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TAX ALERT

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PROPOSED CHANGES TO UNDERSTATEMENT PENALTY REGIME

The draft Taxation Administration Laws Amendment Bill, 2013 (TALAB) was released by the South African Revenue Services (SARS) on 5 July 2013 for public comment.

The TALAB proposes, amongst other things, that several amendments be made to the Tax Administration Act, No 28 of 2011 (TAA) in respect of understatement penalties.

We have previously discussed the mechanics of understatement penalties in the TAA in our Tax Alerts of 22 July 2011 and 5 October 2012. In terms of s222(1) of the TAA a taxpayer must pay an understatement penalty if that taxpayer has made or caused an 'understatement'. SARS has no discretion in imposing such a penalty.

The understatement penalty is a percentage based penalty determined with reference to the taxpayer's behaviour. In this regard a table in s223 of the TAA assigns a specific percentage to the relevant behaviour. In standard cases, the percentage ranges from a minimum of 25% to a maximum of 200%. Similarly, SARS has no discretion to reduce the applicable percentage where it has been determined that a taxpayer falls within a particular behavioural category.

The TALAB promises some relief to taxpayers subject to this rather harsh penalty regime.

Under the present provisions, a taxpayer must technically pay an understatement penalty where an honest mistake has resulted in an understatement, provided that the taxpayer's behaviour falls into an applicable category in the penalty table. For example, if a taxpayer has made an honest mistake and this resulted in a 'substantial understatement', the taxpayer would have to pay a 25% penalty. SARS has no discretion to not impose the penalty or to impose a penalty at a lower percentage.

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The TALAB proposes that an exception be introduced in respect of taxpayers who make or cause an understatement due to a '*bona fide* inadvertent error'.

A draft explanatory memorandum on the objects of the TALAB (memorandum) was released together with the TALAB. The memorandum explains that to determine whether an understatement was caused by a '*bona fide* inadvertent error', SARS will have regard to 'the circumstances in which the error was made', but also other factors including:

- the taxpayer's knowledge, education, experience, and skill;
- the size or quantum, nature and frequency of the error;
- whether similar errors were made previously; and
- in case of arithmetical errors, whether the taxpayer has procedures in place to detect such errors.

In respect of errors relating to the interpretation of tax laws, SARS will have regard to:

- the complexity of the provisions;
- whether the taxpayer tried to understand the provisions, including consulting the relevant explanatory memoranda or making reasonable enquiries; and
- whether the taxpayer relied on information (incorrect or misleading) which came from a reputable source and a reasonable person in the same circumstances would find the information complex.

The TALAB proposes further relief in the form of a reduction of some of the penalty percentages in the penalty table in s223 of the TAA.

In respect of standard cases, the new penalties are to be reduced as follows:

	Current penalty percentage	Proposed penalty percentage
Substantial understatement	25%	10%
Reasonable care not taken in completing return	50%	25%
No reasonable grounds for tax position taken	75%	50%
Gross negligence	100%	100%
Intentional tax evasion	200%	200%

The reasons provided in the memorandum for the reduction is to align the percentages with that of 'comparative tax jurisdictions where largely similar penalty regimes apply'.

In terms of s223(3), an understatement penalty imposed by SARS must be remitted where the taxpayer has fully disclosed particulars of the arrangement to SARS by no later than the due date of the relevant return, and the taxpayer was in possession of a tax opinion, which must meet certain requirements. One such requirement is that the tax opinion must have been issued by no later than the date that the relevant return was due.

The TALAB proposes that the said requirement must be deemed to have been met if the return was due by 1 October 2012. This implies that the taxpayer may rely on an otherwise qualifying opinion even if it was obtained after 1 October 2012, in respect of a matter where the taxpayer's return was due by that date.

The TALAB also now makes it clear that a taxpayer may indeed object against the imposition of an understatement penalty in terms of s224 of the TAA, and not only to the refusal by SARS to remit a penalty under s223(3) of the TAA.

A further clarification made by the TALAB is that the term 'understatement' is now defined as any prejudice to SARS or the fiscus, irrespective of the tax period in which the prejudice manifests. For example, a taxpayer cannot argue that an understatement did not cause prejudice to SARS in the relevant tax year because the taxpayer was in an assessed loss position that year. If the assessed loss would have been reduced had the understatement not been made, and SARS would only have been prejudiced in a future year, it would still be an 'understatement'.

The TALAB proposes that the above amendments apply retrospectively, with effect from the commencement date of the TAA (being 1 October 2012).

Specifically, in this regard, taxpayers on whom SARS has imposed understatement penalties at the current higher rates should insist that SARS reduce the rates in accordance with the TALAB.

Taxpayers are also afforded a further opportunity to obtain qualifying tax opinions to request remittance of understatement penalties in respect of substantial understatements.

Heinrich Louw

SARS CONFIDENTIAL INFORMATION: TOO CONFIDENTIAL?

The draft Taxation Administration Laws Amendment Bill, 2013 (TALAB) released on 5 July 2013 has extended the definition of 'SARS confidential information' to include information relating to the auditing procedures or methods used by SARS in a tax assessment.

Section 67 of the Tax Administration Act, No 28 of 2011 (TAA) contains a general prohibition on disclosure of certain information, including 'SARS confidential information'. Essentially, the secrecy of 'SARS confidential information', defined under s68(1) of the TAA, must be preserved and it may only be disclosed to another person if disclosure is necessary for performance of a function under the relevant section. SARS officials are required to make a solemn declaration to uphold the secrecy of such information.

Presently, the definition of 'SARS confidential information' includes, personal information about SARS employees, information supplied by a third party to SARS, information that could be damaging to the economic interests or financial welfare of South Africa or certain security information related to SARS buildings. Section 30 of the TALAB proposes an amendment to the definition of 'SARS confidential information' contained in s68(1) of the TAA, to include as confidential information: "information relating to the examining or auditing procedure or method used by SARS, the disclosure of which could reasonably be expected to jeopardise the effectiveness thereof".

Therefore, this amendment would result in SARS not having to provide taxpayers with reasons for their determination of an assessment amount or the method behind the calculation which resulted in the tax amount assessed, should such disclosure jeopardise the effectiveness thereof. Essentially, it appears that SARS is seeking the power to refuse to provide the taxpayer with the procedural steps taken to arrive at the total on a tax assessment. The reason for such a refusal, when requested by the taxpayer, would then undoubtedly be that disclosure of audit or examination methods used to arrive at the assessment would jeopardise the effectiveness of such assessment in the hands of SARS.

The Short Guide to the Tax Administration Act, 2011 (Short Guide), dated 5 June 2013, provides that one of the objects of the TAA is "to promote a better balance between the powers and duties of SARS and the rights and obligations of taxpayers and to make this relationship more transparent". The Short Guide reveals that international experience has demonstrated that if taxpayers perceive and experience the tax system as fair and equitable, they will be more inclined to fully and voluntarily comply with it.

The proposed amendment to s68(1) of the TAA seems to fly in the face of SARS's intentions for transparency and fairness. On the contrary, it results in decreasing the rights of the taxpayer with regard to requests for information or reasons and withholds information necessary for expedient resolution of tax disputes.

The TALAB is still in draft form and public comments have not yet been considered. We hope that SARS will be swayed to consider revising the amendment of s68(1) of the TAA, bringing it in line with their goal of building a tax system with which taxpayers will be more inclined to fully and voluntarily (if not happily) comply.

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