can be imposed on a standard case where reasonable care was not taken by the taxpayer in completing his tax return in terms of section 223(1)(ii) of the TA Act (28 of 2011).

The definitions relevant to the provisions on the imposition of an understatement penalty percentage are covered in section 221 of the TA Act (28 of 2011). It is unfortunate, however, that the definitions given in section 221 are very limited and do not define any of the so-called behaviours identified by the understatement penalty percentage table provided for in the TA Act

(28 of 2011). Important terminology not covered by the definitions in section 221, but included under the provisions of Chapter 16 is *inter alia* the behaviours "reasonable care", "reasonable grounds for tax position", "gross negligence" and "intentional tax evasion".

The following definitions that are applicable to the understatement penalty percentage table in section 223 can be found in section 221 of the TA Act (28 of 2011):

- *"repeat case" means a second or further case of any of the behaviours listed under items (i) to (v) of the understatement penalty percentage 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 in respect of a tax period as a result of a default in rendering a return; an omission from a return; an incorrect statement in a return; or if no return is required, the failure to pay the correct amount of tax.*

If it is taken into account that prior to the enactment of the TA Act (28 of 2011), SARS recognised the problem of over- and under-charging of penalties and opted to make use of a non-legislated adapted Hong Kong penalty table adopted from the Hong Kong penalty provisions, it becomes clear that during the enactment of the TA Act (28 of 2011), the legislature erred in not extending the list of definitions under section 221 of the TA Act (28 of 2011) to include all the reference terms used in the understatement penalty percentage table and also used during the pre-TA Act (28 of 2011) era under the Hong Kong penalty table. This can be seen as an unfortunate error that may effectively have a negative impact on taxpayers' rights to equality and administrative justice.

As mentioned above and in the light of the fact that most of the mentioned behaviours in the understatement penalty percentage table are not defined in the TA Act (28 of 2011), a discussion follows on how each of these behaviours should be interpreted. This discussion will in relevant circumstances include a comparative approach in cases where uncertainty prevails when it is taken into account that limited case law exists to define or explain these terms.

3.3 Taxpayer's behaviours

3.3.1 "Substantial understatement"

If no other behaviour can be defined when evaluating the facts of a case, then an understatement penalty percentage will be triggered if a substantial understatement is present. According to section 221 of the TA Act (28 of 2011), a substantial understatement means that the prejudice to SARS must exceed the greater of 5 per cent of the tax properly chargeable or refundable, or R1 million. A substantial understatement can in other words be defined as a case where the prejudice to SARS is above the threshold. The highest applicable percentage must be applied regardless of the underlying cause of the understatement in terms of section 222(2) of the said act.

Due to the fact that the highest applicable penalty percentage must be applied, the total shortfall must be corresponded with the most appropriate behaviour as listed in the understatement penalty percentage table and then a penalty percentage must be allocated by further applying the penalty table to the taxpayer's conduct during the audit.

A specific rule is provided for in the TA Act (28 of 2011), specifically section 223(3), which allows the remittance of a substantial understatement. Under section 223(3), SARS must remit a penalty imposed for a substantial understatement if it is satisfied that the taxpayer made full disclosure of the arrangement that gave rise to the prejudice. This should be done by no later than the date that the relevant return was due. In addition, the taxpayer must be in possession of an opinion by a registered tax practitioner that took into account the relevant facts and circumstances of the arrangement and that confirmed that the taxpayer's position will more likely than not be upheld if the matter proceeds to court.

The purpose of the remission is to recognise the scenario where a taxpayer took particular care before preparing a return.

3.3.2 "Reasonable care"

3.3.2.1 "Reasonable care" within the context of the TA Act (28 of 2011)

According to section 29 and section 31 of the TA Act (28 of 2011), a taxpayer must take reasonable care in keeping records and in providing complete and accurate information to SARS, as taxpayers are legally responsible for their own tax affairs. Unfortunately and as previously mentioned, "reasonable care" is not defined in the TA Act (28 of 2011), and as a result, its ordinary meaning must apply (SARS, 2012:64).

Having regard to the ordinary meaning of "reasonable care", it seems that in the context of the TA Act (28 of 2011), failure by an entity or its agent to take reasonable care will have to be evaluated on the grounds of all of the relevant acts or omissions by the taxpayer leading to the false or misleading statement made by him. However, a liability to penalty can only be imposed where the conduct of the taxpayer is not of the same standard of care that is expected of a reasonable person in similar circumstances. In other words, identifying what ought to have been done or ought not to have been done to avoid the risk of making a statement that is false or misleading, underpins the imposition of a penalty for failing to take reasonable care.

The ordinary meaning of "reasonable care" in terms of Australian law and cases are defined as follows: In the Australian case of Reeders v Federal Commissioner of Taxation (2001), a penalty had been imposed under the former section 226G of the Australia Income Tax Assessment Act (27 of 1936) (hereafter referred to as the ITAA (27 of 1936)) in respect of the agent's presumed lack of reasonable care due to the absence of evidence to show that reasonable care had been taken. The Australian Administrative Appeals Tribunal (AAT) found that the Commissioner's decision-making process was flawed because it had failed to identify and consider the evidence that suggested a lack of care. The AAT decided that the entity and its tax agent had demonstrated reasonable care in relation to a claim made to deduct self-education expenses.

At paragraph 16 of the judgment, tribunal member McCabe stated that if the taxpayer is able to satisfy the decision-maker that the taxpayer or his or her tax agent took the relevant reasonable care then in terms of section 226G, a penalty should not be imposed in the event of a shortfall. A penalty under section 226G is not triggered until the decision-maker is satisfied that both legs of the section are satisfied.

According to the SARS Short Guide to the Tax Administration Act (SARS, 2012:64), "reasonable care" means that a taxpayer is required to take the degree of care that a reasonable, ordinary person in the circumstances of the taxpayer would take to fulfil his or her tax obligations. This *inter alia* includes, for example, that a taxpayer must have tried his or her best to lodge a correct tax return. "Reasonable care" does not mean perfection, but requires an effort commensurate with the reasonable person in the taxpayer's circumstances. Therefore, if the taxpayer uses an adviser to complete a return on his behalf and the practitioner does not exercise reasonable care, the taxpayer is liable to pay an understatement penalty. Similarly a taxpayer will be liable for the actions of its employees.

From the above explanation included in the Short Guide to the TA Act (28 of 2011) by SARS it, can be derived that SARS considers the question of "reasonable care" based on the common law concept of the "reasonable man test". By requiring action by the taxpayer equating to the reasonable person in the taxpayer's circumstances and evaluating taxpayers' actions based thereon as a guideline for making decisions on a taxpayer's degree of "reasonable care" is in itself controversial. Where a taxpayer took reasonable care in obtaining a practitioner to complete his tax return and the practitioner did not exercise reasonable care, the taxpayer will be penalised for any understatement. The question that then arises is whether it cannot be said that "reasonable care" was indeed taken by the taxpayer when obtaining the services of a tax practitioner.

3.3.2.2 "Reasonable care" within the context of foreign law

The Australian Government Revised Explanatory Memorandum to the New Tax System (Tax Administration) Bill (2 of 2000) (the EM) states that reasonable care requires a taxpayer to make a reasonable attempt to comply with the provisions of the Income Tax Assessments Act (ITAA Act) (27 of 1936) and regulations. It requires care in relation to all the taxpayer's circumstances, including the taxpayer's knowledge, education, experience and skill.

Australian law, similar to the position in South Africa, does not define the concept of "reasonable care". The expression, however, has a long history of usage in the context of Australian tort law. A failure to exercise reasonable care in relation to conduct causing harm is central to proving negligence. The Australian Oxford Dictionary (1999), defines "care" as "…serious attention; heed; caution; pains". "Reasonable" is defined as "within the limits of reason; not greatly less or more than might be expected". In proving negligence, the standard of care demanded of a person subject to a duty of care depends on what a reasonable person would have done or not in response to a risk of injury that is foreseeable. This involves the application of an objective test generally without regard to the personal characteristics or peculiarities of the person whose conduct is in question. To this extent there is a difference between the test for proving negligence and determining whether there was reasonable care in complying with tax obligations which does not have regard to particular circumstances, including knowledge, education, experience and skill (ATO, 2008:6).

Even though the personal circumstances form part of the test for determining whether or not reasonable care is shown in complying with tax obligations, it is largely absent from the test applied in proving negligence. However, the courts have formulated principles to determine whether there has been a breach of the standard of care expected of a reasonable person to give guidance to the meaning of the expression "reasonable care". In particular, the factors that are taken into account by the courts in deciding whether behaviour is negligent are also relevant to making a decision about whether there is a liability to administrative penalty in the case where the taxpayer has failed to take reasonable care (ATO, 2008:6).

The actual intention of the person said to be at fault is not relevant, because the test for establishing negligence is an objective one. The fact that the person has tried to act with reasonable care is not in question – what is relevant is whether, on an objective analysis, reasonable care has been shown. This point is made in the ATO Miscellaneous Taxation Ruling: Penalty relating statements: meaning of reasonable care, recklessness and intentional disregard (ATO, 2008:6) where it explains that the reasonable care test should not include a test of whether the taxpayer actually foresaw the impact of the act, but whether a reasonable person in similar circumstances would have foreseen it. The test therefore does not depend on the actual intentions of the taxpayer.

Another important aspect of the reasonable care test that has a clear link to the principles applied in the law of negligence is that 'reasonable' is not synonymous with the highest possible level of care or perfection. Perfection or the use of increased knowledge or experience gained in hindsight after the event should not form part of the investigation into what is reasonable in the circumstances. That matter must be judged in prospect and not in retrospect, as was held in an Australian case Maloney v Commissioner for Railways (NSW) (1978).

There is no presumption that the existence of a shortfall amount causally linked to a false or misleading statement necessarily or automatically points to an omission to take reasonable care. The evidence must support the conclusion that the standard of care taken by the taxpayer has not met the standard that would be reasonably expected in the circumstances. This was noted by Hill and Hely JJ in Hart v. Federal Commissioner of Taxation (2003) and emphasised in Reeders v Federal Commissioner of Taxation (2001).

The evaluation of the appropriate standard of care required in making a statement should be based on personal circumstances such as age, health and background, the taxpayer's level of knowledge, education, experience and skill, and the taxpayer's understanding of the tax laws involved (ATO, 2008:6).

3.3.3 "Reasonable grounds for tax position"

The EM (2 of 2000) on the ITAA Act (27 of 1936) explained the test for whether or not a reasonable ground for the "tax position" was taken by the taxpayer. It is stated that the test does not require the taxpayer's position to be a "better view" than that of the Commissioner, but that the standard should just as likely be correct as it can be incorrect. It should not more likely be correct than not.

Where an underpayment of tax occurs due to a difference in a taxpayer's interpretation of the application of a tax act from that of the tax authority, an understatement penalty percentage is payable if the taxpayer's position could not be reasonably argued. A taxpayer's interpretation of the application of the law is reasonably arguable if, having regard to the relevant authorities, it would be concluded that what is being argued by the taxpayer is at least as likely correct as not correct (SARS, 2012:64). Taxpayers must not only take reasonable care, but must also adopt a reasonably arguable tax position therein that it would be concluded in the circumstances at hand and having regard to relevant authorities that it is at least as likely to be correct as incorrect.

In the Australian case of Walstern v Federal Commissioner of Taxation (2003) it was held that room should be made for a real and rational difference of opinion between the views of the taxpayer and those of the Commissioner such that, while the taxpayer's view is ultimately seen to be wrong, it is nevertheless about as likely to be correct as the correct view.

According to the SARS Short Guide to the Tax Administration Act (SARS, 2012:64) certain factors that should be taken into account to evaluate the taxpayer's tax position underlie one or more aspects of a tax return. These factors include 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 if an amount qualifies as a reduction of tax payable. If a shortfall arises because of a substantive disagreement concerning the interpretation and application of a provision, the understatement penalty percentage will be imposed if the taxpayer's position is not based on reasonable grounds and facts.

The purpose is not to levy a penalty when SARS disagrees with a position taken by the taxpayer and interpreted differently by that taxpayer, but to attach a penalty in cases where a taxpayer assumes such a position unreasonably. There is an inherent risk in merely assuming a tax position (SARS, 2012:65).

3.3.4 "Gross negligence"

Gross negligence is described as doing (or not doing) something in a way that suggests complete or high level of disregard for the consequences of the TA Act (28 of 2011) (SARS, 2012:65). Although the term "gross negligence" is not capable of precise definition, cases arising from areas of law other than tax law provide some guidance on its meaning (Van der Zwan, 2013) and Government RSA (Department of Industry) v Fibre Spinners and Weavers (Pty) Ltd, 1977).

In the case of S v Van Zyl (1969) it was held that it is non-consciousness of risk-taking that distinguishes gross negligence from ordinary negligence. A person's conduct in relation to risk that a person is conscious of could depart so radically from the standard of the reasonable person that it can amount to gross negligence (C.S.A.R. v Adlington & Co., 1906). It was suggested in Transnet Limited v The owners of the MV Stella Tingas and the MV Atlantica (2002) that where considering gross negligence in relation to a person consciously taking a risk, the conduct in question must involve a departure from a standard of the reasonable person to such an extent that it may be categorised as extreme complete obtuseness of mind and must be demonstrated.

The meaning of "gross negligence" is a conscious and voluntary disregard of the need to use reasonable care, which is likely to cause foreseeable grave injury or harm to persons, property or both. When compared with ordinary negligence, it is conduct that is extreme and not just failure to take reasonable care. Ordinary negligence and gross negligence differ in relation to the degree of inattention by the taxpayer. Both differ from wilful conduct, which is wilful in that it is reasonably considered to cause injury. This distinction is important, since contributory negligence is a lack of care combined with certain conduct causing injury. To completely bar this action is not a defence to wilful conduct, but is a defence to gross negligence (Lehman & Phelps, 2005).

Gross negligence can in short be defined as an indifference to, and a blatant violation of, a legal duty with respect to the rights of others.

3.3.5 "Intentional tax evasion"

The most severe penalty is preserved for cases where a taxpayer has acted with the intention of evading tax. The meaning of tax evasion in terms of section 235 of the TA Act (28 of 2011) includes actions that are intended to reduce or extinguish the amount that should be paid, or that inflate the amount of a refund that is correctly refundable to the taxpayer. In terms of section 235(*a*) – (*e*) of the TA Act (28 of 2011), these actions include the making of a false statement in a return, documenting and signing these documents submitted without reasonable grounds for believing they are true, giving a false answer to a request for information from SARS, preparing and maintaining or authorising the preparing or maintaining of false books of account or other records, making use of or authorising the use of fraud or contrivance, or making a false statement for purposes of obtaining a refund of or exemption from tax.

"Intentional tax evasion" is defined as an intentional and fraudulent attempt to escape payment of taxes and can be as a whole or in part. Evasion is distinguished from attempts to use interpretation of laws or creative accounting, being avoidance, to reduce the amount of tax (Hill & Hill, 2005).

Intentional tax evasion can exist if a false statement is made in a return. This can also be the case where a person fails to file a return. The important factor in this instant, however, is that the taxpayer must have acted with the intent indeed to evade tax. Intent is wilful. When conduct is aimed at disobeying or wholly disregarding a known legal obligation, it can be said to be intentional. In this regard knowledge of illegality is crucial. It is important to also note that it is irrelevant whether SARS acts on or accepts a false declaration at the time that it is made. If SARS accepts the declaration but, later on audits the taxpayer, and determines the correct tax position, the original intention to evade tax is not excused. Intention may, at times, be difficult to distinguish from an action that is regarded as grossly negligent (SARS, 2012:65).

Due to the fact that the application of tax law is subjective and that such an application may be complex to a particular taxpayer, it could be that a genuine misunderstanding of the practical application of a taxing provision exists. This fact cannot be said to indicate intentional tax evasion. If the taxing provision is uncertain and conflicting and the taxpayer applies a reasonable interpretation to the relevant provision, it is doubtful that an intention to evade tax could be proven. The more appropriate behavioural category to evaluate would be whether the taxpayer had taken a tax position on unreasonable grounds or, at worst, that the taxpayer has been grossly negligent. The nature of the actions that underlie an understatement and the circumstances of the taxpayer are influencing factors (SARS, 2012:65).

The U.S. Supreme Court, in Spies v United States (1943), ruled that an overt act is necessary to give rise to the crime of income tax evasion. Therefore, an attempt to evade tax is required rather than passive neglect to file a return, which could be prosecuted under section 7203 of the Internal Revenue Code (the IRC) (26 of 1986) in the United States of America (USA) as a misdemeanour. According to the Supreme Court in Sansone v United States (1965), a conviction under section 7201 of the IRC (26 of 1986) requires proof beyond a reasonable doubt of three elements. Firstly, the existence of a tax deficiency, secondly, a wilful attempt to evade tax, and thirdly, an affirmative act that constitutes the evasion. This can practically speaking be a double set of books, false invoices or documents. In some cases even just the mailing of a false return may constitute the overt act required under section 7201 of the IRC (26 of 1986).

From South African case law and the definitions, intentional tax evasion can be defined as the process whereby a person, through commission of fraud, unlawfully pays less tax than the law mandates (ITC no. 1295 (1979); ITC no. 1430 (1987); CIR v BP Miller (1993)).

3.4 Taxpayer's conduct

In the context of the understatement penalty percentage table, a taxpayer's conduct is measured from left to right on the table, numbered form *(i)* to *(v)* in section 223 of the TA Act (28 of 2011), whereas behaviours as discussed in paragraph 3.3 will be considered in the context of the understatement penalty percentage table from top to bottom on the table. Refer to Table 3.1 in this regard.

When deciding on the correct penalty percentage to be levied according to paragraph *(i)* to *(v)* of section 223(1) and after a decision was made on the "behaviour" of the taxpayer by the SARS official, a decision must be made on the conduct of the taxpayer (SARS, 2012:63).

The understatement penalty percentage table identifies four different categories that relate to a taxpayer's conduct. The categories of conduct that will be discussed and defined in relevant terms hereunder are the following:

- Voluntary disclosure before notification of audit;
- Voluntary disclosure after notification of audit;
- Obstructive conduct, or repetitive case conduct; and
- Standard case conduct.

3.4.1 "Voluntary disclosure"

The TA Act (28 of 2011) makes provision for a permanent legislative framework for voluntary disclosures that applies to all tax types under sections 225 to 233 of the TA Act (28 of 2011). Prior to the enactment of the TA Act (28 of 2011), a voluntary disclosure programme that dealt with voluntary disclosures in the interim existed. This interim programme expired in October 2011, but was included in the TA Act (28 of 2011) in terms of section 225 and section 226. The main purpose of a voluntary disclosure framework is to enhance voluntary compliance by taxpayers in the interest of the good management of the tax system and the best use of SARS's resources (SARS, 2012:65).

Section 229(*b*) of the TA Act (28 of 2011) provides that when a voluntary disclosure was made by a taxpayer and a voluntary disclosure agreement was reached with SARS, the relief in respect of any understatement penalty percentage should be granted in terms of column 5 and 6 of the understatement penalty percentage table in section 223. To make a voluntary disclosure means the taxpayer has to disclose a default or omission made by him/her. This should be done before SARS becomes aware of the omission or default, but it does not have to be a disclosure as indicated in Part B of Chapter 16. The voluntary disclosure could even just be the making of or requesting the making of a correction. It can be a formal or informal disclosure; however, a voluntary disclosure application will have to be made by the Voluntary Disclosure Programme (VDP).

3.4.2 "Obstructive taxpayer"

The meaning of "obstructive" taxpayer is not defined in the TA Act (28 of 2011). To illustrate that a taxpayer is obstructive, there should be a pattern of not responding or incomplete responses from the taxpayer in relation to the requests for relevant material in terms of section 31 of the TA Act (28 of 2011). In terms of section 251 and section 252 of the TA Act (28 of 2011), the SARS official will have to ensure that the requests for relevant material are considered to have been delivered.

The SARS official needs to have objective evidence to support his or her argument that the taxpayer is obstructive. The word "obstructive" is commonly used together with certain terminology in its ordinary meaning, which includes, but is not limited to, words such as unhelpful, difficult, awkward, blocking, delaying, contrary, stalling, inhibiting, restrictive, hindering, unco-operative, disobliging and unaccommodating (Burton's Legal Thesaurus, 2007).

3.4.3 "Repeat Case"

A "repeat case" is defined in section 221 of the TA Act (28 of 2011) as in essence any repeat of any of the behaviours in a five year cycle from the previous case. There is, however, an exception in cases where a taxpayer applied for the voluntary disclosure relief more than once in a five year cycle in terms of section 221 of the TA Act (28 of 2011). The word "case" is not defined in the TA Act (28 of 2011). It is assumed that a case could be considered by the Commissioner as a case when a previous additional assessment was raised.

When taking into account that a taxpayer has applied for voluntary disclosure relief at least three times in a five year cycle, it may initially seem that the taxpayer will have to be penalised under column 4 of the penalty table when determining the understatement penalty percentage for the third case, because it is a repeat case. However, section 229(*b*) of the TA Act (28 of 2011) overrides this. Section 229(*b*) of the TA Act (28 of 2011) provides that the understatement penalty percentage in cases of voluntary disclosure relief provided for in part B of Chapter 16 of the TA Act (28 of 2011) can only be considered based on the percentages provided for in column 5 and 6 of the understatement penalty percentage table. This exception only applies when the subsequent understatement is identified as part of an application for voluntary disclosure relief.

3.4.4 "Standard case"

The term "standard case", as with most terms referred to in the penalty table, is not defined in the TA Act (28 of 2011). Having regard to the ordinary meaning of the word "standard case", it can be assumed that if all the other taxpayer's conducts that are tabled and discussed above do not apply, it can only be seen as a conduct of a "standard case". As a result, it is submitted that a "standard case" can be seen to mean that neither a voluntary disclosure before notification of an audit nor a voluntary disclosure after notification of audit was made and that the taxpayer could not have been seen as an obstructive taxpayer or that the case cannot be seen as a repeat case. The case can only be considered as a "standard case".

3.5 Conclusion

It appears that the new understatement penalty percentage regime has swung the odds of collecting more tax squarely in favour of SARS. The TA Act (28 of 2011) does not leave any room for SARS to apply their own discretion anymore as had been the case with the IT Act (58 of 1962) and the VAT Act (89 of 1991). In the event where SARS had the discretion to remit or reduce understatement penalties, they could have considered mitigating factors to remit or reduce an understatement penalty. In the meantime, taxpayers have to be vigilant in their tax affairs and remain compliant in all aspects (Kotze, 2012).

It is submitted that SARS can be seen to be given great power in taking punitive measures. However, when it comes to collecting tax debt owing to it, it is important to remember that SARS retains substantial powers (Kotze, 2012).

Having regard to the pre-TA Act (28 of 2011) penalty provisions, referring to the Hong Kong penalty table, section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991), the measures that are being set in place by the TA Act (28 of 2011) can be seen to be a great improvement on the previous regime (as indicated in paragraph 2.2). Having regard to the fact that no guidelines existed on the levying of penalties, the TA Act (28 of 2011) has brought about great changes and opened up the possibility of even greater development in this area. The TA Act (28 of 2011) is still in its infancy, and will no doubt undergo further amendments and additions in future, even as both taxpayers and SARS try to come to grips with the full effect of the TA Act (28 of 2011).

CHAPTER 4

HONG KONG PENALTY TABLE AS A "BLUEPRINT" FOR THE UNDERSTATEMENT PENALTY PERCENTAGE TABLE UNDER THE TA ACT (28 OF 2011)

4.1 Introduction

In Chapter 2, the pre-TA Act (28 of 2011) penalty provisions, which included the Hong Kong penalty table, were introduced and discussed. The use of the Hong Kong penalty table was an attempt by certain SARS offices administratively to levy lesser penalties on taxpayers for their tax wrongdoings. The table was unfortunately never "set in stone" due to its never having been enacted. However, the unofficial usage of this Hong Kong penalty table provided some SARS officials with greater guidance on the exercising of their discretion and introduced an environment where fairer penalty levying could be done, as opposed to the system provided for in the pre-TA Act (28 of 2011) provisions.

The fact that certain SARS offices implemented the Hong Kong penalty table as a guideline for penalty levying prior to the TA Act (28 of 2011) set the course to a more structured and guided method of penalty levying. A similar penalty table was consequently provided for in the TA Act (28 of 2011). Considering the fact that the Hong Kong penalty table was internally used by certain SARS offices (Lombard, 2008), the Hong Kong penalty table played a big part in the inclusion of the current understatement penalty percentage table found in section 223 of the TA Act (28 of 2011). It would therefore be insightful to compare the current understatement penalty percentage table in section 223 of the TA Act (28 of 2011) to the Hong Kong penalty table previously used by certain SARS offices and to the improvements in Hong Kong with regard to their penalty levying system in terms of section 82A of the Hong Kong Special Administrative Region Inland Revenue Department Policies: Penalty Policy of the Inland Revenue Ordinance (IRO) Part XIV (2012).

This chapter provides a detailed overview of the Hong Kong penalty table that was adopted by certain SARS offices prior to the understatement penalty percentage provisions under the TA Act (28 of 2011) in order to provide a fairer penalty system to taxpayers. It also addresses changes that were made to the Hong Kong penalty table since the adoption and how it compares to the penalty provisions in the TA Act (28 of 2011) in order to find alternatives and possible improvements to the penal provisions in the TA Act (28 of 2011) (refer to objective (iii), paragraph 1.3).

4.2 Comparison of the understatement penalty percentage table under the TA Act (28 of 2011) to the Hong Kong penalty table

It is unfortunate that taxpayers, prior to the enactment of the TA Act (28 of 2011), could be charged at a rate of 200 per cent as determined by section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991). The levying of a 200 per cent penalty was law and no movement away from such a penalty could be made, unless extenuating circumstances could be proved by the taxpayer as determined by section 76(2) of the IT Act (58 of 1962). Certain SARS offices recognised that the 200 per cent penalty was not fair and, as mentioned, adopted the Hong Kong penalty table to help with the penalty decision-making process (Lombard, 2008).

Comparing the Hong Kong penalty table in Chapter 2 (Table 2.1) used by certain SARS offices to the understatement penalty percentage table in section 223 in the TA Act (28 of 2011), there are numerous similarities that can be identified.

The first important similarity is that the maximum penalty percentage of 200 per cent that could be levied under the Hong Kong penalty table remained at 200 per cent. In both tables the taxpayer's conduct should be or should have been obstructive and should have shown disregard for the law, and the taxpayer's behaviour should be intentionally to evade tax. A few additional behaviours are included in each table and although worded differently, at face value seem to be very similar. The Hong Kong penalty table stipulated that the taxpayer's conduct must have been a disclosure or omission, denial or uncooperativeness, with a serious intent to evade tax, whereas the TA Act (28 of 2011) states the taxpayer's conduct must be obstructive, a repeat case or intentional tax evasion (see Chapter 3 for definitions).

A notable difference of the understatement penalty percentage table from the Hong Kong penalty table is that it makes provision for a 0 (zero) per cent penalty to be levied, whereas in the case of the Hong Kong penalty table, the minimum percentage that may have been levied was 5 per cent. However, it should be noted that a 0 per cent penalty will only be considered by SARS if the taxpayer voluntary disclosed his wrongdoings before he received a notification that he would be audited in terms of understatement penalty percentage table section 223 of the TA Act (28 of 2011).

Another notable difference was that the Hong Kong penalty table did not make provisions for voluntary disclosure conduct and only focused on cases where the taxpayer had already received a notification that he would be audited. The TA Act (28 of 2011) also includes the latter, being cases where the taxpayer had already received a notification that he would be audited, and similar to the Hong Kong penalty table stipulates a minimum penalty percentage of 5 per cent (taking into account that the taxpayer should make full voluntary disclosure of its wrongdoings).

Other notable differences between the understatement penalty percentage table and the Hong Kong penalty table are that when a taxpayer did not take reasonable care in his tax affairs, the maximum penalty under the TA Act (28 of 2011) is 75 per cent, whereas in the Hong Kong penalty table the maximum penalty is 50 per cent. In the event where the taxpayer showed a behaviour of gross negligence in his tax affairs, a maximum of 125 per cent will be charged according to the understatement penalty percentage table, whereas a maximum penalty of 100 per cent will be charged according to the Hong Kong penalty table.

In the case of the understatement penalty percentage table, the levying of a percentage penalty on an audit where the taxpayer shows behaviours of no intention to evade tax, there is no gross negligence, has taken reasonable care in completing his tax return, has adhered to the provisions laid out by the relevant acts, is co-operative in the audit and, lastly, the audit case is not a "repeat case" (see Chapter 3 for definition of repeat case) the case will then be considered to be a "standard case", with a minimum of a 25 per cent understatement penalty. When considering the same behaviours by a taxpayer in the Hong Kong penalty table, only 10 per cent would have been levied.

In terms of the TA Act (28 of 2011) table, a minimum of a 25 per cent understatement penalty percentage will be charged on a "standard case", with the presence of the behaviour of "substantial understatement". "Substantial understatement" is defined under section 221 of TA Act (28 of 2011) (refer to paragraph 3.2 for the definition). As can be seen in the Hong Kong penalty table, the minimum percentage in the same circumstances could only be 5 per cent. The differences between the two tables are quite substantial and therefore require further investigation.

4.2.1 Cases where substantial understatement occurs

Public comments to the Standing Committee on Finance (SCOF): Report-Back Hearings (2011) on the Tax Administration Bill (TAB) (11 of 2011), raised the following issue with regard to the understatement penalty percentage in cases of specific "substantial understatement". Taxpayers indicated that circumstances could arise where a taxpayer takes a reasonable position in a tax return that ultimately results in a substantial understatement. For example, a taxpayer could reasonably contend that an amount of income is of a capital nature and not taxable for income tax purposes, but such amount is ultimately held by the courts to be taxable. In such cases the taxpayer faces a penalty of at least 25 per cent. This situation is untenable and taxpayers should be free to adopt reasonable tax positions without fear of suffering understatement penalties (SCOF, 2011:59)

It was the submission from the taxpayers that no penalty should be applied where the taxpayer had reasonable grounds for the position taken and no regard should be had to the size of the understatement (SCOF, 2011:59). Accordingly, item (i) of the table in section 223 of the TA Act (28 of 2011) should be deleted. The response from the Standing Committee was that the substantial understatement penalty percentage is intended to act as a disincentive to taxpayers taking aggressive positions where large amounts are at stake. It was felt that in the knowledge that substantial understatements are detected and successfully challenged, the worst that can happen is that the tax that should have been paid is paid, along with interest at market-related rates. The committee indicated the concern here related to large corporate and high net worth taxpayers. The provisions have been reviewed in this light and improvement has been effected (SCOF, 2011:59).

It was communicated by the committee that in terms of section 221 of the TA Act (28 of 2011), a "substantial understatement" occurs when the prejudice to the *fiscus* is the lesser of 10 per cent of the tax properly chargeable or refundable and R1 million. The penalty for a "substantial understatement" is therefore incurred from a potentially low monetary threshold (SCOF, 2011:59). In order to resolve this difficulty, it was recommended that a substantial understatement occurred when the prejudice to the *fiscus* was the greater of 5 per cent of the tax properly chargeable and R1 million. The 5 per cent threshold was proposed bearing in mind the lower bound of the materiality threshold that is commonly used in audit practice when applied to net income (SCOF, 2011:59).

The Committee also indicated that the principles of corporate governance place a duty on larger taxpayers to include tax risk management in their governance structure. Even full compliance with such tax risk management, however, will not eliminate disagreements as to interpretation between taxpayers and SARS. It was recommended by the Committee that the power to remit a substantial understatement penalty percentage be granted subject to a rigorous test, being that the substantial understatement occurred despite a diligent approach to tax compliance (SCOF, 2011:60).

The Committee recommended a two-step test, given the size of the amounts and the sophistication of the taxpayers involved. The first step was that the taxpayer had to have fully disclosed the arrangement that gave rise to the prejudice to the *fiscus* to SARS by no later than the date that the relevant return was due. The second was that the taxpayer had to have held an opinion by a registered tax practitioner that confirmed that the position was more likely than not to be upheld if the matter proceeded to Court. In order to ensure that the return was accurate, it was proposed that this opinion must have been issued prior to the date that the relevant return was due and must have taken account of the specific facts and circumstances of the arrangement (SCOF, 2011:60).

Considering the above comparison between the understatement penalty percentage table and the Hong Kong penalty table previously used as a guideline for some SARS officials, it is clear that the understatement penalty percentage table under the TA Act (28 of 2011) is harsher, due to the fact the certain behaviours are not defined, together with the high penalty percentages.

4.3 Developments in the Hong Kong penalty table

Since the unofficial adoption of the Hong Kong penalty table (before the enactment of the understatement penalty percentage table under the TA Act (28 of 2011)), the Hong Kong Special Administrative Region Inland Revenue Department reviewed this penalty table as used by them and made some changes thereto. The revised table was used by the Hong Kong Special Administrative Region Inland Revenue Department as a guideline for their penalty levying.

Apart from the fact that the penalty percentages have severely increased from the Hong Kong penalty table used by certain SARS offices, the Hong Kong Special Administrative Region Inland Revenue Department introduced with the revised Hong Kong penalty table a commercial restitution (C.R.) penalty on top of the normal penalty, which consequently severely increased the maximum penalty that can be charged (refer to Table 4.1, Note 3). An extract of the revised Hong Kong penalty table is contained in Table 4.1 below.

Table 4.1: Revised Hong Kong penalty table

Category of Disclosure and Work Involved								
Nature of Omission / Understatement (see Note 1 below)	**Full Voluntary Disclosure**		**Disclosure with FULL Information Promptly on Challenge**		**Incomplete or Belated Disclosure**		**Disclosure Denied**	
	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.	Normal Loading	Max. incl. C.R.
Group (a)	15	60	75	100	140	180	210	260
Group (b)	10	45	50	75	110	150	150	200
Group (c)	5	30	35	60	60	100	100	150

Note 1 : **Group (a)** – cases where the taxpayers show intentional disregard to the law and adopt deliberate cover-up tactics involving the preparation of a false set of books, padded wage rolls and fictitious entries or multiple omissions over a long period of time.

Group (b) – cases with slightly less serious acts of omission resulting from recklessness including the "hand in the till" type of evasion, failure to bring to account sales of scrap, and sheer gross negligence.

Group (c) – cases where the taxpayers fail to exercise reasonable care and omit profits/ income such as lease premium, once-off commission, etc.

Note 2 : The penalty loading is expressed as a percentage of the tax undercharged.

Note 3 : For cases completed after 30 November 2003, the C.R. is at 7 per cent per annum monthly compounded for periods up to and including 30 November 2003 and at the best lending rate monthly compounded for periods after 30 November 2003.

Source: Hong Kong Special Administrative Region Inland Revenue Department. Policies: Penalty Policy in terms of section 82A of the IRO Part XIV (2012).

Upon review of the two tables (old vs revised), the following amendments are identified: The penalty charge for reasonable care not taken has increased from the maximum of 50 per cent under the old Hong Kong penalty table to 150 per cent under the revised Hong Kong penalty table. In cases where the taxpayer committed a serious tax offence, the penalty has increased from 200 per cent to 260 per cent. In cases where the taxpayer committed an offence that was linked to the behaviour of gross negligence, the penalty has increased from 100 per cent to 200 per cent under the revised Hong Kong penalty table.

The procedures for levying a penalty seems not to have changed in respect of the old and revised Hong Kong penalty tables. The assessment recommendations made by the assessors during its field audits are generally based on a tax penalty table. In both tables as far as these field audit cases and investigations are concerned, tax offences are classified into three groups of culpability, namely: (a) intentional disregard, (b) recklessness and (c) no reasonable care. Moreover, each group of offence is further classified into four categories of co-operation, ranging from "voluntary disclosures" to "disclosure denied" (Yeung, 2012). The groups of culpability remain unchanged in both the old and the revised Hong Kong penalty tables, but in the revised Hong Kong penalty table it was amended to include a factor of C.R.

In terms of the revised Hong Kong penalty table, the penalty amount that is determined by using the culpability groups mentioned above is added to the commercial restitution value, which is determined by the tax undercharged multiplied by the then best lending rates. This computation is usually done by the assessor with a computer program (Yeung, 2012). In any case, the total penalty rate is restricted to the revised Hong Kong penalty table, which can be seen in Table 4.1.

The aggravating and mitigating factors of the Hong Kong penalty table listed in section 82A, paragraph 4 also remained the same in the revised penalty table (refer to Table 2.2). A penalty to be imposed in a particular case did not only depend on the penalty table, but also on surrounding circumstances such as aggravating and mitigating factors. The aggravating factors refer mainly to the unco-operative attitude of the taxpayer. Under both Hong Kong penalty tables, although the Hong Kong Special Administrative Region Inland Revenue Department says the penalty may be adjusted upward by the aggravating factors, this rarely happens in practice because doing so will likely bring the case to the penalty reviewing committee, adding to the workload of the investigation officer (Yeung, 2012).

When comparing the two Hong Kong penalty tables to each other, one finds that an effort was made by the Hong Kong Special Administrative Region Inland Revenue Department to provide guidance with regard to defining certain categories of behaviour. A similar effort is lacking under the TA Act (28 of 2011). The TA Act (28 of 2011) makes use of categories of behaviour but omits to define them and does not provide any guidelines or definitions for the "behaviours" of the taxpayer indicated in paragraph 3.2. This is clearly a problem and open to criticism due to interpretational and practical discrepancies that may arise.

These behaviours were discussed in paragraph 3.3, where the focus was placed on defining them in terms of other revenue authorities and general practices. An attempt was then made in this dissertation to refine some of the behaviours and to fit the refined behaviours into the understatement penalty percentage table as set out in the TA Act (28 of 2011).

4.4 Conclusion

Despite the fact that the definitions discussed in this chapter are not defined in the TA Act (28 of 2011) (refer to paragraph 3.3), the fact that aggravating and mitigating factors are not enacted in any way or included in any policy and hence not provided to SARS as a method for reducing a penalty charge referred to in paragraph 2.3, it can still be said that the current understatement penalty percentage table used by SARS to determine the penalties for taxpayer's wrongdoings is by far fairer when compared to the revised Hong Kong penalty table. It should also be considered that in Hong Kong there are documented cases were taxpayers have received the death penalty for tax evasion, according to BBC News (2001) per Chinese news agency Xinhua.

It would be insightful to make further comparisons of the understatement penalty percentage table under the TA Act (28 of 2011) with similar measures in other countries so as to enable South Africa to understand and review the understatement penalty percentage table under section 223 of the TA Act (28 of 2011), in order to determine if the understatement penalty percentage table is fair or whether there is room for improvement. In the next chapter, the Australian, the United Kingdom and New Zealand penalty levying regimes will be compared to the South African understatement penalty percentage table under section 223 of the TA Act (28 of 2011).

CHAPTER 5

INTERNATIONAL COMPARATIVE STUDY OF THE SOUTH AFRICAN UNDERSTATEMENT PENALTY PERCENTAGE PROVISIONS UNDER THE TA ACT (28 OF 2011)

5.1 Introduction

This chapter focuses on a comparison of the South African penal provisions in sections 221 to 223 of the TA Act (28 of 2011) with the penal provisions in other countries such as Australia (AU), the United Kingdom (UK) and New Zealand (NZ). These countries were selected based on the fact that they are part of the OECD English-speaking countries, and in addition to the latter, it is widely known that South African law is partly based on English law (Zimmermann and Visser, 1996:14) due to the great degree of colonial influence on the Roman-Dutch law from which South African Law originated. Countries like Australia (Brink & Viviers, 2012: 439) and New Zealand (Ministry of Justice, 2010) have legal systems also largely based on English law, and as a result will be useful comparative countries to study. The objective of this chapter is to find alternatives to the South African penalty provisions under sections 221 to 223 in the TA Act (28 of 2011) and to determine if there is room for improvement (refer to objective (iii), paragraph 1.3.2).

South Africa has made a positive shift to an approach that is more in line with the approach of penalty levying followed internationally by various countries by the enactment of the TA Act (28 of 2011). In paragraph 3.2, it was indicated that the understatement penalty percentage provisions enable SARS to levy different penalty percentages in procedurally the same way as Australia (AU) in paragraph 5.2, the UK in paragraph 5.3 and New Zeeland (NZ) in paragraph 5.4, based on the conduct and behaviours of taxpayers. As previously mentioned in paragraph 2.2, the pre-TA Act (28 of 2011) penalty provisions wording of section 76 of the IT Act (58 of 1962) was unfortunate. A careful reading of section 76 indicated that SARS was obliged to impose a 200 per cent penalty in cases of understatement (Olivier, 2004:284). By the enactment of the TA Act (28 of 2011), SA has moved in the right direction when having regard to the penalty levying system previously in place in South Africa (refer to paragraph 2.2). This can also be seen by the study below of the tax legislation, law and policy from AU, the UK and NZ.

Guidelines in the form of tables and more defined rules also provide a more favourable outcome, as can be seen below, in contrast to the pre-TA Act (28 of 2011) penalty provisions.

Principles and procedures regarding the levying of understatement penalties have already been tested and thought through by the above-mentioned countries. Although not without fault, it appears as if the principles and procedures regarding the levying of understatement penalties are successful and accessible to the general public. Principles and procedures are communicated to members of the public in each country by communiqués and standardised question tables, such as the following, for example: In AU the Report on Aspects of Income Tax Self Assessment (ATO, 2004) document is available for public viewing. This communication was published for purposes of improving the transparency of the process of imposing penalties on taxpayers who understate a tax liability and the abolition of the separate penalties for failing to follow a tax office private ruling. The report also recommends administrative action to clarify the standard of care required of taxpayers (ATO, 2004). In NZ, the Taxpayers Obligations, Interest and Penalties IR240 document is also available for public viewing on the NZIR website (NZIR, 2012). In the UK, HMRC published communication on the HMRC website clarifying the penalty system in the UK; documents include HMRC: New Tax Penalties, how to avoid them (HMRC, 2010) and also HMRC: Compliance checks series, Penalties for inaccuracies in returns and documents (HMRC, 2012).

All of these countries' procedures relating to penalty levying are comparable to the legislative framework brought about by the TA Act (28 of 2011), if one compares the different penalty tables to each other, namely Table 3.1, the understatement penalty percentage table in SA, Table 5.1 of the AU penalty table, Table 5.2 of the UK penalty table and Table 5.3 of the NZ penalty table. The penalty procedures of these countries also specifically provide for greater fairness in penalty percentages as compared to the maximum 200 per cent penalty that could have been levied in terms of the pre-TA Act (28 of 2011) penalty provisions.

In order to determine if the penalty provisions in South Africa under sections 221 to 223 of the TA Act (28 of 2011) are fair penalty provisions, it is necessary to compare the penalty tables used in foreign countries such as AU, the UK and NZ to the understatement penalty percentage provisions in SA.

5.2 Overview of Australia (AU) penalty table

This paragraph explains the penalties that can apply if a taxpayer understates his tax liability in the ATO. In terms of the Report on Aspects of Income Tax Self Assessment (ATO, 2004), penalties exist as sanctions to motivate taxpayers to comply with all their tax obligations. The penalties relevant here are those that apply where, in self-assessing, a taxpayer understates his liability and therefore pays less tax than he ought to. These are known as tax shortfall penalties (ATO, 2004).

Tax shortfall penalties may apply if a taxpayer has a tax shortfall resulting from making false or misleading statements, omitting income, over-claiming deductions or claiming deductions that are not allowable. In terms of section 284-75(1) to (4) of the TAA (1 of 1953), this will, however, also depend on the degree of blameworthiness on the taxpayer's part. Failing to provide a document for purposes of calculating a tax liability, applying an income tax law in a way that is not reasonably arguable, disregarding a private ruling and entering into a tax avoidance scheme or having a transfer pricing adjustment all form part of these types of penalties.

Shortfall penalties largely depend on the taxpayer's behaviours. The main penalties are calculated as a percentage of the taxpayer's shortfall amount. Table 5.1 indicates the various penalty amounts. The amount of shortfall penalty for which a taxpayer may be liable depends on the reason (cause) for the shortfall, as set out in the following scale.

Table 5.1: AU penalty table

Cause of shortfall	**Base penalty amount (% of shortfall)**
Intentional disregard of a taxation law	75
Failure to provide a document necessary for the Commissioner to work out the liability	75
Recklessness	50
Lack of reasonable care	25
Taking a position that is not reasonably arguable on a large item	25
Disregard of a private ruling	25

Source: AU Penalty Table, subdivision 284-B sections 284-90 of the AU TAA (1 of 1953).

In terms of section 284-90 of the AU TAA (1 of 1953) the starting point (or base) for determining the penalty amount is a percentage of the shortfall. Sections 284-75(1) to (4) and sections 284-225 of the AU TAA (1 of 1953) determine that a penalty percentage can be varied up or down according certain circumstantial facts that may be presents. These facts include questions of whether the taxpayer has hindered the tax office in investigating the shortfall, has previously had a shortfall with a similar cause, or has voluntary disclosed the shortfall to the tax authority. Furthermore, sections 284-75(5) and (6) of the AU TAA (1 of 1953) determine a scale to ensure that a taxpayer is not penalised for making a false or misleading statement if he had taken reasonable care to be truthful and accurate in making the statement.

The two key definitions in the table are "reasonable care" and "reasonably arguable". Section 284-15 of the AU TAA (1 of 1953) states that a taxpayer has taken a reasonably arguable position where his tax return is, "about as likely to be correct as incorrect". The ATO advised the Joint Committee on Public Accounts and Audit (JCPAA) in the Parliament of AU on the difference between exercising reasonable care and a failure to do so (AU Government, 2007).

In an effort to provide clarity to the Committee and the taxpayer, the ATO defined "reasonable care", which is not defined in tax law, and "reasonably arguable", which is only defined in general terms in The Explanatory Memorandum to A New Tax System, Tax Administration Bill (2 of 2000) (the EM). This *communiqué*, as well as the ATO, Taxation Rulings, TR 94/4 and TR 94/5 (ATO, 2008) provides some explanation of these concepts. To a certain extent the AU courts have also provided guidance on these meanings, as in the recent case of Walstern Pty. Ltd. v Commissioner of Taxation (2003), which considered section 226K of the AU Income Tax Assessment Act (27 of 1936). This case can be seen as the precursor to the current penalty for not having a reasonably arguable position. Nevertheless, there may be some scope to clarify the terms.

"Reasonable care" and "reasonably arguable position" within the context of AU law were thoroughly discussed in paragraph 3.3.2.2. In short, it is important to note that the EM (2 of 2000) makes the following points about the reasonable care test:

- *The test requires a taxpayer to exercise the care that a reasonable person would be likely to have exercised in the circumstances of the taxpayer (including his knowledge, education, experience and skill).*

- *Taxpayers must take reasonable care not only in the preparation of their tax returns, but throughout the year on matters that may impact on their tax obligations, for example, record keeping.*

- *The reasonable care test is not intended to be overly onerous for taxpayers completing their own returns. For most taxpayers, [this is] an earnest effort to follow TaxPack, a booklet of instructions issued by the ATO to assist individuals in completing their income tax return* (Smith & Richardson, 2013: 328).

- *On questions of interpretation, if the taxpayer is uncertain about the correct treatment of a tax-related matter, reasonable care requires that they make reasonable enquiries to resolve the issue. Reasonable enquiry would include consulting someone or reference to a Tax Office publication to satisfy them about the proper tax treatment of the matter.*

- *Where a tax agent completes a return, the standard of care expected of the agent is much higher than the standard expected of the client.*

The EM (2 of 2000) in short also defines "reasonably arguable position" as follows:

For large items which are tax shortfalls exceeding the greater of AUS $10,000 or 1 per cent of the income tax payable by the taxpayer, the taxpayer must not only have taken reasonable care, but must also have adopted a reasonably arguable position. In terms of sections 284-90 item 4 and sections 284-15 of to the AU TAA (1 of 1953) a position is reasonably arguable if it would be concluded in the circumstances, having regard to relevant authorities, that it is at least as likely to be correct as incorrect.

The EM (2 of 2000) explains this concept further as a position that is in a contentious area of the law, where the relevant law is unsettled. This unsettledness of the law results in serious questions about its application under the circumstances of the particular case. The test as explained by the EM does not require the taxpayer's position to be the "better view" or even as "at least as likely to be correct as incorrect". In addition it does not require the position to be more likely to be than not. However, the "reasonably arguable position" standard will never be satisfied if a taxpayer takes a certain position which cannot be defended in court or that is fairly unlikely to succeed in court. The strength of the taxpayer's argument could on the contrary be sufficient to support a satisfaction that a reasonable expectation that the taxpayer could win in court does exist. In such a case the taxpayer's argument will have to be cogent, well-grounded and very considerable in its persuasiveness.

In the AU case, Walstern v FCT (2003), Justice Hill said (at paragraph 108 of his judgment) that the case must be one where reasonable minds could differ as to which view was correct. He explains that it is important that there be room for a real and rational difference of opinion between the parties. In other words, while the taxpayer's view is ultimately seen to be wrong, it should nevertheless be more or less as likely to be correct as the opposite view taken, which turns out to be the correct view.

The ATO also advised the JCPAA that the ATO increased the base penalty by 20 per cent if the taxpayer was found to have taken steps to prevent, mislead or obstruct the Commissioner from finding out about the shortfall. If the taxpayer became aware of the shortfall but did not inform the Commissioner within a reasonable time, or was previously liable to a penalty for having a tax shortfall, the base penalty will be increased (sections 284–20 of the AU TAA (1 of 1953)).

On the other hand, according to sections 284–225 of the AU TAA (1 of 1953) the ATO decreases the base penalty if the taxpayer discloses the shortfall to the ATO. The reduction will depend on when the disclosure is made. If the disclosure is made before an audit commences, then the reduction is 100 per cent for a shortfall of less than $1,000 or 80 per cent for a shortfall of $1,000 or more. If the taxpayer discloses the shortfall to the ATO after an audit has commenced, the reduction will only be 20 per cent, should the disclosure save the ATO significant time and/or resources.

5.3 Overview of the United Kingdom (UK) penalty table

In terms of HMRC: New Tax Penalties on a new penalty system, published in April 2010 (HMRC, 2010), the HMRC has brought into effect legislation regarding penalties which affects returns submitted in respect of their tax period that was to commence on 1 April 2009. This new system covered all personal tax returns, Pay As You Earn (PAYE) year-end returns, as well as Corporation Tax and VAT returns. Penalties levied under this new system were not new penalties, but indeed a variety of different penalties inherited from both the departments of Customs and Excise and of Inland Revenue. These penalties covered individuals who underpaid tax by not registering, and those who submitted no tax return at all.

One aim of the new penalty system was to encourage business and individuals who wanted to be part of the economy to legitimately be so. By not complying with the law, it was felt that the illegitimate informal economy undermined the competitiveness of honest businesses and individuals. This could harm consumers and reduce or erode tax receipts (HMRC, 2010).

In terms of Chapter 9, schedule 41, paragraph 1 of the Her Majesty's Treasury (HMT): Finance Act (2008), the new penalties applied to almost all the taxes, duties and levies administered. A penalty based on a failure to notify the HMRC was replaced by a similar penalty introduced under the new penalty system. This similar penalty was based on inaccuracies of a return rendered and was based on the same principles as the prior similar penalty (HMRC, 2010).

It was felt that a new system was needed as the HMRC felt that multiple penalty systems could cause confusion and lead to inconsistencies in the application of penalties. In addition, it was felt that multiple penalty systems could result in an unnecessary administrative burden for the taxing authority (HMRC, 2010).

A penalty is charged if a return or related document containing an inaccuracy was sent or submitted to the HMRC and that return or document results in tax being unpaid, understated or over-claimed. In addition, it is required that the submission of the inaccurate documentation should have been careless or deliberate or deliberate and concealed. The HMRC refers to these deliberate and careless actions as behaviours (HMRC, 2012).

The amount of penalty for which a taxpayer may be liable will depend on the reason for the inaccuracy on the return or document. The penalty amount is set out in the following table.

Table 5.2: UK penalty table

Nature of offence	Max %	Min Unprompted	Min Prompted
Reasonable Care	0%	0%	0%
Careless Action	30%	0%	15%
Deliberate no concealment	70%	20%	35%
Deliberate with concealment	100%	30%	50%

Source: UK penalty table for inaccuracies in return Chapter 9, schedule 41, paragraph 13 HMT: Finance Act (2008).

The penalty will be based on the behaviour of the person concerned and is a percentage of the potential lost revenue (PLR). For a deliberate and concealed failure, the penalty charged will be a maximum of 100 per cent of the PLR, for a deliberate but not concealed failure, the maximum penalty will be 70 per cent of the PLR, and for any other case such as a lack of care, the maximum penalty will be 30 per cent of the PLR (HMT Finance Act (2008) Chapter 9, schedule 41, paragraphs 6(1)(a) – (c)). In disclosure cases the HMRC indicates its willingness to grant taxpayers a reduction of these penalties (HMT Finance Act (2008) Chapter 9, schedule 41, paragraph 12(2)(1)). The amount depends on whether the disclosure is "unprompted" or "prompted".

Disclosure takes place where a taxpayer discloses a failure, reasonably assists the HMRC to calculate the resulting unpaid tax and allows access to records to check the amount of unpaid tax (HMT Finance Act (2008) Chapter 9, schedule 41, paragraphs 12(2)(a) - (c)). A disclosure is regarded as unprompted if the taxpayer has no reason to believe that the HMRC has discovered or is about to discover the failure. The actual reduction in the penalty depends on the quality of the disclosure, including timing, nature and extent (HMT Finance Act (2008) Chapter 9, schedule 41, paragraph 12(3)(a) and 12(4)).

It is noted that where the taxpayer is simply careless in not making the necessary notification, the reduction in the penalty will include an evaluation of the amount of time that has elapsed since any tax first became unpaid as a result of the failure (HMT Finance Act (2008) Chapter 9, schedule 41, paragraph 13(5)(a) and 13(6)(b)). The HMRC can reduce the penalty if special circumstances are involved. In such a case the officer dealing with the case should take into consideration whether the taxpayer had informed the HMRC timeously and if any special circumstances were involved (HMT Finance Act (2008) Chapter 9, schedule 41, paragraph 14). The behaviours evaluated under the UK penalty table can be explained under the headings following below.

5.3.1 "Reasonable Care"

"Reasonable care" is not defined in the HMT: Finance Act (2008), but would include any minor omission that was not classified as careless (Nixonwilliams, 2011). According to the HMRC, everyone has a responsibility to take reasonable care over their tax affairs. What "reasonable care" is, will depend on each taxpayer's abilities and circumstances. If a taxpayer took reasonable care to get things right, but his return or document still contained an inaccuracy, the HMRC would not charge a penalty. According to the HMRC, some of the ways a taxpayer can take reasonable care include keeping enough records to make accurate tax returns, keeping those records safe, asking the HMRC or a tax adviser if he is not sure about anything and following any advice given (HMRC, 2012).

5.3.2 "Carelessness"

Being "careless" is defined as "failure to take reasonable care" (HMRC, 2012). Although reasonable care is not defined in the HMT Finance Act (2008) the HMRC considers that the definition of the term "careless" equates to that of "negligence" (Nixonwilliams, 2011). "Negligence" is defined as an omission to do something which a reasonable man, guided by those considerations which ordinarily regulate human conduct, would do, or something which a prudent and reasonable man would not do (Blyth v The Company of Proprietors of The Birmingham Waterworks, 1856).

It is expected that, if a taxpayer comes across something different or unusual in his own tax affairs which creates in him uncertainty of the tax consequences, he should seek advice from an advisor or the HMRC directly. If this is not done the taxpayer's actions will be regarded as "careless" and not those of a "reasonable person" (Nixonwilliams, 2011).

5.3.3 "Deliberate no concealment"

According to the HMRC, the behaviour of "deliberate no concealment" is where a person knowingly and intentionally gives an inaccurate document but has not taken additional active steps to hide the inaccuracy. Examples of these would be the paying of wages without operating PAYE, knowingly missing off sales from records i.e. doing jobs for cash, deliberately under valuing stock or work in progress at year-end, and deliberately withdrawing money from an incorporated business account to use for personal expenses whilst making no attempt to make sure it is taxed correctly (HMRC, 2012).

5.3.4 "Deliberate with concealment"

A taxpayer's action that is regarded as "deliberate with concealment" is regarded as the most serious of the offences. It occurs when a taxpayer gives a document to the HMRC knowing that it has errors in it and in addition takes further steps to ensure that these errors are not discovered by the HMRC. This might involve creating fictitious records, meeting notes or deliberately destroying records to cover up errors (HMRC, 2011).

5.4 Overview of New Zealand (NZ) penalty table

A shortfall penalty is imposed as a percentage of a tax shortfall (a deficit or understatement of tax), which is defined under sections 141(1) - 141(14) of the NZ Tax Administration Act (TA Act, 166 of 1994), resulting from certain actions on the part of a taxpayer. The law divides these actions into five categories of fault, with a specified penalty rate for each category.

The five categories are as follows: "not taking reasonable care", "unacceptable tax position", "gross carelessness", "abusive tax position" and "evasion" (sections 141A - 141E of the NZ TA Act (166 of 1994)). The penalty increases in proportion to the seriousness of the fault.

Shortfall penalties largely depend on the taxpayer's behaviours. The main penalties are calculated as a percentage of the taxpayer's shortfall amount. Table 5.3 shows the various penalty amounts. The amount of shortfall penalty for which a taxpayer may be liable, depends on the reason for the shortfall, as set out in the following table.

Table 5.3: NZ penalty table

Fault	**Standard penalty (% of tax shortfall)**
Not taking reasonable care	20%
Unacceptable tax position	20%
Gross carelessness	40%
Abusive tax position	100%
Evasion	150%

Source: NZ penalty table Chapter 9, sections 141A – 141E of the NZ TA Act (166 of 1994).

5.4.1 "Not taking reasonable care"

NZ tax law requires a taxpayer to take reasonable care in meeting his tax obligations. Generally, this means a taxpayer must take the same care that a reasonable person in the same circumstances would take. The standard does not require perfection on the part of the taxpayer (NZIR, 2012). The penalty for not taking reasonable care is 20 per cent of the tax shortfall with a maximum shortfall penalty of NZ$50,000 according to sections 141JAA and 141A of the NZ TA Act (166 of 1994).

The NZ$50,000 cap applies to tax shortfalls that are identified through voluntary disclosures by the taxpayers or by audits done within a certain period. This period is the greater of three months, or the lesser of a return period, versus six months, according to section 141JAA(1) of the NZ TA Act (166 of 1994). When dealing with business taxpayers, the term "reasonable care" will mean that the taxpayer has put adequate recordkeeping systems in place as well as procedures to ensure that all income and expenditure are properly recorded and accounted for. However, an arithmetical error does not in itself necessarily indicate that reasonable care was not taken (NZIR, 2012).

A reasonable person would be expected to seek professional advice if he is uncertain about how the law finds application. The same standards of providing accurate and adequate information, however, will still apply, as he is also expected to provide his tax agent with the right information. If he does not comply, he may receive a penalty according to section 141A(2B) of the NZ TA Act (166 of 1994).

To determine if a taxpayer has taken reasonable care, the NZIR will take certain circumstances into account. Circumstances that would affect a decision on the penalty to be levied would include, for example, the complexity of the law and the transaction, the difficulty of interpreting the law, the amount and seriousness of the shortfall, and the difficulty and possible expense to take precautions against such a shortfall occurring. In addition the age, health and background of the taxpayer concerned are also relevant. Other circumstances that may be taken into account when businesses are involved are the size and nature of the business, the internal controls in place, the business's record-keeping practices, any system failures that may have played a role, *etcetera* (NZIR, 2012).

5.4.2 "Unacceptable tax position"

The legal definition of an unacceptable tax position is one that fails to meet the standard of being as likely to be correct as not correct (see section 141B(1) of the NZ TA Act (166 of 1994)). This means that the position taken by the taxpayer does not need to be the correct position, or even one that has as much as a 50 per cent chance of success. However, it must be capable of being seriously considered by a court of law (NZIR, 2012).

The penalty for a tax shortfall resulting from an unacceptable tax position is calculated as 20 per cent of the resulting tax shortfall. A penalty will be charged if both of the following conditions are met: firstly, the tax shortfall must have resulted from an income tax position that was about as likely to be correct as not correct, and secondly, the tax shortfall must exceed both NZ$50,000 and 1 per cent of the total tax figure for the relevant return period (see section 141B(1)-(2) and 141B(4) of the NZ TA Act (166 of 1994)). The purpose of these conditions is to establish higher standards for tax positions in cases where larger amounts of tax are involved. This reasoning is given for the implementation of thresholds for the amounts of tax involved (NZIR, 2012).

In terms of sections 141H(1) and 141G - 141I of the NZ TA Act (166 of 1994), in the event that a penalty has been levied against a taxpayer, the NZIR retains a discretion to refrain from imposing the unacceptable tax position penalty. This will be the case where certain criteria are present. For the penalty to not be imposed, the shortfall must have been seen to have resulted from a clear mistake or simple oversight made by the taxpayer. In addition, the shortfall must also have been voluntarily disclosed before a notification of a pending audit. In such instances the taxpayer is not liable to pay the penalty if the shortfall arose between 1 April 2003 and 31 March 2008.

5.4.3 "Gross carelessness"

In terms of sections 141C(2) and 141C(3) of the NZ TA Act (166 of 1994), in tax matters "gross carelessness" consists of behaviours that demonstrate a high degree of carelessness and disregard for the consequences when a tax shortfall arises. Conduct that can be classified as "gross carelessness" is conduct that creates a higher risk for the occurrence of a tax shortfall and which would have been foreseen by a reasonable person in the circumstances similar to the taxpayer's. In this instance it makes no difference whether the taxpayer was aware or not of being grossly careless or even if he intended to be so. In other words "gross carelessness" means doing something or refraining there from in a way that, in all circumstances, will suggest or imply complete or a high level or degree of disregard for the consequences of the action or omission that caused the shortfall. The penalty for "gross carelessness" is 40 per cent of the tax shortfall involved.

5.4.4 "Abusive tax position"

The penalty for taking an abusive tax position is 100 per cent of the tax shortfall involved. This penalty is purportedly intended to deter taxpayers from entering into anti-avoidance arrangements. An abusive tax position has tax avoidance as a dominant purpose and as a result the penalty is based on an unacceptable tax position according to sections 141D(3) and 141D(7) of the NZ TA Act (166 of 1994).

There are several signs pointing to a possible dominant anti-avoidance purpose for a tax position or scheme. These signs include various markers such as indications of artificiality (fake transactions), contrivance, circularity (pooling) of funding, concealment of information and unreliable interpretations of the law (NZIR, 2012).

5.4.5 "Evasion"

Tax evasion in this framework involves evading an assessment or the payment of tax by the taxpayer's or on its (or another's) behalf. Examples of evasion will include the use of deducted taxes other than for its lawful purpose, and knowingly making an illegal deduction or to levy withholding tax. If a taxpayer knowingly obtains a refund that he is not lawfully entitled to or when someone enables someone else to obtain a refund knowing that the other person is not entitled to such a payment or refund, it is also seen as evasion (section 141E(1)(a) – (f) of the NZ TA Act (166 of 1994)). The penalty for evasion is 150 per cent of the resulting tax shortfall in terms of section 141E(4) of the NZ TA Act (166 of 1994). However before imposing a shortfall penalty, in cases like these consideration may be given to rather prosecute the evasion. According to the NZIR a taxpayer can be sentenced to a term of imprisonment of up to five years and/or a fine of up to NZ$50,000 (NZIR, 2012).

5.5 Conclusion

The question needs to be asked if the penalty percentages levied in South Africa are fair, compared to those in the AU, UK and NZ (other countries). Overall it appears that tax penalties in South Africa are broadly in line with those of other countries. For one, irrespective of the fact that different terminology is used by each country, in essence the taxpayer's behaviours taken into account for penalty levying are similar. However in South Africa most of these behaviours are not defined (refer to paragraph 3.2). Secondly, the penalty percentages for AU, the UK and NZ are more or less the same, except for NZ that has a higher maximum penalty of 150 per cent for tax evasion. In South Africa the penalty percentages are in line with these countries, with the exception that only South Africa and the UK provide for a 0 per cent penalty to be levied and that the maximum penalty in South Africa is 200 per cent for tax evasion (South Africa's crime and corruption statistics may be indicative for the reason why South Africa levy a 200 per cent penalty, it was however not compared to the other countries as it was not crucial for this study). However, comparing South African penalty percentages together with the behaviours that are not defined, South Africa is harsher than the other countries. South Africa can levy a 75 per cent penalty for not taking reasonable care, whereas the range for the other countries is between 0 per cent and 25 per cent, and in the case of gross negligence a 125 per cent can be levied in South Africa, whereas in the other countries the range is between 15 per cent and 50 per cent (refer to Table 3.1; Table 5.1; Table 5.2 and Table 5.3).

From an overview of the above chapter, it is clear that the TA Act (28 of 2011) in South Africa is still a very new act. In comparing South Africa penalty percentages to the above countries, it is clear that South Africa penalty percentages are harsh, levying the highest maximum penalty of 200 per cent compared to the other countries, with only New Zealand having a maximum penalty percentage of 150 per cent. It can be assumed, based on the fact that South Africa is a developing country and with that, has a developing economy, that these are the reasons for the high penalty percentages. The fact that the AU, UK and NZ has already tested and communicated the subject of penalty levying, whereas in South Africa only limited information has been communicated (paragraphs 3.2 and 3.3), sets these countries far ahead of South Africa when it comes to the penalty regime.

However, in South Africa the penalty levying system that was introduced in the TA Act (28 of 2011) was welcomed by many taxpayers, according to the Standing Committee on Finance: Report-Back Hearings on TAB (11 of 2011) (National Treasury, 2011:59). As from the enactment of sections 221 to 223 of the TA Act (28 of 2011), there are now set guidelines and measurements to determine the levying of an understatement penalty.

However, the fact must be considered that there are certain shortfalls in the TA Act (28 of 2011) penalty provisions, taking into account that most behaviours (in paragraphs 3.3 and 3.4) are not defined in the understatement penalty percentage table in section 223(1) of the TA Act (28 of 2011), which creates an endless discussion. Considering the above, there is clearly still room for improvements and amendments to the understatement penalty percentage provisions.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

The TA Act (28 of 2011) was enacted for purposes of consolidating all tax administrative provisions into one piece of legislation. In addition to achieving the abovementioned goal, the TA Act (28 of 2011) has provided some much needed guidance in the tax administration process, it has also addressed and moved a step into the right direction with regard to protecting taxpayers' right to administrative justice. However, the TA Act (28 of 2011) has unfortunately not been able to address controversial issues and criticism. In this study, specific emphasis was placed on the penalty levying regime under section 221 to 223 of the TA Act (28 of 2011), better known as the understatement penalty percentage provisions.

The main purpose of this exploratory research was to refine the understatement penalty percentage provisions in relation to the TA Act (28 of 2011) and to clarify certain issues relating to the treatment of tax penalties. In order to address these issues the research objectives included firstly the review of the pre-TA Act (28 of 2011) penalty provisions, including the use of the Hong Kong penalty table. Secondly, the aim was to evaluate the effectiveness of the regulations of the understatement penalty percentage provisions under the TA Act (28 of 2011), and to identify possible problems with the application and interpretation of the understatement penalty percentage provisions under the TA Act (28 of 2011). Thirdly, the understatement penalty percentage provisions under the TA Act (28 of 2011) and pre-TA Act (28 of 2011) penalty provisions were compared to foreign legislation and penal provisions. The comparative countries included the Hong Kong Special Administrative Region of China, Australia, the United Kingdom and New Zealand.

This chapter draws conclusions from the research objectives and provides recommendations to address the problem statement (refer to paragraph 1.2). Suggestions for future research are also offered.

6.2 Achievement of research objectives

In order to achieve the research objectives of this study, a literature review and comparative study were necessary to critically analyse and compare various pieces of legislation and precedents, including South African and foreign laws and legislation. Under the pre-TA Act (28 of 2011) penalty provisions, a matter of great concern was the fact that in the tax legislation and administrative provisions of the time, no set guidelines or rules existed to regulate the levying of additional taxes and penalties, and so inevitably the taxpayer enjoyed no proven administrative and constitutional justice. The objective with the literature review and comparative study was to refine the term "understatement penalty" and to clarify certain issues relating to the treatment of understatement penalty percentage provisions under the TA Act (28 of 2011) and pre-TA Act (28 of 2011) provisions.

The problem investigated in the study was to refine the understatement penalty percentage provisions under the TA Act (28 of 2011) and to clarify certain issues relating to the treatment of tax penalties. In order to determine if the research problem has been addressed, it firstly has to be determined if the individual research objectives have been met, which are as follows:

(i) To critically analyse various legislative provisions prior to the TA Act (28 of 2011) relating to the penalty levying under section 76 of the IT Act (58 of 1962) and section 60 of the VAT Act (89 of 1991), including the use of the adapted Hong Kong penalty table that had been adopted to assist the Commissioner in its decision-making.

- The literature review conducted in Chapter 2 revealed that the pre-TA Act (28 of 2011) penalty provisions were unfortunate in the sense that South Africa was obliged to impose a 200 per cent penalty. In addition, the Commissioner had the discretion to remit the additional tax as he deemed fit. The study revealed that SARS was vested with the powers to levy additional tax but no limitation to these powers existed. As a result, SARS was widely criticised for these vested powers to levy additional tax (refer to paragraph 2.2). In order to resolve any problems and to address the criticism received, certain SARS offices recognised the need for improvement and opted to make use of the non-legislated Hong Kong penalty table, to enable it to overcome the levying of unfair penalties (refer to paragraph 2.3).

It is clear from the literature study that the Hong Kong penalty table played a pivotal role in the development of the understatement penalty percentage table under the TA Act (28 of 2011).

(ii) To evaluate the effectiveness of the regulations of the understatement penalty percentage provisions under the TA Act (28 of 2011), and to identify possible problems with the application and interpretation thereof by the Commissioner.

- The literature review conducted in Chapter 3 revealed that certain behaviours referred to in the understatement penalty percentage table under the TA Act (28 of 2011), were not defined. These behaviours are "Reasonable care", "Reasonable grounds for tax position", "Gross negligence" and "Intentional tax evasion". The result is that the application thereof by SARS raises confusion. It is a known fact that not all parties will interpret behaviours and provisions in the same way. The literature review revealed that most of these behaviours could to an extent be defined by the application of case law, foreign law and publications on the interpretation of these behaviours by different countries.

  The study revealed that in the event of the levying of an understatement penalty, certain additional factors also have to be taken into account. These factors are referred to as "conducts" and are unfortunately also not defined. These include "Obstructive taxpayers" and "Standard cases". An effort was made by SARS to define the relevant behaviours and conducts with the publication of the SARS Short guide to the Tax Administration Act (SARS, 2012). Unfortunately, SARS failed to consider or incorporate the views of other countries and their application and interpretation of these behaviours and conducts. The literature study in Chapter 3 revealed that due to the fact that the TA Act (28 of 2011) is still in its infancy, future amendments and additions will without a doubt need to be made.

  However, it is worth mentioning that despite, the problems that may still exist under the new penalty regime as identified in this study, it is apparent that the enactment and application of the understatement penalty percentage provisions under the TA Act (28 of 2011) is a positive step in the right direction to provide the much-needed guidance to SARS officials.

(iii) To compare the understatement penalty percentage provisions under the TA Act (28 of 2011) and pre-TA Act (28 of 2011) penalty provisions to foreign legislation and penal provisions in order to find alternatives and possible improvements to the TA Act (28 of 2011). The comparative countries included the Hong Kong Special Administrative Region of China, Australia, the United Kingdom and New Zealand. It also addresses changes that were made to the Hong Kong penalty table since the adoption and how it compares to the penalty provisions in the TA Act (28 of 2011), in order to find alternatives and possible improvements to the penal provisions in the TA Act (28 of 2011).

- The literature review and comparative study conducted in Chapter 4 revealed that the pre-TA Act (28 of 2011) penalty provisions were set at levying a 200 per cent penalty. The study revealed that certain SARS offices recognised the problem of using a set percentage of 200 per cent and opted to use their discretion to implement the use of the Hong Kong penalty table to make provision for the possibility of levying a lesser penalty (Lombard, 2008). The literature review revealed that since the enactment of the TA Act (28 of 2011), the Hong Kong Special Administrative Region Inland Revenue Department has updated their penalty system, with harsher penalties compared to the previous Hong Kong penalty table. The literature study in Chapter 4 included a comparison between the understatement penalty percentage provisions under the TA Act (28 of 2011), the pre-TA Act (28 of 2011) penalty provisions and the Hong Kong penalty table. The literature review revealed that certain behaviours identified in Chapter 3 of the study that were not defined in the understatement penalty percentage provisions under the TA Act (28 of 2011) were defined in the Hong Kong penalty table. The penalty levying provisions are not the same when the different penalty percentages are compared (refer to paragraph 4.2). The Hong Kong Special Administrative Region Inland Revenue Department made provision for mitigating factors in levying a lesser penalty, which is not the case in the TA Act (28 of 2011). It was revealed that the current penalty regime in the TA Act (28 of 2011) is more harsh than the previously used Hong Kong penalty table (refer to paragraph 4.2).

The study revealed that it was clear that the Hong Kong penalty table played an important role in drafting the current understatement penalty percentage table in section 223 of the TA Act (28 of 2011). Therefore, the understatement penalty percentage provisions under the TA Act (28 of 2011) were further compared to the revised Hong Kong penalty table. The study revealed that the understatement penalty percentage provisions have now become more favourable than previously with regard to the fact that a maximum penalty of up to 260 per cent could be levied under the revised Hong Kong penalty table, and a commercial restitution penalty on top of the normal penalty has been introduced (refer to paragraph 4.3). However, the revised Hong Kong penalty procedures in essence remained unchanged when compared to the older Hong Kong penalty table version.

Despite the fact that the Hong Kong penalty table provided the much needed guidance for a revised penalty regime in South Africa, it is important to make mention that in Hong Kong there are documented cases where taxpayers have received the death penalty for tax evasion, according to the BBC News (2001) per Chinese news agency, Xinhua. How unfortunate these cases however might be, it is enlightening to know that the all-important issue of administrative justice entrenched in our constitution will in all cases have the final say, and will obviously play an important role for the further development of the understatement penalty percentage provisions under the TA Act (28 of 2011) further (refer to paragraph 4.2).

- The literature review conducted together with the comparative study in Chapter 5 revealed that the South African understatement penalty percentage provisions under the TA Act (28 of 2011) compared to the Australian, the United Kingdom and New Zealand (other countries) penalty provisions differ in more than one way from these countries. Findings in this chapter can be summarised as follows: Overall it appears that tax penalties in South Africa are broadly in line with the other countries. For one, irrespective of the fact that different terminology is used by each country, in essence the taxpayer's behaviours taken into account for penalty levying are similar. However, in South Africa most of these behaviours are not defined (refer to paragraph 3.2). Secondly, the penalty percentages for AU, the UK and NZ are more or less the same, with the exception of NZ, with a higher maximum penalty of 150 per cent for tax evasion. In South Africa the penalty percentages are in line with these countries with the exceptions that only South Africa and the UK provide for a 0 per cent penalty to be levied and that the maximum penalty in South Africa is 200 per cent for tax evasion. However, comparatively speaking, and taken together with the fact that the behaviours are not defined, South African penalty provisions are harsher. South Africa is levying the highest maximum penalty of 200 per cent compared to the other countries, with only NZ following with a maximum penalty percentage of 150 per cent. South Africa can levy a 75 per cent penalty for reasonable care, whereas the range for the other countries are between 0 per cent and 25 per cent, and in the case of gross negligence, a 125 per cent can be levied in South Africa whereas in the other countries the range is between 15 per cent and 50 per cent.

Based on the findings of the literature study from each chapter, the enactment of the understatement penalty percentage provisions under the TA Act (28 of 2011) on 1 October 2012 partially achieved the objective of providing taxpayers with a fairer penalty levying system compared to the pre-TA Act (28 of 2011) penalty provisions. However, it can be concluded that the TA Act (28 of 2011) has failed in providing proper guidance and measurements for levying an understatement penalty percentage under the TA Act (28 of 2011), especially because of the fact that certain behaviours are not defined therein, as well as the harsh accompanying penalty percentages. Therefore, owing to the achievement of the research objectives, it can be concluded that the research problem has been sufficiently addressed.

6.3 Recommendations

In order to address certain inherent flaws that were identified in section 221 to 223 of the TA Act (28 of 2011), the following recommendations are put forward:

- National Treasury needs to provide proper definitions for the following behaviours: "reasonable care", "no reasonable grounds for tax position taken", "gross negligence", "obstructive taxpayer", "tax evasion" and "standard case". These definitions should be benchmarked to other countries, case law and communicated publications.

- National Treasury needs to refine the understatement penalty percentage table in section 223 of the TA Act (28 of 2011), considering the penalty percentage levied linked to the relevant behaviour. The penalty percentages overall are in line with those of other counties, but if the percentages linked to the behaviours are considered, the understatement penalty percentage provisions are harsh.
- Proper guidelines and publications on the current and new penalty system in South Africa should be communicated to the general public by SARS. The use of the SARS website to launch a platform for frequently asked questions and answers with regard to the understatement penalty percentage provisions is strongly recommended.
- SARS's discretion to levy and remit penalties under the TA Act (28 of 2011) should be revisited, as SARS's discretion has been taken away or is very limited, compared to the pre-TA Act (28 of 2011) penalty provisions (Croome & Strydom, 2012).

6.4 Suggestions for future research

This study has identified numerous potential topics for future research:

- Considering the fact that the TA Act (28 of 2011) was enacted on 1 October 2012, a future study would be to establish from what date the understatement penalty percentage should be applicable. Based on the fact that the trigger for the understatement penalty percentage is when a tax return is filed, careful consideration should be given to tax returns that were filed before the commencement date of the TA Act (28 of 2011).
- Another future study would be to establish what tax rate to apply when dealing with losses in general, considering that an understatement penalty percentage is calculated by applying the applicable penalty percentage to the shortfall. Section 222(3)(*c*) of the TA Act (28 of 2011) ensures that a taxpayer in a loss position will be levied a penalty in the year the incident occurred, rather than to postpone the penalty to a year when the taxpayer is in a taxable position. If the prejudice to be corrected is the reduction of a loss, then the shortfall is the difference between the claimed loss and the corrected amount of the loss, multiplied by the maximum tax rate applicable to the taxpayer as determined by section 222(5) of the TA Act (28 of 2011). For

example, in the case of individuals, small business corporations and micro-businesses, consideration should be given to the maximum rate and what it will be.

- Another future study would be to determine if a "substantial understatement" penalty according to section 221 of the TA Act (28 of 2011) is determined by adding together all the categories of behaviours (refer to paragraph 3.3.1 for the definition and calculation).
- A future study is also necessary in the following matter: The term "repeat case" is defined under section 221 of the TA Act (28 of 2011), but what is not defined regarding a "repeat case" is whether it is a recurrence of any of the behaviours and not only a repeat of the same category of behaviour.
- Lastly, a future study would be appropriate of the case where an understatement penalty percentage is applied to amounts carried forward, meaning the amounts may not have an impact on the taxpayer's current year tax affairs (no loss to *fiscus*) but may have a impact on his future tax affairs based on a declaration made in a prior year (resulting maybe in a loss to the *fiscus*), e.g. in terms of retirement annuity contributions and medical scheme fee tax credits.

Based on the above, further research is therefore necessary to achieve a balance of fairness in the understatement penalty percentage provisions under the TA Act (28 of 2011).

6.5 Conclusion

The understatement penalty percentage provisions under the TA Act (28 of 2011) have introduced significant changes to the way in which penalties will in future be decided. The TA Act (28 of 2011) is still young, so the need for even further improvements and amendments to the current penalty levying exists. Despite this fact, it is clear that the understatement penalty percentage provisions will bring much needed transparency, objectivity and predictability to SARS's imposition of penalties with regard to any alleged wrongdoings by taxpayers in their tax affairs, compared to pre-TA Act (28 of 2011) penalty provisions.

However, even though the understatement penalty percentage provisions under the TA Act (28 of 2011) will provide the much needed guidance in terms of understatement penalty percentage levying in South Africa, the understatement penalty percentage provisions remain hash for the following reasons: For one, the fact that SARS still levies a 200% understatement penalty, compared to some foreign countries, is hash (paragraph 5.5). Secondly, the fact that most of the behaviours and conducts in the understatement penalty percentage table are not defined, together with the high accompanying penalty percentages, is harsh (paragraph 3.3 and 3.4). Thirdly, the behaviours and conducts of the taxpayer play a pivotal role in determining an understatement penalty. SARS does not provide any form of proper guidance or communication of the manner in which SARS will determine a taxpayer's behaviour or conduct (paragraph 3.3). Fourthly, the discretion for SARS to remit an understatement penalty percentage has been taken away, compared to the pre-TA Act (28 of 2011) penalty provisions (paragraph 3.5). It would seem that administrative justice had failed the taxpayers in terms of SARS's levying a fair understatement penalty percentage under the TA Act (28 of 2011). That said, the South African penalty regime will never be perfect for both SARS and its taxpayers, but the concept of determining a fair penalty is not asking for too much.

The focus of this study was to the refine the understatement penalty percentage provisions under the TA Act (28 of 2011) and to clarify certain issues relating to the treatment of tax penalties. It was determined in this study by evaluating the penalty provisions in other foreign countries and their application of their penalty provisions that the penalty provisions can indeed be refined in South Africa. The study also determined that the treatment of the tax penalties can also be clarified by addressing some issues in the understatement penalty percentage table. The issues included some behaviours that are not defined in the understatement penalty percentage table, together with the high accompanying penalty percentages. Secondly, there is the fact that the discretion of the Commissioner was repealed, compared to the pre-TA Act (28 of 2011) penalty provisions. Thirdly, there is an absence of consideration of any mitigating and aggravating factors that may result in a fairer penalty. And lastly, there is a lack of communication by SARS with taxpayers as regards the application of the understatement penalty percentage provisions. With reference to pre-TA Act (28 of 2011) legislation, foreign penalty policies, interpretation, rulings and foreign legislation, the issues can be clarified. Owing to the achievement of each of the research objectives (refer to paragraph 6.2), it can be concluded that the understatement penalty percentage provisions in South Africa can indeed be refined, and certain issues clarified.

Finally, the taxpayers of South Africa have been provided with penalty provisions that are clearer and more concise compared to pre-TA Act (28 of 2011) penalty provisions, and the hope exists that the government will still refine some of the understatement penalty percentage provisions under the TA Act (28 of 2011), in order for fair understatement penalties eventually to be levied.

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