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TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

THE PRICE IS NOT RIGHT: ADVERTISING AND THE VAT ACT

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WHEN IS AN ERROR A *BONA FIDE* INADVERTENT ERROR?

On 4 November 2016 judgment was handed down by the Tax Court of South Africa (held in Cape Town) in the matter of *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service*, Case number ITI13772.

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Facts

The complainant, Munian, lodged a consumer complaint against a print advertisement for safety gear clothing sold by the respondent, Over-All Gear CC. The respondent's advertisement featured different ranges of security uniforms, reflective jackets, safety boots and conti suits. At the bottom of the advertisement it stated, among other things, "PRICES VALID UNTIL STOCKS LAST. PRICES EXCLUDING VAT". The complainant objected to the fact that the advertised prices excluded VAT. The respondent submitted, among other things, that it was a registered VAT vendor, is charged VAT in all processes of manufacture or purchasing of stock and is therefore entitled to charge VAT on its prices. For these reasons, the respondent's advertising clearly indicated that its prices exclude VAT, meaning that there could be no confusion. In support of this argument, the respondent made reference to other safety wear companies that excluded VAT and provided a copy of its VAT registration documentation from SARS.

Ruling of the ASA Directorate

In terms of clause 19.4 of section II of the ASA's Advertising Code of Practice (Code), s64 and s65 of the VAT Act have to be considered. Section 64(1) of the VAT Act states that any price charged by a vendor for a taxable supply shall for purposes of the VAT Act be deemed to include any VAT that is to be levied on such supply in terms of s7(1)(a). Section 65 of the VAT Act states that any price advertised or quoted by a VAT vendor must include VAT and the vendor must state in the advertisement or quote that the price includes VAT, unless the total amount of VAT in terms of s7(1)(a), the price excluding tax and the price inclusive of tax are advertised or quoted. Importantly, s65 goes on to state that if the VAT vendor decides to advertise or quote the VAT, the price exclusive of VAT and the price inclusive of VAT separately, both prices must be advertised or quoted with equal prominence and impact.

In its ruling, the ASA Directorate referred to its decision in Republic Bus & Truck/W Heckroodt/18961 (2 February 2012), where SARS had clarified, among other things, that the practice of only reflecting a price excluding VAT on an advertisement does not comply with the requirements of s65 and that it is not permissible to quote the price excluding VAT and have a statement that VAT has been excluded. In light of the above authority, the ASA Directorate found that the mere inclusion of a statement to the effect that "prices exclude VAT" is not compliant with the provisions of the VAT Act, which in

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In its Ruling, the ASA Directorate noted that the practice of the respondent in this case appears to be relatively widespread in the respondent's industry, but that it cannot impose the Ruling on other advertisers as it can only act on complaints against one advertiser at a time.

turn means that such advertising contravenes clause 19.4 of section II of the Code. The fact that the respondent is registered for VAT and is entitled to charge VAT is not relevant to this enquiry.

The ASA Directorate therefore upheld the complaint and made the following order:

- the advertising must be withdrawn;
- the process to withdraw the advertising must be done with immediate effect on receipt of the Ruling;
- the withdrawal of the advertising must be completed within the deadlines stipulated by Clause 15.3 of the ASA's Procedural Guide, which states that the time within which an advertisement must be withdrawn depends on where the advertisement appeared e.g. newspapers, radio etc; and
- the advertising may not be used in its current format.

Comment

In its Ruling, the ASA Directorate noted that the practice of the respondent in this case appears to be relatively widespread in the respondent's industry, but that it cannot impose the Ruling on other advertisers as it can only act on complaints against one advertiser at a time. Taxpayers who are making use of this practice should therefore take heed of this Ruling and amend their advertising accordingly, so as to prevent themselves from being hauled before the ASA at a later stage. Although s58 of the VAT Act does not list the abovementioned practice as an offence for which a taxpayer could pay a fine or face imprisonment, a taxpayer could suffer reputational damage if it is found to have contravened this provision of the VAT Act and the issue becomes public.

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WHEN IS AN ERROR A *BONA FIDE* INADVERTENT ERROR?

The focus of this article is whether the South African Revenue Service (SARS) was correct to levy an understatement penalty in the circumstances.

A "bona fide inadvertent error has to be an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive".

On 4 November 2016 judgment was handed down by the Tax Court of South Africa (held in Cape Town) in the matter of *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service*, Case number ITI13772.

In this case the court had to consider whether the taxpayer, ABC Holdings (Pty) Ltd, was entitled to claim a deductible allowance of enhancement income of R9,354,458.00 received in terms of a contract for future expenditure in terms of s24C of the Income Tax Act, No 58 of 1962 (Act) for its 2011 year of assessment. The other issue that arose in this case and which is the focus of this article, was whether the South African Revenue Service (SARS) was correct to levy an understatement penalty in the circumstances.

The facts of this matter, briefly, are that the taxpayer conducts the business of administering and managing retirement villages and their frail care centres. It claimed the s24 allowance in its 2011 year of assessment. Subsequently, SARS conducted an audit during January 2014 and notified the taxpayer that the s24C allowance was incorrectly claimed by the taxpayer. As a result of the disallowance by SARS, the taxpayer was held liable for the income tax payable on the above amount as well as an understatement penalty in the amount of R261,924.80.

After the court found that the taxpayer was not entitled to claim a deduction in terms of s24C, it had to consider whether SARS was correct in levying an understatement penalty in terms of the provisions of s222 and s223 of the Tax Administration Act, No 28 of 2011 (TAA). The taxpayer submitted that the understatement arose as a result of a *bona fide* inadvertent error, contemplated in s222(1), in which case no understatement penalty would be payable by the taxpayer. In considering whether the understatement penalty arose due to a *bona fide* inadvertent error, the court noted that the taxpayer was assisted by Mr E of LL Accountants and that a tax opinion was obtained from a Professor T, which was attached to the notice of objection and in which Prof T concluded that the s24C allowance could be claimed.

In terms of s221 of the TAA, an "understatement" means any prejudice to SARS in respect of a tax period as a result of a default in rendering a return, an omission for a return, an incorrect statement in a return, or failure to pay the correct amount of tax where no return is required. Such understatement penalty would not be payable if it arose due to a *bona fide* inadvertent error, as stated in s222(1). As the TAA does not define the meaning of the phrase "*bona fide* inadvertent error" the court considered the dictionary meaning of these words. It concluded from these dictionary meanings that a "*bona fide inadvertent error has to be an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive*".

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The court held, however, that there was merit in excusing the taxpayer for its reliance on Prof T's opinion on the basis of it being lay on issues of tax and the law and therefore ordered that the understatement penalty be remitted.

The court found that on the facts of the present matter, there was no doubt that the taxpayer had acted in good faith and with no intention to deceive. Since Prof T had gone as far as interpreting case law on the interpretation of contracts, some of which was relied on by the taxpayer's counsel in his argument, it could have given the impression that his interpretation of s24C would more than likely be upheld in court. It could therefore be argued that Prof T strayed into offering a legal opinion, which would make the taxpayer's argument less plausible. The court held, however, that there was merit in excusing the taxpayer for its reliance on Prof T's opinion on the basis of it being lay on issues of tax and the law and therefore ordered that the understatement penalty be remitted.

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BBBEE STATUS: LEVEL THREE CONTRIBUTOR
Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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