DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

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REMISSION OF UNDERSTATEMENT PENALTIES UNDER THE TAX ADMINISTRATION ACT

The ability to request remission for, or object to, the imposition of understatement penalties, in terms of the Tax Administration Act, No 28 of 2011 (TAA), has been severely curtailed and could see taxpayers left with no remedies at all.

In our Tax Alert of 5 October 2012, we discussed the provisions relating to understatement penalties contained in Chapter 16 of the TAA. The understatement penalty provisions replaced the provisions of s76 of the Income Tax Act, No 58 of 1962 (ITA) and s60 of the Value-Added Tax Act, No 89 of 1991 in terms of which the South African Revenue Service (SARS) had an open-ended discretion to impose additional tax of up to 200%, which was subject to reduction having regard to the surrounding circumstances of the case.

An 'understatement' is defined in s221 of the TAA as any prejudice to SARS or the *fiscus* in respect of a tax period as a result of default in rendering a return, an omission from a return, an incorrect statement in a return, or failure to pay the correct amount of tax where no return is required. A 'substantial understatement' is defined as any case where the prejudice to SARS or the *fiscus* exceeds the greater of 5% of the amount of tax properly chargeable or refundable under a tax act, or R1 million.

The penalty in respect of an understatement is percentage based and is determined with reference to the following table contained in s223 of the TAA.

1. Item	2. Behaviour	3. Standard Case	4. If obstructive, or if a 'repeat 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%

continued

Assuming one is dealing with a 'standard case', SARS would simply determine in which category (items (i) to (v) of the table) the understatement falls in order to determine the applicable penalty percentage.

Where the understatement is not a 'substantial understatement', and items (ii) to (v) do not apply, the understatement penalty will be zero. This would be the case where a voluntary disclosure has been made to SARS.

However, where the understatement is a 'substantial understatement', and items (ii) to (v) do not apply, then an understatement penalty of 25% will apply. In fact, SARS has no discretion but to impose the penalty if the requirements are met.

In the latter case, a taxpayer may request that SARS remit the penalty in terms of s223(3) of the TAA. However, the taxpayer must have:

- made full disclosure of the arrangement giving rise to the prejudice by no later than the date the relevant return was due; and
- been in possession of an opinion by a registered tax practitioner, which opinion was issued no later than the relevant return date, which took account of the specific facts and circumstances of the arrangement and *confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court*.

Therefore, in order to have any chance of firstly making a request to remit an understatement penalty, a taxpayer must comply with both requirements of s223(3) of the TAA. If any one requirement missing, a taxpayer may not request a remission of the understatement penalty where a 'substantial understatement' is applicable. Where the requirements of s223(3) of the TAA have been met, the taxpayer is then given a specific right to object and appeal (s224 of the TAA) if the decision to remit was not in its favour.

The request for remission option is not available to a taxpayer where any other category, other than 'substantial understatement' applies. If SARS entertains a request for remission and exercises a favourable discretion, it is highly likely that SARS will be acting *ultra vires*.

But what about the normal avenues of objection and appeal against an understatement penalty where a penalty is imposed for anything other than a 'substantial understatement'?

Regarding the general dispute resolution provisions, s104 of the TAA, relating to objection and appeal against an assessment or decision, provides that a taxpayer who is aggrieved by an assessment may object to such assessment. 'Assessment' is defined in s1 of the TAA as a determination of the amount of *tax liability* or refund, by self-assessment or assessment by SARS. Section 221 of the TAA defines 'tax', for purposes of Chapter 16 only, as excluding penalties and interest. It appears that s104 of the TAA also does not provide for objection against an understatement penalty imposed under s223 of the TAA as the definition of 'tax' excludes penalties and interest. It is therefore debatable whether an understatement penalty determination by SARS is an assessment subject to objection and appeal under normal principles.

It would seem then that where a taxpayer is dissatisfied with the determination by SARS as to which item in the table is applicable, other than a 'substantial understatement', the taxpayer will likely have to make use of review proceedings under the Promotion of Administrative Justice Act, No 3 of 2000.

Of particular concern in terms of s223(3) of the TAA is the requirement that an opinion by a tax practitioner under s223(3) must provide that the taxpayer's position will more than likely be upheld if it proceeds to court. Many opinions merely state that the taxpayer has a reasonable argument in justifying a particular position taken. This becomes problematic where no opinion was obtained prior to entering into an arrangement which is now the subject of an understatement penalty and specifically where this arrangement was entered into before s223(3) was enacted. The transitional provisions indicate that the TAA is presumed to operate as if the provisions were in force at the time the arrangement was entered into.

This situation is potentially problematic and it remains to be seen what the extended practical implication will be.

Ruaan van Eeden and Danielle Botha

TAXES ON INCOME AND SUBSTANTIALLY SIMILAR TAXES FOR PURPOSES OF SOUTH AFRICA'S TAX TREATIES BINDING GENERAL RULING (INCOME TAX) NO. 9 (ISSUE 2)

Binding General Ruling 9 (BGR9), dated 19 February 2013, deals with the taxes administered by SARS that equate to taxes on income or substantially similar taxes for purposes of South Africa's tax treaties.

There has always been a debate as to whether dividends tax was or could be regarded as constituting a similar tax for tax treaty purposes that has now been clarified in BGR9.

BGR9 sets out the South African Revenue Service's (SARS) view on:

- the taxes that constitute taxes on income or similar taxes for purposes of South Africa's tax treaties; and
- the issue of whether dividends tax constitutes a tax covered under South Africa's tax treaties, (which has subsequently replaced STC) being imposed after tax treaties have already been entered into and signed.

The Ruling

In terms of BGR9, the following taxes are essentially covered by a treaty, namely:

- Normal tax on taxable income, which includes a taxable capital gain.
- Withholding tax on royalties, a final tax payable by non residents on income derived from royalties or similar payments.
- Withholding tax on interest (effective 1 July 2013).
- Tax on foreign entertainers and sportspersons.
- Turnover tax on micro businesses.
- STC (repealed 1 April 2012).
- Dividends tax

Background to STC and Dividends Tax

STC

STC was repealed as of 1 April 2012 and has been replaced by dividends tax. Generally, STC was not regarded as a tax on dividends but fell under business profits and therefore no limit on the STC levied by South Africa could be imposed. Usually the treaty will apply to any identical or substantially similar taxes, and that was one of the reasons for the demise of STC which was held not to be a similar tax to any other.

In terms of *Volkswagen of South Africa (Proprietary) Limited v C:SARS 70 SATC 195*, the South African resident was a wholly owned subsidiary of a German holding company in Germany who sought to argue that the withholding tax was a similar tax to STC and sought to obtain an effective rate of 7,5% under the Article 7 (business profits) of the double taxation agreement (DTA) between Germany and South Africa as opposed to the 12,5% paid on the dividend by the South African subsidiary. The court viewed STC as a tax on the company declaring the dividend and not a tax on the recipient shareholders. The court held that STC was not similar to a withholding tax and therefore it was not a tax on dividends as contemplated in the tax treaty and fell outside the ambit of Article 7 of the DTA.

Dividends Tax

Dividends tax came into effect on 1 April 2012. Essentially dividends tax will apply in respect of a dividend declared and paid on or after 1 April 2012. The dividends tax provisions differentiate between a dividend (being a regular dividend) and a dividend consisting of a distribution of an asset *in specie*, for example a share. Dividends tax will be levied at a rate of 15% of the amount of any dividend paid by a company. Where a regular dividend is paid or becomes payable, the liability for dividends tax is on the beneficial owner of the dividend in terms of s64EA of the Income Tax Act, No 58 of 1962. Where a dividend *in specie* is declared it will fall on the company paying the dividend.

BGR9 dealt with the issue of whether dividends tax is covered by South Africa's tax treaties as a covered tax. In terms of BGR9, dividends tax will be viewed as a covered tax under South Africa's tax treaties and BGR9 applies with effect from 19 February 2013 for an indefinite period of time.

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