Tax Administration – Understatement penalties before 1 October 2012

The promulgation of the Tax Administration Act No. 28 of 2011 (the TAA), which came into effect on 1 October 2012, brought into effect a basis for the imposition of penalties in respect of "understatements". An understatement arises where a return is not submitted, amounts are omitted from or deductions are erroneously claimed in a return submitted to SARS.

The understatement penalty is a percentage-based penalty applied to the "shortfall". The shortfall is defined in the following terms in section 222(3):

> *"(3) The shortfall is the sum of–*
> *(a) the difference between the amount of 'tax' properly chargeable for the tax period and the amount of 'tax' that would have been chargeable for the tax period if the 'understatement' were accepted;*
> *(b) the difference between the amount properly refundable for the tax period and the amount that would have been refundable if the 'understatement' were accepted; and*
> *(c) the difference between the amount of an assessed loss or any other benefit to the taxpayer properly carried forward from the tax period to a succeeding tax period and the amount that would have been carried forward if the 'understatement' were accepted, multiplied by the tax rate…"*

Prior to 1 October 2012, the various acts that imposed taxes contained their own rules for the imposition of penalties. With the advent of the TAA, these were repealed.

Issues concerning the imposition of understatement penalties

have arisen as a result of the original assessment after 1 October 2012 of returns filed with SARS prior to 1 October 2012 or adjustments made after 1 October 2012 as a result of audits of assessments issued in respect of returns filed before
1 October 2012 (which assessments may have been issued before 1 October 2012).

Taxpayers have argued three fundamental issues regarding these penalties.

- First, the issue of additional assessments was made after 1 October 2012, but the audit or investigation relating to the understatement had been completed before that date, and they should therefore have been subject to the penalty regime under the relevant tax act that applied before
1 October 2012.
- Secondly, they submitted the returns at a time when the law did not expose them to the penalty regime now in place, and therefore were unable to avail themselves of certain safeguards afforded in the TAA.
- Thirdly, the TAA does not contain provisions for remission of the penalty for understatement if there were extenuating circumstances, whereas provisions in the Income Tax Act No. 58 of 1962 (the Act), prior to their repeal by the TAA, had made such provision.

SARS, to its credit, has recognised the inequity of this switch in penalty regimes and has sought to provide for a more equitable basis for the transition from the previous legislation to the new legislation through amendments incorporated in the Tax Administration Laws Amendment Act No. 39 of 2013 (the TALAA), which came into effect on 16 January 2014. The relevant amendments were made retroactive to 1 October 2012.

The relevant amendments were effected to section 270, which

provided for the transition from the previous legislation to the current legislation.

Delay in issuing additional assessments

Section 270(6) was substituted and section 270(6A) was inserted by the TALAA to deal with this issue. Section 270(6)(*a*) provides that additional tax, penalty or interest which could have been imposed but for the repeal of the relevant provisions in the tax act may be imposed as if the relevant provisions in the tax act had not been repealed if the additional tax, penalty or interest "would have been capable of being imposed".

Section 270(6A) provides that an amount is regarded as having been capable of being imposed if "the verification, audit or investigation necessary to determine the additional tax, penalty or interest had been completed before the commencement date of this Act" (i.e. before 1 October 2012).

Substantial understatement relief

The first issue raised was that a penalty for a "substantial understatement" may be remitted in full if, prior to the date for filing of a return, the taxpayer was in possession of an opinion of a registered tax practitioner that stated that it was more likely than not that the filing position adopted by the taxpayer would be upheld if the issue were to proceed to court on appeal. Taxpayers argued that they would have availed themselves of that facility had they been aware of it at the time they filed their return.

The amendment, found in section 270(6B), provides that the requirement that an opinion was obtained timeously is regarded as having been met. The Explanatory Memorandum to the Tax Administration Laws Amendment Bill, 2013 (the TALAB), explains the position in the following terms:

"One of the requirements for remittance is that the taxpayer must be in possession of an opinion by a registered tax

practitioner, regarding the arrangement in issue that was issued by no later than the date that the relevant return was due.

As a taxpayer submitting a return before commencement of the Act was not aware of this requirement at that time, this amendment will enable taxpayers seeking remittance of a “substantial understatement penalty” in respect of an understatement made before the commencement date of the Act, to use an opinion obtained after the relevant return was submitted.”

Taxpayers objecting to penalties imposed in respect of a substantial understatement may therefore retroactively avail of this concession by obtaining an opinion from a registered tax practitioner if the circumstances are appropriate.

Extenuating circumstances
Under the Act, prior to 1 October 2012, the penalty that could be imposed for understatement was, in the discretion of the Commissioner, an amount equal to twice the tax payable. In addition, the additional tax charge could be remitted by the Commissioner in whole or in part if the Commissioner was satisfied that there were extenuating circumstances, and provided that there was no intention to evade tax.

The amendment to the Tax Administration Act (the TAA), contained in section 270(6D), provides relief in respect of an understatement penalty that has been imposed on a return filed before 1 October 2012. A taxpayer may object to the penalty (whether or not objection has been made against the assessment in question). If the return was required under the Act, a senior SARS official, if satisfied that there are extenuating circumstances, must, in considering the objection, remit the penalty in whole or in part.

Practically, where an objection against the assessment has already been filed and a taxpayer wishes to object to the

penalty by raising extenuating circumstances, the secondary objection must be filed manually with SARS, as the e-filing system is not configured to handle the additional or secondary objection to the assessment.

Welcome relief

The amendments to section 270 of the TAA are most welcome and bring a touch of sanity and realism to the resolution of inequities that would otherwise have arisen.

Cliffe Dekker Hofmeyr
TAA: Sections 222, 270
Explanatory Memorandum to the TALAB, 2013