DLA CLIFFE DEKKER HOFMEYR

TAX

ALERT

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IN THIS ISSUE

REASONABLE CARE IN COMPLETING TAX RETURNS

Judgement was handed down in the case of *Harding v Revenue and Customs Commissioners* [2013] UKUT 575 (TCC) in the Upper Tribunal (Tax and Chancery Chamber) on 15 November 2013. The case revolved around the question of whether an omission by a taxpayer of a severance payment in his tax return amounted to a 'careless mistake' in terms of the United Kingdom Finance Act, 2007 (UK Finance Act).

Background

The Appellant held a senior position in a company forming part of a leading accounting practice. He entered into a compromise agreement with his employer whereby his contract of employment was terminated and he received approximately £110,000.00 in severance payments (payment). The amount included performance-related bonuses in relation to his work. The Appellant omitted to include this payment in his tax return. However, his previous employer submitted a tax return to Her Majesty's Revenue and Customs (HMRC), which included the payment. Consequently, he was assessed by HMRC and a penalty was imposed on him for careless inaccuracy in his return due to the understatement of his income.

First-tier Tribunal

The Appellant appealed against the penalty to the First-tier Tribunal (FTT) on the grounds that his failure to include the payment in his return was not careless, as he genuinely believed that the payment would not be subject to tax because it was made after the termination of his employment. The Appellant's employment was terminated on 31 October 2008 and his payment was only received later in November 2008. In support of his argument, the Appellant submitted evidence regarding an article from a tax website purportedly stating that severance payments such as the one received by him, were not taxable when they were paid after termination of employment.

The FTT dismissed the appeal stating that they were satisfied that the Appellant entertained considerable doubt as to whether the amount was in fact taxable, but failed to take steps to ascertain the correct position. Furthermore, there was no evidence that the Appellant took appropriate advice from an independent source or the HMRC.

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Upper Tribunal

The Appellant subsequently appealed to the Upper Tribunal.

The Upper Tribunal examined the article on which the Appellant relied as well as the compromise agreement entered into with his employer and found that:

- The compromise agreement contained a paragraph headed "Taxation" which provided that the first £30,000.00 of the payment was not subject to tax, but that any remaining balance shall be subject to deductions in respect of tax at the appropriate rate.

- The article made it clear that any payment received in connection with the termination of employment is taxable, but that in some circumstances the first £30,000.00 of such payment is tax free.

The Upper Tribunal consequently held that the decision of the FTT be upheld for the following reasons:

- The Appellant admitted that he considered that the payment was possibly subject to tax.

- The Appellant is an intelligent person, who held a senior position in a company forming part of an accountancy practice. It was not credible to propose that he could conclude that there was no possibility of the payment being taxable.

- The self-assessment the Appellant made contained an inaccuracy which led to an understatement of his liability to tax. That inaccuracy was careless, since it was due to the failure of the Appellant to take reasonable care.

- The Appellant failed to take reasonable care because he knew, or should reasonably have known, that there was at least a possibility that the payment was liable to tax.

Relevance for South African taxpayers

Schedule 24 to the UK Finance Act contains provisions largely similar to those of the Tax Administration Act, No. 28 of 2011 (TAA) in that it provides that a penalty may be levied on an understatement of tax liability, where the understatement was the result of an inaccuracy in a return due to a failure by the taxpayer to take 'reasonable care'. 'Reasonable care' implies that the taxpayer knew or should reasonably have known that the given outcome could occur.

S223 of the TAA contains the understatement penalty percentage table. In terms of item (ii) of the table, where reasonable care was not taken in completing a return, a penalty percentage of 15% must be applied in respect of standard cases, and 50% where the taxpayer's behaviour has been 'obstructive' or if the matter was a 'repeat case'.

In a South African context, in determining whether 'reasonable care' was taken, one would test the conduct in question against the objective criterion of the reasonable person. This means that conduct will be seen as negligent, or that reasonable care was not taken, if it is not in accordance with the conduct expected of the reasonable person who finds himself in the same situation. Conduct will be negligent where the reasonable person would have acted differently under the same circumstances, in that he would have reasonably foreseen the consequences of his actions, and taken steps to avoid such consequences. This test was laid down in *Kruger v Coetzee* 1966 (2) SA 428 (A).

If the facts in the Harding case were to be tested against the TAA, and the 'reasonable person' test was applied, then it is submitted that the South African Tax Court would likely have come to the same conclusion as that reached by the Upper Tribunal.

One could however speculate whether the same set of facts would be considered by the South African Revenue Service (SARS) to fall within the ambit of item (iv) of the penalty percentage table,

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being 'gross negligence'. Generally the 'reasonable person' test is also applied when testing for gross negligence, however, in terms of SARS's Short Guide to the TAA, gross negligence calls for a disregard of the consequences of one's actions and recklessness.

Conceivably, SARS could consider such an omission on a return as 'intentional tax evasion' in terms of item (v) of the penalty percentage table. However, the concept of intention generally requires a person to direct his will at achieving a particular result while being aware that the conduct in question is wrongful (*Dantex Investment Holdings (Pty) Limited v Brenner* 1989 (1) SA 390). SARS's Short Guide to the TAA describes intention in terms of item (v) of the table as 'acting wilfully or with a guilty mind'.

The relevance of the Harding case for South African taxpayers is that the fact that one genuinely believes that a particular tax position is correct will not absolve one from penalties where reasonable steps were not taken to make sure that the position taken is indeed correct. It is therefore crucial that taxpayers obtain the necessary tax advice, especially in circumstances where the facts raise some doubt.

Danielle Botha

INTERNATIONAL TAX TRANSPARENCY: THE NEED FOR AUTOMATIC EXCHANGE OF INFORMATION

In recent years, the international tax environment has seen an increase in the global drive towards greater financial transparency and the automatic exchange of financial information, which replaces the earlier standard of information exchange on request.

The standard of exchanging information automatically calls on jurisdictions to obtain information from financial institutions and to exchange that information automatically with other jurisdictions on an annual basis to detect, deter and discourage offshore tax abuses.

South Africa plays a leading role in the global movement towards transparency and the exchange of information in tax matters to ensure fairness in the international tax system and to prevent the erosion of the international tax base. To this end, on 8 February 2013, the National Treasury and the South African Revenue Service (SARS) announced that negotiations with the United States of America's (USA) Department of the Treasury had commenced, with the aim of entering into an inter-governmental agreement in respect of the USA's Foreign Account Tax Compliance Act (FATCA).

By way of background, FATCA is a USA law, enacted in 2010 to combat offshore tax evasion and to recoup much needed revenues. FATCA therefore requires non-USA foreign financial institutions and non-USA non-financial entities to identify and disclose their USA account holders and members or become subject to a new 30% USA withholding tax.

Accordingly, once the inter-governmental agreement is signed into law, the USA Treasury will view South African financial institutions, such as custodial institutions, depository institutions, investment entities and specified insurance companies (unless

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they present a low risk of being used for evading tax), as being generally compliant with FATCA. Furthermore, once the inter-governmental agreement takes effect, the relevant financial institutions in South Africa will be required to obtain information on USA citizens and to report such information to SARS, which will in turn exchange the information with the USA in accordance with the relevant provisions of the double taxation agreement entered into between South Africa and the USA.

To cater for the automatic exchange of specified information by financial institutions, SARS has proposed a business requirement specification (BRS) which will regulate the systematic and periodic transmission of taxpayer information by the source country to the residence country.

To give effect to the requirement to provide information for purposes of FATCA, SARS has published two draft public notices in terms of s26 and s29 of the Tax Administration Act, No. 28 of 2011 (TAA), which requires a return as specified in the BRS, and s30 of the TAA, which requires the record keeping of this information. The closing date for comments to the draft public notices is 6 June 2014.

Although there is a global drive and indeed a global need for the automatic exchange of information, the *onus* of implementing such a reporting structure lies not so much with the relevant revenue authority but rather with the selected financial institutions as the financial institutions will have to ensure that the mechanism of the reporting process is fully understood and synchronised with its existing reporting requirements.

It will be interesting to see how financial institutions develop the necessary systems and frameworks to facilitate its reporting obligations to mitigate its reputational risk and risk of financial penalties.

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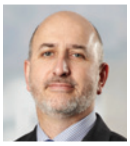

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