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TAX ALERT

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UNDERSTATEMENT PENALTY: WHEN CAN SARS POTENTIALLY ALLEGE 'GROSS NEGLIGENCE' OR 'INTENTIONAL TAX EVASION'?

The Tax Administration Act, No 28 of 2011 (TAA) introduces the 'understatement penalty' in Chapter 16.

Section 223 contains an 'understatement penalty percentage table'. According to the SARS Short Guide on the TAA (Guide) the penalty will be determined by locating each case within the table that assigns a percentage to objective criteria. SARS carries the onus of proving that the grounds exist for imposing the understatement penalty.

In a previous article we considered the two 'behaviours', being 'reasonable care not taken in completing return' and 'no reasonable grounds for 'tax position' taken'.

This article looks at the behaviours of 'gross negligence' and 'intentional tax evasion'.

In analysing the above-mentioned concepts we again refer to the Australian Tax Office's (ATO) guidance in Miscellaneous Tax Ruling (MT 2008/1) which deals extensively with the meanings of 'reasonable care, recklessness and intentional disregard'.

Meaning of 'gross negligence'

The Guide (par 16.5.5) states that 'gross negligence' "...essentially means doing something in a way that, in all circumstances, suggests or implies complete or a high level of disregard for the consequences. The test ... is objective and is based on what a reasonable person would foresee as being conduct which creates a high risk of a tax shortfall occurring. Gross negligence involves recklessness but, unlike evasion, does not require an element of *mens rea*, meaning wrongful intent or 'guilty mind', or intent to breach a tax obligation."

Whereas the TAA uses the concept of 'gross negligence', the ATO in MT 2008/1 refers to 'recklessness'. In content the two concepts overlap.

According to MT 2008/1 'recklessness' assumes that the relevant behaviour shows disregard of or indifference to a risk that is foreseeable by a reasonable person. It refers to the comments of Cooper J in *BRK (Bris) Pty Ltd v. Federal Commissioner of Taxation [2001] FCA 164; 2001 ATC 4111; (2001) 46 ATR 347* (at paragraph 77):

- "Recklessness in this context means to include in a tax statement material upon which the Act or regulations are to operate, knowing that there is a real, as opposed to a fanciful risk that the material may be incorrect, or be grossly indifferent as to whether or not the material is true and correct, and a reasonable person in the position of the statement-maker would see there was a real risk that the Act and regulations may not operate correctly to lead to the assessment of the proper tax payable because of the content of the tax statement. So understood the proscribed conduct is more than mere negligence and must amount to gross carelessness."

In the case of *Shawinigan Ltd v. Vokins & Co Ltd [1961] 2 Lloyd's Rep 153 at 162; [1961] 1 WLR 1206 at 1214; [1961] 3 All ER 396,* Megaw J noted that the degree of the risk and the gravity of the consequences needed to be weighed, in deciding whether conduct is reckless. Each case has to be considered on its particular facts and not by reference to any formula.

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In *Hart v. FC of T (2003) 131 FCR 2003; [2003] FCAFC 105* the question was whether deductions for aircraft expenses had been disallowed properly because the activities did not constitute the carrying on of a business. On appeal the Full Federal Court found the claim to the tax deduction to be so tenuous that it was only explicable on the basis of gross negligence in propounding the claim. No subjective enquiry as to whether the tax agent had actual knowledge that the statement was false was needed: the facts objectively analysed spoke for themselves. A reasonable tax agent would have foreseen the significant risk that the claim for the deduction was highly likely to involve an incorrect application of the law. In the circumstances, disregarding this risk equalled recklessness.

Meaning of 'intentional tax evasion'

The Guide points out (at paragraph 16.5.6) that this behaviour attracts the most severe penalty. It states that "The most important factor is that the taxpayer must have acted with intent to evade tax." The Guide acknowledges, though, that intention may, at times, be difficult to distinguish from an act that is grossly negligent.

MT 2008/1 points out that the adjective 'intentional' requires something more than reckless disregard of or indifference to a taxation law.

Whereas an objective test applies to determine whether there has been a lack of 'reasonable care' or that 'recklessness' was present, the test for intentional disregard is purely subjective in nature. The actual intention of the taxpayer is therefore crucial.

Intentional disregard requires actual knowledge on the taxpayer's part that the statement made is false. To establish this, the taxpayer must understand the effect of the relevant tax provision and how it applies to him/her/it and, furthermore, make a deliberate choice not to comply. It follows that dishonesty is a requirement of behaviour reflecting an intentional disregard for the operation of the law. However, dishonesty is not a feature in instances revealing an absence of 'reasonable care' or where 'recklessness' is present.

Evidence of the taxpayer's intention should be found through direct evidence or by inference from all the surrounding circumstances, including the taxpayer's conduct (refer *Weyers v. Federal Commissioner of Taxation [2006] FCA 818; 2006 ATC 4523; (2006) 63 ATR 268).*

Conclusion

In respect of a 'standard case' the TAA penalty percentage table imposes a 100% penalty in respect of gross negligence. A 150% penalty applies where SARS can show intent to evade.

In light of these high penalty percentages, it is necessary that SA taxpayers understand what hurdles SARS must jump first before it can slot a taxpayer into these categories on the TAA penalty matrix.

Johan van der Walt

NEW BINDING PRIVATE RULING (BPR 141) - TRANSFERS FROM UNTAXED POLICY HOLDER FUNDS

The South African Revenue Service (SARS) issued a new Binding Private Ruling (BPR) on 28 March 2013 on the "Transfer of Securities from an untaxed policyholder fund of a long term insurer to an untaxed policyholder fund of another long term insurer."

The ruling deals with whether the transfer of securities from an untaxed policyholder fund (UPF) of one long term insurer to a UPF of another long term insurer will be exempt from securities transfer tax (STT) in terms of s8(1)(a)(iii) of the Securities Transfer Act, No 25 of 2007 (STT Act) as part of a restructuring in terms of s45 of the Income Tax Act, No 58 of 1962 (Act).

The applicant and co applicant were both registered long term insurance companies, residents of South Africa and wholly owned subsidiaries of Holdco.

The proposed transaction was as follows:

- Holdco would transfer the business of the applicant to the co-applicant in terms of s38 of the Long Term Insurance Act, No 52 of 1998 and the business of the applicant would be transferred at net asset value on loan account to the co-applicant under s45 of the Act.
- The transfer would include the transfer of securities from the UPF of the applicant to the UPF of the co applicant.

SARS ruled that no STT will be imposed or levied on the transfer of securities from the applicant to the co-applicant despite the fact that s45 of the Act is precluded from applying to the transfer if assets to be held in a UPF in terms of s41(3) of the Act.

This binding private ruling is valid for a period of two years.

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