The understatement penalty regime in terms of the Tax Administration Act 28 of 2011

By

Prishni Chetty

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Student number: u16008562

UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA
Faculty of Law

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Biographical information of student	
Student #	16008562
Title	Ms
Surname	Chetty
Initial(s)	P
Registered for the: LLM / MPhil (coursework) ◉ : or LLM / MPhil ○ : or LLD / PhD ○	
Email	prishni30@gmail.com
Mobile phone #	0727479714

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Co-supervisor	*Head of Department* Phumudzo Munyai — Digitally signed by Phumudzo Munyai Date: 2023.10.23 11:32:45 +02'00'

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ABSTRACT

The principal goal of penalties is based on a simple premise, namely that the threat of punishment deters unwanted behaviour (i.e., non-compliance and tax evasion). The purpose of the understatement penalty ("**USP**") regime under the Tax Administration Act, 28 of 2011 ("**TAA**") is to encourage voluntary compliance and deter unwanted behaviour such as non-compliance and tax evasion. Thus, the purpose of the understatement penalty regime is not to raise money for the *fiscus*, but rather to ensure taxpayer compliance.[1]

As a result of the absence of a clear definition of the meaning of the phrase "*bona fide* inadvertent error", taxpayers are subjected to an inconsistent application of the criteria by SARS officials that could result in subjectivity and the imposition of understatement penalties in situations where it is not applicable.

Included in the definition of 'tax' are penalties (including USPs in terms of section 221). The constitutionality of the USP regime is yet to be raised and disputed by a taxpayer in the Constitutional Court, however, the question arises as to whether, having regard to the purpose of the USP regime as well as the burden of proof, it is reasonable and justifiable for SARS to levy USPs which become due and payable when an assessment is issued before SARS can actually satisfy its burden of proof?

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[1] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.

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ABBREVIATIONS

ITA	Income Tax Act
ITC	Income Tax Case
CC	Constitutional Court
CGT	Capital Gains Tax
PAJA	Promotion of Administrative Justice Act
TAA	Tax Administration Act
USP	Understatement Penalty
VDP	Voluntary Disclosure Programme
SA	South Africa
SARS	South African Revenue Service
SCA	Supreme Court of Appeal

Chapter 1: Introduction, overview of research and chapter exposition

1.1 Introduction

The South African tax system contains various penalties. The SARS Short Guide to the Tax Administration Act[2] (the "**SARS Short Guide**") states that the principal goal of penalties is based on a simple premise, namely that the threat of punishment deters unwanted behaviour (i.e., non-compliance and tax evasion). It stands to reason that if the most probable punishment outweighs the prospect of a tax benefit, a rational person will not undertake the activity that may result in such a punishment.[3]

The purpose of the understatement penalty ("**USP**") regime under the Tax Administration Act, 28 of 2011 ("**TAA**") is to encourage voluntary compliance and deter unwanted behaviour such as non-compliance and tax evasion.[4] Thus, the purpose of the understatement penalty regime is not to raise money for the *fiscus*, but rather to ensure taxpayer compliance.[5] It is interesting to note that in the 2022 fiscal year, penalties were included in 'Non-tax revenue', which amounted to *circa* R45,169 billion. This included mineral royalties of R14,2 billion, but also income from certain mining leases *etc.* collected by the South African Revenue Service ("**SARS**").[6] Thus, there is a likelihood that the amount of penalties collected by SARS exceeds the amount of mineral royalties. It is clear that the USP regime provides SARS with a significant amount of income, although the main purpose of the regime is not to raise revenue.[7]

SARS may impose an understatement penalty pursuant to the provisions of section 222 of the TAA in the event of an 'understatement'. If there is an 'understatement', SARS needs to consider whether the understatement results from a "*bona fide* inadvertent error". If SARS establishes that the understatement is as a result of a "*bona fide* inadvertent error", then that is the end of the inquiry, and SARS may not impose an understatement penalty. However, in the

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[2] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018.
[3] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 75.
[4] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 3.
[5] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[6] SARS Release of the 15th Annual Edition of Tax Statistics dated 3 march 2023 available at: https://www.sars.gov.za/media-release/release-of-the-15th-annual-edition-of-tax-statistics/#:~:text=Total%20tax%20revenue%20collected%20by,%2F13%20to%202017%2F18.
[7] SARS' revenue statistics do not separately disclose how much penalties they have imposed. Absence the assistance of data, it is difficult to make assessments of the statistics.

absence of a "*bona fide* inadvertent error", SARS needs to identify the appropriate behaviour, as set out in the table contained in section 223 of the TAA, under which a taxpayer's conduct is alleged to fall into.[8]

Section 222(2) provides that a USP is determined with reference to the highest applicable percentage in accordance with the table contained in section 223, which takes into account, firstly, the "behaviour" of the taxpayer. The table sets out six behaviours, ranging from the lowest to the highest penalties:

i. Item (i): 'Substantial understatement';
ii. Item (ii): Reasonable care not taken in completing return;
iii. Item (iii): No reasonable grounds for 'tax position' taken;
iv. Item (iv) 'Impermissible avoidance arrangement';
v. Item (v) Gross negligence; and
vi. Item (vi) Intentional tax evasion

The percentage of each behaviour then increases depending on whether the behaviour was a "Standard case" or if it was an "…obstructive, or if it is a 'repeat case'". The table also allows for a reduced percentage where there has been "Voluntary disclosure after notification of audit or criminal investigation" and "Voluntary disclosure before notification of audit or criminal investigation". In some instances, this penalty can even be remitted to zero.

It appears as though categories (ii) to (vi) require a level of blameworthiness. If this is the case, then the question arises as to whether a "*bona fide* inadvertent error" exclusion could still apply for behaviours other than to a "substantial understatement".[9] SARS seemingly answers the question of whether a "*bona fide* inadvertent error" has been committed by asking "…*whether reasonable care had been taken in completing the return*."[10] SARS is of the view that the only errors that can be said to be *bona fide* are involuntary typographical mistakes. All other errors are, according to SARS, based on a "…bona fide incorrect reasoning, or an opinion incorrectly interpreted without the intention to deceive…", however, "…*the payment, non-payment, or*

[8] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[9] Pinch, 2023 "What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?" available at: ENSafrica - News - What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?.
[10] Pinch, 2023 "What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?" available at: ENSafrica - News - What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?.

incorrect statement itself cannot be said to be validly unmeant."[11] The distinction between these phrases is important in the context of a Voluntary Disclosure Programme ("**VDP**") application as it is a requirement that the disclosure must involve a listed behaviour contained in the table in section 223.[12]

In terms of section 223(3)(b), SARS must remit a 'penalty' imposed for a 'substantial understatement' if the taxpayer had an opinion which was issued by an independent registered tax practitioner that complies with the following requirements:

i. *"it was issued by no later than the date that the relevant return was due;*
ii. *it was based upon full disclosure of the specific facts and circumstances of the arrangement;*
iii. *in the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance provisions of a tax Act, the taxpayer must be able to demonstrate that all of the steps in or parts of the arrangement were fully disclosed to the tax practitioner, whether or not the taxpayer was a direct party to the steps or parts in question; and*
iv. *confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court."*

herein referred to as a "**section 223 opinion**".

Section 222(1) of the TAA directs that a taxpayer 'must' pay a USP in the event of an 'understatement' - unless there has been a *bona fide* inadvertent error. It can, therefore, be argued that section 222(1) effectively means that SARS has no discretion to impose an understatement penalty if there is an 'understatement' as defined, provided that SARS has ruled out a *bona fide* inadvertent error.[13] It is, therefore, imperative to understand what a *bona fide* inadvertent error means, how it can be proved that the taxpayer has committed a *bona fide* inadvertent error and to know who bears the burden of proving that there has or has not been a *bona fide* inadvertent error.

[11] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 17.
[12] Pinch, 2023 "What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?" available at: ENSafrica - News - What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?.
[13] van Zyl "The new understatement penalty regime: A sharp 'sword'?" (2014) Journal of Economic and Financial Science, vol.7, no.3 at p 906.

Recently, our courts have considered SARS' onus to prove the understatement penalties that it imposes. The main issues in these cases have been what would constitute proof of a *bona fide* inadvertent error and under what circumstances SARS may assume *male fides*. In *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service*,[14] the tax court held that:

> "*… the 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*."[15]

The SARS Guide to Understatement Penalties ("**SARS USP Guide**") prefers a very narrow interpretation and states as follows:

> "*An inadvertent error is one that does not result from deliberate planning, and a bona fide inadvertent error is one that genuinely does not result from deliberate planning. Importantly, the lack of deliberate planning must relate to the error, that is, the default, omission, incorrect statement, failure to pay the correct tax, or impermissible avoidance arrangement must be genuinely involuntary*."[16]

The SARS USP Guide indicates that:

> "*If the act or omission of the taxpayer is not encapsulated in any of the listed behaviours, there is no basis for the determination of a penalty and consequently there can be no penalty*."[17]

The High Court in the matter of *Lance Dickson Construction CC v Commissioner for the South African Revenue Service*[18] confirmed the principle that SARS bears the onus of proving the behaviour which it alleges. The High Court found that the court *a quo* (the Tax Court) had erred in confirming the USP imposed by SARS of 25 per cent for the reason that SARS could not prove the factual basis for the imposition of the penalty when the taxpayer challenged its determination in the Tax Court. The High Court found that SARS could not prove behaviour

[14] *ABC (Pty) Ltd v Commissioner for the South African Revenue Service* (ITI13772) [2016] ZATC 7 (4 November 2016).
[15] *ABC (Pty) Ltd v Commissioner for the South African Revenue Service* (ITI13772) [2016] ZATC 7 (4 November 2016) at 45.
[16] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 16.
[17] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 17.
[18] *Lance Dickson Construction CC v The Commissioner for the South African Revenue Service* (A211/2021) [2023] ZAWCHC 12 (31 January 2023).

(ii) and that the court was not competent to make a determination on behaviour (iii) because SARS did not allege this behaviour.[19]

In the matter of *Commissioner for the South African Revenue Service v Thistle Trust,*[20] a judgment by the Supreme Court of Appeal ("**SCA**"), SARS conceded that the understatement by the Thistle Trust was as a result of a "*bona fide* inadvertent error". This was because the Thistle Trust had relied on an independent legal opinion and believed, in good faith, that its view was correct. The Thistle Trust was, thus, alleviated from paying the USP. The court found that SARS had correctly conceded that the understatement was as a result of a "*bona fide* inadvertent error" and for this reason, SARS had no basis to impose the USP.[21]

In a recent SCA matter of *Commissioner for the South African Revenue Service v Coronation Investment Management SA (Pty) Ltd,*[22] the taxpayer placed reliance on an independent legal opinion which it did not disclose to SARS. Due to the non-disclosure of the opinion, SARS drew a negative inference that the opinion was not in support of the position taken by the taxpayer. For this reason, SARS contended that the understatement was not as a result of a *bona fide* inadvertent error. The SCA held that for SARS to speculate that a tax opinion does not align with the taxpayer's position for the mere reason that the taxpayer did not disclose the opinion to SARS, is not sufficient to attribute *male fides* on the part of the taxpayer.[23] The court, therefore, held that SARS' claim for USPs must fail.[24]

The cases as mentioned above, illustrate the principle that the onus of proving USPs lies on SARS. SARS is required to prove the factual basis for the determination of USPs and should it fail to do so, it will have no basis, either in fact or law, to levy USPs.[25] It is not entirely clear, however, who bears the burden of proving whether a *bona fide* inadvertent error has or has not been committed.

[19] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[20] *The Commissioner for the South African Revenue Service v The Thistle Trust* (516/2021) [2022] ZASCA 153; 2023 (2) SA 120 (SCA).
[21] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[22] *The Commissioner for the South African Revenue Service v Coronation Investment Management SA (Pty) Ltd* (1269/2021) [2023] ZASCA 10.
[23] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[24] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[25] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.

1.2 Research problem and research questions

The purpose of the TAA is to, *inter alia,* provide for the imposition of understatement penalties. The question arises as to what constitutes sufficient proof for SARS to levy a USP and whether the current process that SARS is required to follow in order to levy a USP would muster constitutional scrutiny.

In the SCA judgment of *Purlish Holdings v The Commissioner for the South African Revenue Service*,[26] the SCA laid out the burden of proof to be discharged by SARS when imposing understatement penalties as follows:

> "*In terms of section 102(2) of the TAA, the burden of proving the facts on which SARS based the imposition of an understatement penalty rests on SARS. Furthermore, the Tax Court is, in terms of section 129(3) of the TAA, enjoined to decide an appeal against an understatement policy on the basis that the burden of proof is upon SARS. Given the aforesaid burden of proof, I am inclined to find merit in the appellant's contention that <u>SARS must not only show that the taxpayer committed the conduct set out in items (a) to (d) of the definition of 'understatement' in s[ection] 221 of the TAA, but also that such conduct caused it (SARS) or the fiscus to suffer prejudice</u>*." (own emphasis)

An "understatement" is defined in section 221 of the TAA in items (a) to (e) to mean "…*any prejudice to SARS or the fiscus as a result of —*

(a) failure to submit a return;

(b) an omission from a return;

(c) an incorrect statement in a return;

(d) if no return is required, the failure to pay the correct amount of 'tax'; or

(e) an 'impermissible avoidance arrangement'."

[26] *Purlish Holdings v The Commissioner for the South African Revenue Service*· (76/18) [2019] ZASCA 04.

Therefore, based on the judgment of the SCA in the *Purlish* case, in order to prove the facts on which an understatement penalty is based, SARS bears the onus of proof regarding:

1. the taxpayer's conduct set out in items (a) to (e) of the definition of "understatement" in section 221 of the TAA; and

2. the prejudice to SARS or the *fiscus* as a result of the taxpayer's conduct.

Van Der Walt states that the SCA concluded in the *Purlish* case that in the context of USPs, prejudice to SARS is "*…not only determinable in financial terms but, that in the specific circumstances of the case, additional resources allocated to and time spent by SARS' employees to understand the affairs of a taxpayer…"* also constitutes prejudice to SARS.[27]

The SARS USP Guide defines "*bona fide*" as "*genuine*" and "*real*".[28] According to Khaki, this refers to a "*…sincere, honest intention or belief and represents the mental and moral state regarding the truth. The opposite of good faith is bad faith (mala fide) and this may involve intentional deceit*."[29]

The terms "*bona fide*" and "inadvertent *error*" are not defined in the ITA or the TAA, therefore, consideration must be given to the ordinary meaning of the words.

"*Bona fide*" means "*in good faith*" and according to the Oxford Dictionary means "*without deception*" or "*genuine*".[30]

"Inadvertent", according to the Oxford Dictionary, refers to that which is "*not done deliberately or intentionally*".[31] According to Khaki, this "*…refers to a state in which a consequence might have arisen from an act or omission which was never intended to arise*."[32]

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[27] van Der Walt, 2019 "Sars is Quite Sensitive (to 'Prejudice')" available at: https://www.polity.org.za/print-version/sars-is-quite-sensitive-to-prejudice-2019-03-28.

[28] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 15.

[29] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf; Raath "Die Mala Fides van Administratiewe Organe Twee Belangwekkende Beslissings in Bophuthatswana" (1983) Journal for Juridical Science, vol. 8, no. 1 at p 84.

[30] Hornby (2020) Oxford Advanced Learner's Dictionary (5th Ed.); Oxford learners Dictionary "Bona fide" available at: https://www.oxfordlearnersdictionaries.com/definition/american_english/bona-fide#:~:text=genuine%2C%20real%2C%20or%20legal%3B,member%20of%20the%20team%20now; Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.

[31] Hornby (2020) Oxford Advanced Learner's Dictionary (5th Ed.); Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.

[32] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.

"*Error*" in this context refers to an outcome which is objectively incorrect.[33] If a subjective interpretation to error is to be applied, the use of the term "*error*" in addition to "*inadvertent*" would be a tautology.[34]

Based on the definitions of the words as set out above, should there be an understatement which results from an unintentional mistake on the part of the taxpayer and such mistake was made honestly and did not involve intentional deceit, SARS will not be entitled to impose the understatement penalty as the relevant understatement would have been made as a result of a "*bona fide* inadvertent error".[35]

In *79 SATC 62*,[36] a judgment given by the Tax Court in Cape Town on 4 November 2016, the court adopted the following approach regarding the meaning of the term *bona fide* inadvertent error:[37]

> *"According to the Oxford Dictionary the origin of the word 'bona fide' is Latin and literally means 'with good faith'. The word is also defined as 'genuine'; 'real'; 'without intention to deceive'. 'Inadvertent' is defined as 'not resulting from' or 'achieved through deliberate planning'. The Merriam-Webster online dictionary gives the following as some of the synonyms for the word inadvertent: 'accidental' 'unintentional', 'unintended', 'unpremeditated', 'unplanned' and 'unwitting'. Error is defined by the Oxford Dictionary as 'a mistake'. It also gives the following synonyms: 'the state or condition of being wrong in conduct or judgement'.*
>
> *It follows from the above that the 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."*[38] (own emphasis)

In order to establish and discuss the purpose of the research I analyse the following:

a) What is the purpose of the USP regime in South African tax law?

[33] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[34] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[35] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[36] *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* 79 SATC 62.
[37] *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* 79 SATC 62 at 44 - 45.
[38] *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* 79 SATC 62 at 77 – 78.

b) When can SARS impose a USP?
c) What is the interplay of section 129 of the TAA and the onus on SARS to prove the behaviour which it alleges?
d) Who bears the burden of proving a "*bona fide* inadvertent error"?
e) How can it be proven that there has been a "*bona fide* inadvertent error"?
f) How can it be proven that there has not been a "*bona fide* inadvertent error"?
g) Can a "*bona fide* inadvertent error" exclusion still apply for behaviours other than a "substantial understatement"?
h) Does the USP regime infringe upon constitutionally protected rights?
i) If the USP regime does infringe upon constitutionally protected rights, is the infringement justified?
j) Are there less restrictive ways to achieve the purpose of the USP regime?
k) Is it justified for a tax debt (which includes a USP) to be due and payable without SARS having discharged its onus?

1.3 Methodology

This study follows a qualitive documentative approach. In order to evaluate whether or not the current legal framework of the USP regime is effectively structured to achieve its purpose of encouraging voluntary compliance and deterring unwanted behaviour such as non-compliance and tax evasion, it is imperative to understand the current landscape of the USP regime. This is done by looking at the onus SARS has to discharge to prove the necessity of an imposition of a USP. I look at the possible responses from a taxpayer upon the imposition of an understatement penalty.

Once the legal framework of the USP regime is set out, I discuss the constitutionality of the USP regime with reference to SARS' burden of proof and the rights of a taxpayer. SARS may impose a USP in an additional assessment without having proven its case. This tax debt, which includes the USP amount, immediately becomes due and payable upon the issuance of the additional assessment. This begs the question of whether SARS has discharged its onus of proving the USP which it alleges.

Lastly, the research reflects on the current laws and makes recommendations on possible solutions and remedies.

1.4 Outline

Chapter 1:

This first chapter provides a brief overview of the research topic and the motivations for the study. The context of the USP regime is set out and from this context I introduce the research questions.

Chapter 2:

This chapter mainly provides an analysis of the USP regime, including the purpose of the regime. It also looks at the onus of proof that lies on SARS to prove the behaviour which it alleges.

Chapter 3:

This chapter looks at the possible responses from a taxpayer upon the imposition of an understatement penalty. *Inter alia*, I look at the meaning of a *bona fide* inadvertent error and a request for suspension of payment.

Chapter 4:

In this chapter, I discuss the constitutionality of the USP regime with reference to the burden of proof and the rights of a taxpayer. I consider if the USP regime infringes on any taxpayer's rights and if this infringement is justified.

Chapter 5:

The final chapter reflects on the findings of this study and concludes the research of this study.

Chapter 2: The purpose and operation of the USP regime

2.1. Introduction

In this Chapter the purpose of the USP regime in South African tax law is discussed. I look at when SARS is entitled to impose a USP and under what circumstances a court may vary a USP rate imposed by SARS.

2.2. What is the purpose of the USP regime in South African tax law?

There are two main objectives of taxation: i) to provide for the financing of public expenditure and ii) to accomplish numerous socio- economic and political objectives such as the redistribution of resources and economic growth.[39]

Tax collection and tax administration go hand in hand.[40] The commission of inquiry into Certain Aspects of the Tax Structure of South Africa (the "**Katz Commission**") highlighted the importance of having good tax administration:[41]

> "*[t]ax policy and tax administration are inextricably linked to tax administration. The Commission in its deliberations has been constantly mindful of the limitations which administratively capacity inevitably place on the scope for adaptions to the tax system, and of the considerable value to the fiscus and the economy of competent and efficacious tax administration. It is apparent, for example, that ... without a good tax administration, tax law and policy cannot be given practical effect*."

The TAA incorporates all the generic administrative procedures into a single Act.[42] Section 2 of the TAA sets out the purpose of the TAA as being to ensure the effective and efficient collection of Tax as defined in section 1 of the TAA (which includes penalties). The purpose is achieved by:[43]

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[39] Legwaila (2020) Tax Law: An Introduction (2nd Ed.) at p 8; Croome (2010) Taxpayer's Rights in South Africa (1st Ed.) at p 3.
[40] Croome & Olivier (2015) Tax Administration (2 Ed.) at p 4 - 5.
[41] The Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa at 3.1.1.
[42] Croome & Olivier (2015) Tax Administration (2 Ed.) at p 3.
[43] Section 2(1) of the TAA.

(a) *"aligning the administration of various tax Acts*[44] *as far as possible;*

(b) *prescribing the rights and obligations of taxpayers and other persons to whom the TAA applies;*

(c) *prescribing the powers and duties of persons engaged in the administration of a tax Act; and*

(d) *generally giving effect to the objects and purposes of tax administration*."

The long title of the TAA states that one of the purposes of the TAA is to provide for the imposition of understatement penalties. The South African tax system contains various penalties. The SARS Short Guide states that the principal goal of penalties is based on a simple premise, namely that the threat of punishment deters unwanted behaviour (i.e. non- compliance and tax evasion).[45] It stands to reason that if the most probable punishment outweighs the prospect of a tax benefit, a rational person will not undertake the activity that may result in such a punishment.[46]

To reflect the purpose of the USP regime, all actions and inactions that have the potential to trigger understatements are ones that negatively affect the submission or content of a return.[47] This includes:[48]

i. "*a default in rendering a return;*

ii. *an omission from, or an incorrect statement in a return;*

iii. *the failure to pay the correct amount of tax when a return is not required; or*

iv. *an impermissible avoidance arrangement*."

It is possible to have more than one of these actions or inactions in a particular tax period. For each action or inaction that causes prejudice to SARS or the *fiscus*, the resultant prejudice is an understatement.[49]

SARS will levy a USP in an assessment based on an estimate where a person fails to submit a return as required or submits a return or information that is incorrect or inadequate. The

[44] excluding customs and excise legislation.
[45] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 75.
[46] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 75.
[47] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80.
[48] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80.
[49] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80.

prejudice that the action or inaction causes does not need to be actual financial loss. If the term "prejudice" was restricted to actual financial loss, an understatement would not occur if it was discovered before the tax or refund was payable. The main emphasis of the USP regime is the deterrence of non-compliant tax behaviour. The regime is intended to address the negative effects of unwanted tax behaviour which is not limited to financial prejudice. For every action or inaction as the case may be, the prejudice is quantified by a shortfall to determine the understatement.[50]

SARS states that for administrative penalties to be effective, the following according to international best practice is fundamental:[51]

i. "*Sanctions must be* ***easily understood*** *by taxpayers and must be easily applied, determined and certain in their outcome;*

ii. ***Certainty****, the perceived probability of being penalised or caught, must exist in the mind of the taxpayer; and*

iii. *A* ***discretionary judgment*** *(within prescribed consistent limits) in imposing sanctions must only be required where non-compliance is based on negligence or intent*."

The above is in line with the cornerstones of a good tax system which are equality, simplicity and certainty and convenience.[52] SARS does not have a discretion to impose USPs. If certain criteria are met, SARS is obliged to levy a USP. The question, thus, arises as to what SARS envisaged as a "discretionary judgment" in imposing sanctions where non-compliance is based on negligence or intent.

In the light of the above requirements for effective penalties, the now repealed section 76 of the ITA which granted SARS an open-ended discretion to impose "additional tax" of up to 200 per cent in the event of default or omission by the taxpayer and to reduce the additional tax if it was determined that there were extenuating circumstances, was replaced by sections 221 – 224 of Chapter 16 of the TAA which some authors believe to be a more equitable and consistent framework for understatement penalties.[53]

[50] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80.
[51] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 75.
[52] Smith (1776) An enquiry into the Nature and Causes of the Wealth of Nations at chapter 2.
[53] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80; Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 1.

Croome and Olivier[54] describe the purpose of sanctions such as penalties by reference to the following extract from RK Gordon in Tax Law Design and Drafting:[55]

> *"Sanctions are perhaps one of the most over relied-upon, and poorly understood tools for enhancing tax compliance. Sanctions can also have more than one purpose. First, the most important component of sanctions is their ability to deter unwanted behaviour, so as to bring about greater compliance. Therefore, sanctions should be applied only to behaviour that is reasonably capable of being deterred. Second, sanctions must be fair under the jurisprudential criteria in effect in a particular jurisdiction. Under the jurisprudential principles of most jurisdictions, this means that sanctions should apply only when the sanctioned person is somehow at fault and should not be unduly harsh or disproportional, or imposed in violation of principles of due process".*[56]

The first purpose as set out by RK Gordon (i.e., to deter unwanted behaviour) is in line with the purpose as set out in the SARS Short Guide. RK Gordon is of the view that deterring unwanted behaviour encourages greater compliance and for this reason, a penalty can only be imposed for behaviours that are capable of being deterred. Tax compliance can be described as "*…the degree to which taxpayers, along with intermediaries like practitioners, meet their legal obligations*."[57]

This brings about the question as to what behaviours can be deterred? Does the meaning of a *bona fide* inadvertent error have anything to do with whether a behaviour is capable of being deterred? Pinch is of the view that:

> "*On the basis that categories (ii) to [(vi)] seem to require a level of blameworthiness, it seems that the "bona fide inadvertent error" exclusion would be most (if not only) relevant in relation to a "substantial understatement*"."

Perhaps this is what SARS envisaged as a 'discretionary judgement' in imposing sanction where non-compliance is based on negligence or intent.[58]

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[54] Croome & Olivier (2015) Tax Administration (2 Ed.) at p 473.
[55]Thuronyi, 1996 "Tax Law Design and Drafting, Volume 1" available at https://www.imf.org/en/Publications/Books/Issues/2016/12/30/Tax-Law-Design-and-Drafting-Volume-1-1550.
[56]Thuronyi, 1996 "Tax Law Design and Drafting, Volume 1" available at https://www.imf.org/en/Publications/Books/Issues/2016/12/30/Tax-Law-Design-and-Drafting-Volume-1-1550.
[57] Bornman & Stack "Rewarding Tax Compliance: Taxpayer's Attitudes and Beliefs" (2015) Journal of Economic and Financial Sciences, vol 8, no. 3 at p 792.
[58] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 75.

It is interesting to note that RK Gordon is of the belief that penalties should only be applied to behaviours that are capable of being deterred. In other words, there should be no penalty for a *bona fide* error. The SA USP regime provides a defence for taxpayers in the event of a "*bona fide* inadvertent error". Whether or not this is a sufficient and fair defence to the imposition of a USP is explored further in Chapter 3.

Croome and Olivier raise the concern that in a South African context, penalties are imposed primarily as a means of raising revenue and not for the intended purpose, which is to deter non-compliance and encourage compliance with the law.[59] SARS, in its annual reports and Tax Statistics, makes no distinction between the amounts collected as tax revenue and the portion that compromises of additional tax, penalties and USP. As a result of the globular figures, it cannot be ascertained by the general public what portion of the total tax collected represents USPs imposed for the violation of the tax laws of South Africa.[60]

The Davis Tax Committee confirmed the importance of building a good tax administrative system. The Davis Committee raised a concern regarding the incentivisation of SARS employees (including the Commissioners for SARS) as follows:[61]

> "*The incentivisation system in which gross tax collections are treated as a major indicator of good performance should be stopped as there is a perception that it foster corruption and abuse of the system.*"

The fact that an incentivisation system in which gross tax collections, including the collection of USPs, is treated as a major indicator of good performance has the potential for fostering corruption and abuse of the limited discretionary power entrusted in SARS officials in suspending the payment of a USP and remitting a penalty.[62]

Croome and Olivier are of the view that penalties should not be regarded as 'normal' for SARS but should only be imposed in situations where the imposition of the penalty will encourage taxpayers to comply with the law. SARS should not summarily impose the highest level of penalty without regard to the particular facts and circumstances or without following due process as required by the Constitution.[63] Section 222(2) of the TAA provides that:

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[59] Croome & Olivier (2015) Tax Administration (2 Ed.) at p 473.
[60] Croome & Olivier (2015) Tax Administration (2 Ed.) at p 473.
[61] Davis Tax Committee in its Introductory Report on Base Erosion and Profit Shitting in South Africa at p 40 – 41.
[62] Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 6.
[63] Croome & Olivier (2015) Tax Administration. (2 Ed.) at p 474.

"*(2) The understatement penalty is the amount resulting from applying the highest applicable understatement penalty percentage in accordance with the table in section 223 to each shortfall determined under subsections (3) and (4) in relation to each 'understatement*'." (own emphasis)

It seems as though the key word in the above provision is "…*highest applicable understatement penalty percentage…*" (own emphasis). The applicability of the penalty percentage depends on the particular facts and circumstances of the matter. In this way, SARS is granted a limited discretionary power to impose a USP in terms of the process as set out in the TAA.

Included in tax collection are amounts collected from penalties (including USPs in terms of section 221). The incentivisation system casts doubt on the fairness of the USP regime. Why would a SARS official fairly rule an understatement as a "*bona fide* inadvertent error" if it would be in their best interest to pursue the imposition of a USP? Moreover, why would a SARS official decide to suspend or remit a USP if it would benefit them not to do so? The purpose of the understatement penalty regime is not to raise money for the *fiscus*, but rather to ensure taxpayer compliance.[64] However, the incentivisation of tax collection (including penalties) casts doubt on the efficacy and fairness of the USP regime.

2.3. Rationale for the percentages and behaviours contained in the USP table in section 223

It is noted that tax penalties in South Africa are much harsher compared to other southern African countries.[65] The evidence regarding the efficacy of audits and penalties on tax compliance are inconclusive as some research show that audits and penalties have a positive effect on compliance and others establish that these measures reduce compliance, while other studies find audits and penalties to have either no or minimal effect on compliance.[66] For example, authors Park and Hyun find that in Korea both penalty and audit rates are an incentive

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[64] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[65] Dare "The Impact of Changes in Audits and Penalties on Tax Compliance Behaviour: Evidence from South Africa" (2020) Southern African Business Review, vol. 24, no.1 at p 2 -3.
[66] Dare "The Impact of Changes in Audits and Penalties on Tax Compliance Behaviour: Evidence from South Africa" (2020) Southern African Business Review, vol. 24, no.1 at p 5.

for taxpayers to increase compliance.[67] Yet, in Denmark, audits are found to have no effect on third-party reported income e.[68]

Dare finds that in a South African context, compliance levels are reduced where penalty rates are exceptionally high but where the likelihood of being audited is low.[69] In other words, high penalties serve as no deterrent where enforcement levels are low or unlikely. Taxpayers perceive an assortment of penalties as scare tactics to deter non-compliance.[70] Dare states that despite penalties and audits being useful tools to encourage tax compliance, these measures should be applied cautiously as taxpayers may perceive threats of a combination of high audits and penalties as proof that non-compliance is common, which suggests that tax authorities are unable to detect it.[71] This perception by taxpayers reduces their intrinsic motivation to comply, which results in a decline in voluntary tax compliance.[72] Furthermore, research has shown that honest taxpayers perceive high audits and penalties as a sign of mistrust by authorities, which further reduces their intrinsic willingness to comply.[73]

Feld and Frey suggest that a psychological contract exists between taxpayers and tax authorities which is based on trust. This psychological contract infers that "*…tax authorities expect taxpayers to declare their true income honestly; and taxpayers expect authorities to treat them respectfully and not suspect or assume them to be tax evaders*."[74] A violation of this contract negatively impacts on taxpayers' willingness to cooperate.[75]

Taxpayer compliance is a complex matter. Various factors play a role in taxpayer compliance, such as taxpayer behaviour, morality and social norms, complexity of legislation, audit rates,

[67] Park & Hyun "Examining the determinants of tax compliance by experimental data: A case of Korea" (2003) Journal of Policy Modeling, vol. 25, no. 8 at p 673–684.
[68] Kleven, Knudsen, Kreiner, Pedersen, & Saez "Unwilling or Unable to Cheat? Evidence From a Tax Audit Experiment in Denmark" (2011) Econometrica, vol.79, no. 3 at p 651–692.
[69] Dare "The Impact of Changes in Audits and Penalties on Tax Compliance Behaviour: Evidence from South Africa" (2020) Southern African Business Review, vol. 24, no.1 at p 17.
[70] Meyer & Van Zyl "Once, twice, three times a penalty and charging interest on a tax debt – Medtronic International Trading SARL v CSARS (33400-2019) [2021] ZAGPPHC (15 February 2021)" (2021) THRHR, vol. 84.
[71] Dare "The Impact of Changes in Audits and Penalties on Tax Compliance Behaviour: Evidence from South Africa" (2020) Southern African Business Review, vol. 24, no.1 at p 17 – 18.
[72] Dare "The Impact of Changes in Audits and Penalties on Tax Compliance Behaviour: Evidence from South Africa" (2020) Southern African Business Review, vol. 24, no.1 at p 18.
[73] Wahl, Kastlunger & Kirchler "Trust in Authorities and Power to Enforce Tax Compliance: An Empirical Analysis of the 'Slippery Slope Framework'" (2010) Law and Policy, vol. 32, no. 4 at p 383–406.
[74]Bornman & Stack "Rewarding Tax Compliance: Taxpayer's Attitudes and Beliefs" (2015) Journal of Economic and Financial Sciences, vol 8, no. 3 at p 792; Feld & Frey "Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation" (2007) Law & Policy, vol. 29, no.1 at p 102- 120.
[75] Alm, Kirchler & Muehlbacher "Combining Psychology and Economics in the Analysis of Compliance: From Enforcement to Cooperation" (2012) Economic Analysis & Policy, vol. 42, no. 2 at p 144.

tax rates, penalties and taxpayer attitude towards the government.[76] Grasmick and Scott find that fear of penalties and audits is not the sole reasons why people pay taxes.[77]

There are a number of studies on taxpayer behaviour towards penalties. In essence, the sources all draw the same conclusion:

i. A penalty that is set too low has no effect.

ii. A penalty must increase in relation to the severity of the transgression.[78]

Based on the existing research, it is clear that the effectiveness of penalties differs from region to region. Penalties alone cannot ensure tax compliance as various factors impact compliance including (but not limited to), audits, transparency of audits, government spending, rate of penalties imposed, the prevalence of corruption, the effectiveness of the administration of the revenue authority, and available incentives.

2.4. When can SARS impose a USP?

From the wording of section 222, SARS is obliged to impose a USP where there has been an understatement by a taxpayer. SARS must determine the applicable penalty by locating each case within a table that assigns a percentage to objective criteria.[79] SARS bears the burden of proving that the grounds exist for imposing a USP.[80] There will be no grounds for the imposition of a USP if the 'understatement' results from a *bona fide* inadvertent error. Chapter 3 goes into more detail on the concept of a *bona fide* inadvertent error.

The USP regime has given rise to several significant disputes between taxpayers and SARS. Based on the wording of the applicable provisions of the TAA, SARS has no discretion to impose an understatement penalty or to impose such a penalty at a lower percentage if certain facts exist.[81]

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[76] Bornman & Stack "Rewarding Tax Compliance: Taxpayer's Attitudes and Beliefs" (2015) Journal of Economic and Financial Sciences, vol 8, no. 3 at p 792; Dare "The Impact of Changes in Audits and Penalties on Tax Compliance Behaviour: Evidence from South Africa" (2020) Southern African Business Review, vol. 24, no.1 at p 3.
[77] Grasmick & Scott "Tax Evasion and Mechanisms of Social Control: A Comparison with Grand and Petty Theft" (1982) Journal of Economic Psychology, vol. 2, no. 3 at p 213- 230.
[78] See for example du Preex & Muthaphuli "The deterrent value of punishment on crime prevention using judicial approaches" (2019) Just Africa, vol. 2019, no.1.
[79] van der Walt, 2013 "Understatement Penalty: When can SARS Potentially Allege 'Gross Negligence' or 'Intentional Tax Evasion'? available at: https://www.cliffedekkerhofmeyr.com/export/sites/cdh/news/publications/2013/tax/downloads/Tax-Alert-19-April-2013.pdf.
[80] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80.
[81] Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 3.

SARS further has limited discretionary powers to remit the mandatory understatement penalty contained in the TAA.[82] Neither the TAA nor the SARS Short Guide provides any guidance as to how SARS should exercise its discretion. The lack of comprehensive guidelines for the imposition of understatement penalties may be detrimental to taxpayers due to inconsistent application of the discretion of SARS and even the possibility of abuse of powers by SARS.[83]

An 'understatement' means "*…any prejudice to SARS or the fiscus as a result of —*

(a) *failure to submit a return required under a tax Act or by the Commissioner;*
(b) *an omission from a return;*
(c) *an incorrect statement in a return;*
(d) *if no return is required, the failure to pay the correct amount of 'tax'; or*
(e) *an 'impermissible avoidance arrangement'*."[84]

It is, therefore, a requirement that for an understatement to exist (and in consequence for a USP to be imposed) there needs to exist prejudice to SARS or the *fiscus*.

In *ITC 1908,*[85] the court was tasked with the interpretation of the words 'any prejudice to SARS or the *fiscus*' as it appears in the definition of 'understatement' in section 221. In *ITC 1908,* the taxpayer had paid provisional tax in respect of the year of assessment in question. When the taxpayer filed its corporate tax return for the same year, it declared itself dormant and filed a 'nil return'. The taxpayer was assessed accordingly in the original assessment. SARS conducted an investigation on the taxpayer and raised additional assessments on the basis that the taxpayer was not dormant and had generated taxable income for the year of assessment in question. On this basis, SARS imposed a USP.[86]

The taxpayer argued that since it paid the tax assessed by way of provisional tax, there could be no prejudice to SARS or the *fiscus* from submission of a nil return. The question for adjudication by the court was whether SARS could impose a USP on the basis that the SARS or the *fiscus* had been prejudiced.

[82] Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 3.
[83] Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 3.
[84] Section 221 of the TAA.
[85] *ITC 1908* 80 SATC 299.
[86] Theron (2020) Practical Guide to Handling Tax Disputes (LexisNexis South Africa) at p 39.

The court held that the prejudice to SARS was in the form of 'opportunity cost' and resource allocation brought about by the investigation of the taxpayer. The prejudice to the *fiscus* was that the money had been paid to the provisional tax account and as a result could not be used by the *fiscus* in its budgetary process.

Van Der Walt states that the SCA concluded in the *Purlish* case that in the context of USPs, prejudice to SARS is "…*not only determinable in financial terms but, that in the specific circumstances of the case, additional resources allocated to and time spent by SARS' employees to understand the affairs of a taxpayer…"* also constitutes prejudice to SARS.[87]

Based on the above, it is clear that the courts and SARS ascribe a very wide meaning to the term "prejudice to SARS or the *fiscus*".[88]

Martitz is of the view that the fact that the quantum of the understatement penalty is determined with reference to the taxpayer's behaviour (applying the table in sec 223(1) of the TAA) which is determined by SARS officials in exercising their discretion, could potentially lead to subjectivity or biased conduct by SARS officials and, therefore, could lead to the inconsistent application of the USP regime.[89]

'Discretion' is defined in the Dictionary as follows:

> "*power of free decision or latitude of choice within certain legal bounds*"[90]
>
> "*the freedom or power to decide what should be done in a particular situation*"[91]
>
> "*the power to decide or act according to one's own judgment*"[92]

An abuse of discretion occurs when a decision is not an acceptable alternative. The decision may be unacceptable because it is logically unsound, because it is arbitrary and not supported by the particular facts, or because it is explicitly prohibited by law.[93]

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[87] van Der Walt, 2019 "Sars is Quite Sensitive (to 'Prejudice')" available at: https://www.polity.org.za/print-version/sars-is-quite-sensitive-to-prejudice-2019-03-28.
[88] Theron (2020) Practical Guide to Handling Tax Disputes (LexisNexis South Africa) at p 39.
[89] Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 6.
[90] Merriam Webster "Discretion" available at: https://www.merriam-webster.com/dictionary/discretion.
[91] Oxford learners Dictionary "Discretion" available at: discretion noun - Definition, pictures, pronunciation and usage notes | Oxford Advanced American Dictionary at OxfordLearnersDictionaries.com.
[92] The Free Dictionary "Discretion" available at: https://www.thefreedictionary.com/discretion#:~:text=n.-,1.,%3B%20prudence%20or%20decorum%3B%20tactfulness.
[93] Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 14.

In *O'Leary v Salisbury City Council*[94] the court held as follows:

> *'When an official is granted an unfettered discretion, there is a limitation of powers implied by law, that the official will apply his mind properly to the question before him, consider it honestly and bona fide, without any ulterior motive and not impose a condition which no reasonable man so acting could have done.*[95]

In the matter of *Lance Dickson Construction CC v Commissioner for the South African Revenue Service*, the High Court set aside the order of the Tax Court in favour of SARS and upheld an appeal by Lance Dickson Construction CC ("**Lance**") with costs.[96]

Lance, in its tax return for the 2017 year of assessment, did not declare any proceeds from the disposal of certain property to a related entity, Kwali Mark Construction CC ("**KMC**"), as it believed and as stated in the agreement of sale between *Lance* and KMC, that capital gains tax ("**CGT**") would be paid by the *Lance* when the property was on-sold by KMC to an unrelated third-party and the relevant proceeds were received by *Lance*. Because these conditions were not fulfilled in the 2017 year of assessment, *Lance* did not declare proceeds on the disposal of the property in its tax return.

SARS disagreed with *Lance* and submitted that CGT should have been paid when *Lance* disposed of the property to KMC, a view that the Tax Court agreed with. SARS also imposed an understatement penalty, in terms of section 222 of the TAA in the event of an "understatement".

As stated in the introduction hereto, if there is an "understatement", SARS must then consider whether the understatement results from a "*bona fide* inadvertent error". If this is established, that is the end of the inquiry, and no understatement penalty may be levied. However, where there is no such error, SARS is required to identify the appropriate behavioural category under which a taxpayer's conduct allegedly resorts in terms of the table set out in section 223 of the TAA before it can impose an understatement penalty.

[94] *O'Leary v Salisbury City Council* 1975 3 SA 859 (RA) at 863.
[95] *O'Leary v Salisbury City Council* 1975 3 SA 859 (RA) at 863.
[96] *Lance Dickson Construction CC v The Commissioner for the South African Revenue Service* (A211/2021) [2023] ZAWCHC 12 (31 January 2023); Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.

In this case, SARS established that there was an "understatement" and because the understatement did not result from a "*bona fide* inadvertent error", SARS levied a penalty of 25 per cent on the taxpayer for "reasonable care not taken in completing return" in terms of the understatement penalty percentage table in section 223 of the TAA.

In the Tax Court proceedings, SARS' factual witness conceded that SARS had erroneously relied on behaviour (ii) "reasonable care not taken in completing return" instead of behaviour (iii) "no reasonable ground for 'tax position' taken", a behaviour that imposes a percentage penalty of 50 per cent (for a standard case).[97]

Notwithstanding SARS' concession, the Tax Court held that despite having no authority to increase the penalty from 25 per cent for behaviour (ii) to 50 per cent for behaviour (iii), it could not allow *Lance* to escape liability for the understatement. The Tax Court, thus, concluded that *Lance* was liable to pay the USP of 25 per cent.[98]

On appeal, the High Court was tasked with determining whether the judgment handed down by the Tax Court was correct. The High Court found that the Tax Court had erred in confirming the USP imposed by SARS of 25 per cent for the reason that SARS could not prove the factual basis for the imposition of the penalty when the taxpayer challenged its determination in the Tax Court.[99] The High Court held that SARS could not prove behaviour (ii) and that the court was not competent to make a ruling on behaviour (iii) because SARS did not allege this behaviour in its pleadings.[100]

The High Court, thus, instructed SARS to exclude the USP imposed in the taxpayer's 2017 additional assessment. Furthermore, the High Court awarded a punitive cost order against SARS as it found that SARS' assessment and imposition of the USP was unreasonable.

Lance illustrates the principle that the onus of proving USPs lies on SARS. SARS is required to prove the factual basis for the determination of USPs and should it fail to do so, it will have

[97] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[98] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[99] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[100] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.

no basis, either in fact or law, to levy USPs.[101] The case also emphasises the importance of SARS following a fair and just process in levying understatement penalties.

2.5. The interplay of section 129 of the TAA and the onus on SARS to prove the behaviour which it alleges

In terms of section 102(2) of the TAA, SARS bears the burden of proving the facts on which it based the imposition of the USP under Part A of Chapter 16 of the TAA.

Section 129(3) of the TAA provides as follows:

> "*(3) In the case of an appeal against an understatement penalty imposed by SARS under a tax Act, the tax court must decide the matter on the basis that the burden of proof is upon SARS and may reduce, confirm or increase the understatement penalty*."

SARS' onus in this regard was dealt with in the High Court case *TCIT13725 DBN,*[102] in which the court held:

> *"The onus on the respondent in this case was to prove the facts upon the basis of which the penalties are said to be justified. To say of conduct that it is grossly negligent is to classify it on a scale of blameworthiness. The onus is on SARS to prove the conduct in question. Having done that, SARS must classify it, for the purposes of Chapter 16, selecting the appropriate description of the behaviour from the options provided in section 223 of the Tax Administration Act."* (own emphasis)

In practise it sometimes happens that SARS requests reasons from a taxpayer as to why a USP should not be imposed without discharging its onus of providing the basis on which it relies for intending to impose the USP. Should the taxpayer choose to respond to the request, this will be without any prejudice to its rights (and without shifting the onus of proof).

[101] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[102] *Mr. A and XYZ CC v The Commissioner for the South African Revenue Service* IT13725 DBN at 20.

In the SCA judgment of *Purlish Holdings v The Commissioner for the South African Revenue Service*,[103] the SCA laid out the burden of proof to be discharged by SARS when imposing understatement penalties as follows:

> "*In terms of section 102(2) of the TAA, the burden of proving the facts on which SARS based the imposition of an understatement penalty rests on SARS. Furthermore, the Tax Court is, in terms of section 129(3) of the TAA, enjoined to decide an appeal against an understatement policy on the basis that the burden of proof is upon SARS. Given the aforesaid burden of proof, I am inclined to find merit in the appellant's contention that SARS must not only show that the taxpayer committed the conduct set out in items (a) to (d) of the definition of 'understatement' in s[ection] 221 of the TAA, but also that such conduct caused it (SARS) or the fiscus to suffer prejudice*." (own emphasis added)

Therefore, based on the judgment of the SCA in the *Purlish* case, in order to prove the facts on which an understatement penalty is based, SARS bears the onus of proof regarding:

1. The taxpayer's conduct set out in items (a) to (e) of the definition of "understatement" in section 221 of the TAA; and

2. The prejudice to SARS or the *fiscus* as a result of the taxpayer's conduct.

Van Der Walt states that the SCA concluded in the *Purlish* case that in the context of USPs, prejudice to SARS is "…*not only determinable in financial terms but, that in the specific circumstances of the case, additional resources allocated to and time spent by SARS' employees to understand the affairs of a taxpayer…"* also constitutes prejudice to SARS.[104]

In the *Lance* case, The High Court found that the court *a quo* incorrectly relied on *Purlish* where the SCA held that the Tax Court cannot increase USPs imposed by SARS. The Tax Court in the *Lance* case held that it did not have the power to increase the USP, but it also could not allow the taxpayer to escape liability for the penalty and, thus, it confirmed the percentage rate imposed by SARS. On appeal, the High Court held that the Tax Court can increase the USP in terms of section 129 of the TAA, but only when SARS requests such an increase in its

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[103] *Purlish Holdings v The Commissioner for the South African Revenue Service* (76/18) [2019] ZASCA 04.

[104] van Der Walt, 2019 "Sars is Quite Sensitive (to 'Prejudice')" available at: https://www.polity.org.za/print-version/sars-is-quite-sensitive-to-prejudice-2019-03-28.

pleadings.[105] A court may, thus, increase, confirm or decrease a USP rate imposed by SARS if it is alleged by SARS in its pleadings (i.e., in the rule 31 or rule 33 statement of the tax court rules, as promulgated under section 103 of the TAA ("**rule**")).

In *Africa Cash & Carry (Pty) Ltd v The Commissioner for the South African Revenue Service*, the court made the following statement:[106]

> "…*pleadings are important and the parties will be kept to their pleadings, where any departure from the pleadings would cause prejudice or prevent a full enquiry. But within those limits a tax court has a wide discretion, for pleadings are made for the court and not the court for pleadings. Where a party has had every facility to place all the facts before the tax court and the investigation into all the circumstances has been thorough, then there is no justification to interfere simply because the pleadings had not been as explicit as they might have been*." (own emphasis)

A court cannot *mero motu* increase, confirm or decrease a USP rate. It is also noteworthy that the court in *Purlish* and *Lance* reiterate that the increase, confirmation or decrease of a USP rate must be alleged by SARS in its pleadings and not by the taxpayer. This confirms that the burden of proof is on SARS.

2.6. Conclusion

While some studies reflect the effectiveness of USPs in ensuring tax compliance, other studies show that penalties are relatively ineffective. Yet, the regional bias and cultural background on which these studies are premised cannot be ignored. Put differently, the effectiveness of penalties differs from region to region and between cultures and societies. Nevertheless, the USP regime in SA tax law is necessary for the deterrence of tax non-compliance even though, it may be perceived as less effective to promote tax compliance. This doubt is compounded by a perception that SARS lacks the skill and power to audit taxpayers and enforce penalties accordingly. Furthermore, doubt is cast on the implementation of the USP regime as the incentivisation of revenue collection, which includes the imposing and collection of USP is enrobed in the high potential for abuse of the discretionary power entrusted in SARS officials. This leads to a concern on the limited discretionary power entrusted on SARS officials to

[105] Carrol, 2023 "SARS Shoots itself in the foot" available at: https://businesstech.co.za/news/finance/674141/sars-shoots-itself-in-the-foot/.
[106] Africa Cash & Carry (Pty) Ltd v The Commissioner for the South African Revenue Service (783/18) [2019] ZASCA 148 (21 November 2019) at 53

choose the appropriate behaviour and USP rate and to decide if a USP should be remitted or suspended. In the next chapter, I discuss the possible responses from a taxpayer upon the imposition of an understatement penalty.

Chapter 3: Possible responses from a taxpayer upon the imposition of an understatement penalty

3.1. Introduction

The payment of tax and USPs is involuntary in that the law requires taxpayers to pay certain amounts to SARS in terms of the provisions of tax Acts.[107] This chapter looks at the possible responses from a taxpayer upon the imposition of an understatement penalty.

3.2. Voluntary disclosure programme

According to SARS, the purpose of the VDP is to enhance voluntary compliance in the interest of increasing tax compliance, good management of the tax system and the best use of SARS' resources.[108] The VDP program is further aimed to encourage taxpayers to voluntarily come forward to regularise their tax affairs with SARS and to avoid the imposition of USPs and certain other administrative penalties as such penalties will be remitted on a successful VDP application.[109] However, a VDP application will only be successful if certain requirements are met.[110]

In terms of section 226 of the TAA, a person may apply, whether in a personal, representative, withholding or other capacity, for voluntary disclosure relief, unless that person is aware of:[111]

i. a pending audit or investigation into the affairs of the person seeking relief which is related to the "default" the person seeks to disclose; or
ii. an audit or investigation that has commenced, but has not yet been concluded, which is related to the "default" the person seeks to disclose.

To ensure that a VDP application is valid, a disclosure must:[112]

i. "*Be voluntary;*

[107] Croome & Croome (2017) Street Smart Taxpayers A Practical Guide to Your Rights in South Africa (Juta) at p 41.
[108] SARS Draft Guide to the Voluntary Disclosure Programme Revision 2 dated 28 June 2021 at p 5.
[109] See *Reed v Minister of Finance and Others* (30832/2015) [2017] ZAGPPHC 916 (2 June 2017) and *Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd* (135/2021) [2021] ZASCA 170 (7 December 2021).
[110] For purposes of this dissertation, I will not consider the requirements for a VDP application to be approved and for USPs to be remitted in terms of the VDP.
[111] SARS Guide to the Voluntary Disclosure Programme dated 24 August 2023 at p 8.
[112] SARS Draft Guide to the Voluntary Disclosure Programme Revision 2 dated 28 June 2021 at p 5 – 6; SARS Guide to the Voluntary Disclosure Programme dated 24 August 2023 at p 2.

ii. *Involve a default which has not occurred within five years of the disclosure of a similar "default" by the applicant or a person referred to in section 226(3);*

iii. *Be full and complete in all material respects;*

iv. *Involve a behaviour referred to in column 2 of the understatement penalty percentage table in section 223;*

v. *Not result in a refund due by SARS; and*

vi. *Be made in the prescribed form and manner*."

The contentious requirement is often the requirement that the disclosure must be "voluntary". In *Purveyors South Africa Mine Services (Pty) Ltd vs Commissioner for the South African Revenue Services*[113] *("**SCA Purveyors**")*, it was held that in order to meet the voluntary requirement, the following threshold must be met –

> *"…errant taxpayers who are not compliant must come clean, out of their own volition and without any prompting, to make amends in respect of their defaults by informing SARS […] Whether a voluntary disclosure has been prompted by a compliance action is a question of fact to be determined by examining the circumstances in which it was made."* (own emphasis)

and

> *"…the taxpayer must take SARS into their confidence and voluntarily make a proper and frank disclosure which is neither prompted nor made as a result of any fear or compulsion."* (own emphasis)

In *Reed v Minister of Finance and Others*[114] ("***Reed***"), it was stated that:

> *""Voluntary" is not defined. Its meaning must be found in the two main sections in which it is used viz 226 and 227. The requirements for a VD application are set out in section 227. These include, in section 227(a), that the disclosure must be "voluntary"."* (own emphasis)

and

[113] *Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd* (135/2021) [2021] ZASCA 170 (7 December 2021).

[114] *Reed v Minister of Finance and Others* (30832/2015) [2017] ZAGPPHC 916 (2 June 2017).

"Section 226 thus contains threshold requirements that are specific to the person of the applicant. The crucial factor is lack of knowledge that there is a pending audit or investigation. Put differently, the applicant has to be ignorant of any pending audit or investigation or audit or investigation that have already commenced. The VD applicant must allege and prove this ignorance. "Voluntary" thus means bringing information to SARS when there ***is no causal SARS investigation*** *underfoot and if there is, in ignorance of it."* (own emphasis)

To summarise the above, in order for a disclosure to be voluntary –

i. the compliance action must not have caused or influenced the taxpayer to make the disclosure of the default to SARS, meaning the default itself was not raised, highlighted, queried or intimated in or by the SARS compliance action; and

ii. the compliance action must not cause the taxpayer to act out of fear for penalties and interest to be levied as concerns the default in question such that the disclosure is made under fear or compulsion caused by the compliance action of SARS.

According to van Zyl and Carney, the requirement of "absence of fear" attributed to the meaning of "voluntary" as set out in the High Court judgment of Purveyors[115] affords an overly restrictive meaning to the voluntary requirement as the avoidance of penalties and interest is an incentive for taxpayers to make use of the VDP. The authors van Zyl and Carney argue that the High Court *Purveyors* judgment effectively nullifies any VDP application as the restrictive interpretation of 'voluntary' is likely to render the majority of VDP disclosures involuntary.[116]

The SCA *Purveyors* judgment states that the compliance action of SARS must not have caused the taxpayer to disclose a default out of fear or compulsion, not that there needs to be an absence of fear. The use of the words "…*made as a result of any fear or compulsion*…" in the judgment should be considered in the context of the VDP and the facts of the matter. The SCA judgment takes precedent over the High Court judgment.[117]

[115] *Purveyors South Africa Mine Services (Pty) Ltd v The Commissioner for the South African Revenue Service* (61689/2019) [2020] ZAGPPHC 404 (25 August 2020)("**High Court Purveyors**").
[116] van Zyl & Carney "Just how voluntary is 'voluntary' for purpose of a voluntary disclosure application in terms of Section 226 of the Tax Administration Act 28 of 2011?" (2021) THRHR vol. 84, no.1 at p 110.
[117] Hahlo and Kahn "The South African Legal System and Its Background" (1968) International & Comparative Law Quarterly, vol. 13, no.3 at p 243.

The VDP is aimed to encourage taxpayers to disclose defaults, unless there is a pending or commenced audit or investigation into the affairs of the person seeking relief which is related to the "default" the person seeks to disclose.[118] The wording and the context of the applicable VDP provisions lead to the reasonable interpretation that a VDP application may be done unless SARS is aware of the default or is likely to become aware of the default by audit or investigation. As per the VDP guide,[119] the VDP program is, *inter alia,* aimed to encourage taxpayers to voluntarily come forward to regularise their tax affairs with SARS and avoid the imposition of certain penalties.[120] The programme, thus, incentivises voluntary disclosure by allowing for the remittance of USPs and administrative penalties if the VDP application is successful. Van Zyl and Carney are correct in arguing that the High Court *Purveyors* judgment would lead to the irrational result that a taxpayer will never be able to successfully apply for a VDP if the incentive is to avoid USPs.

The requirement of "absence of fear" attributed to the meaning of "voluntary" affords an overly restrictive meaning to the term "voluntary". Taxpayers, generally, utilise the VDP specifically because they want to avoid the penalties and prosecution. These incentives are what lures defaulting taxpayers to come forward on a voluntary basis. The restrictive interpretation is likely to render the majority of VDP disclosures involuntary.[121] It is, thus, clear that the aim of the VDP is in line with the aim of the USP regime in that both are aimed to encourage tax compliance. The VDP program encourages compliance by incentivising taxpayers to make voluntary discourse in return for the remittance of the USP and the USP regime encourages compliance by penalising non-compliance.

3.3. *Bona fide* inadvertent error

The term "*bona fide* inadvertent error" is not defined in the TAA. The SARS USP Guide prefers a very narrow interpretation and states as follows:

> "*An inadvertent error is one that does not result from deliberate planning, and a bona fide inadvertent error is one that genuinely does not result from deliberate planning. Importantly, the lack of deliberate planning must relate to the error, that is, the default,*

[118] SARS Guide to the Voluntary Disclosure Programme dated 24 August 2023 at p 8.
[119] SARS Draft Guide to the Voluntary Disclosure Programme Revision 2 dated 28 June 2021.
[120] SARS Draft Guide to the Voluntary Disclosure Programme Revision 2 dated 28 June 2021 at p 2; also see *Reed v Minister of Finance and Others* (30832/2015) [2017] ZAGPPHC 916 (2 June 2017) and *Purveyors South Africa Mine Services (Pty) Ltd v Commissioner for the South African Revenue Services (Pty) Ltd* (135/2021) [2021] ZASCA 170 (7 December 2021).
[121] van Zyl & Carney "Just how voluntary is 'voluntary' for purpose of a voluntary disclosure application in terms of Section 226 of the Tax Administration Act 28 of 2011?" (2021) THRHR vol. 84, no.1 at p 110.

> *omission, incorrect statement, failure to pay the correct tax, or impermissible avoidance arrangement must be genuinely involuntary*."[122]

The SARS USP Guide defines "*bona fide*" as "*genuine*" and "*real*".[123] According to Khaki, this refers to a "*…sincere, honest intention or belief and represents the mental and moral state regarding the truth. The opposite of good faith is bad faith (mala fide) and this may involve intentional deceit*."[124]

The terms "*bona fide*" and "inadvertent *error*" are not defined in the ITA or the TAA, therefore, consideration must be given to the ordinary meaning of the words.

"*Bona fide*" means "*in good faith*" and according to the Oxford Dictionary means "*without deception*" or "*genuine*".[125]

"Inadvertent", according to the Oxford Dictionary, refers to that which is "*not done deliberately or intentionally*".[126] According to Khaki, this "*…refers to a state in which a consequence might have arisen from an act or omission which was never intended to arise*."[127]

"*Error*" in this context refers to an outcome which is objectively incorrect.[128] If a subjective interpretation to error is to be applied, the use of the term "*error*" in addition to "*inadvertent*" would be a tautology.[129]

Based on the definitions of the words as set out above, should there be an understatement which results from an unintentional mistake on the part of the taxpayer and such mistake was made honestly and did not involve intentional deceit, SARS should not be entitled to impose a USP as the relevant understatement would have been made as a result of a "*bona fide* inadvertent error".[130]

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[122] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 16.
[123] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 15.
[124] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf; Raath "Die Mala Fides van Administratiewe Organe Twee Belangwekkende Beslissings in Bophuthatswana" (1983) Journal for Juridical Science, vol. 8, no. 1 at p 84.
[125] Hornby (2020) Oxford Advanced Learner's Dictionary (5th Ed.); Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[126] Hornby (2020) Oxford Advanced Learner's Dictionary (5th Ed.); Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[127] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[128] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[129] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.
[130] Khaki, 2017 "Penalties: the application of "bona fide inadvertent error" available at: https://www.accountancysa.org.za/wp-content/uploads/2018/05/Integritax_Mar_2017_Issue_210.pdf.

In *79 SATC 62*,[131] a judgment given by the Tax Court in Cape Town on 4 November 2016, the court adopted the following approach regarding the meaning of the term *bona fide* inadvertent error:[132]

> *"According to the Oxford Dictionary the origin of the word 'bona fide' is Latin and literally means 'with good faith'. The word is also defined as 'genuine'; 'real'; 'without intention to deceive'. 'Inadvertent' is defined as 'not resulting from' or 'achieved through deliberate planning'. The Merriam-Webster online dictionary gives the following as some of the synonyms for the word inadvertent: 'accidental' 'unintentional', 'unintended', 'unpremeditated', 'unplanned' and 'unwitting'. Error is defined by the Oxford Dictionary as 'a mistake'. It also gives the following synonyms: 'the state or condition of being wrong in conduct or judgement'.*
>
> *It follows from the above that the 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."*[133] (own emphasis)

SARS seemingly answers the question of whether a "*bona fide* inadvertent error" has been made by enquiring into whether reasonable care had been taken in completing return.[134] SARS proclaims its interpretation of the term in its USP Guide. SARS is of the view that the only errors that can be said to be *bona fide* are involuntary typographical mistakes. All other errors are, according to SARS, based on a "*…bona fide incorrect reasoning, or an opinion incorrectly interpreted without the intention to deceive, the payment, non-payment, or incorrect statement itself cannot be said to be validly unmeant*."[135] The distinction between these phrases is important in the context of a VDP application as it is a requirement that the disclosure must "involve a behaviour referred to in column 2 of the understatement penalty percentage table in section 223".[136]

The SARS USP Guide is not binding on SARS or taxpayers. It can, however, be presented as "evidence" of how SARS interprets provisions.[137] The Constitutional Court ("**CC**") in *CSARS*

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[131] *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* 79 SATC 62
[132] *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* 79 SATC 62 at 44 - 45.
[133] *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* 79 SATC 62 at 44 - 45.
[134] Pinch, 2023 "What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?" available at: ENSafrica - News - What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?.
[135] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 17.
[136] Pinch, 2023 "What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?" available at: ENSafrica - News - What constitutes a "bona fide inadvertent error" for purposes of understatement penalties?.
[137] *The Commissioner for the South African Revenue Service v Bosch and* Another 2015 (2) SA 174 (SCA).

v Marshall NO has, however, qualified this approach adopted by the SCA in the light of the "*fundamental contextual change […] from legislative supremacy to constitutional democracy*".[138] Therefore, the "*unilateral practice of one part of the executive arm of government*" can only "play" a questionable "*role in the determination of the reasonable meaning to be given to a statutory provision*".[139] Whereas it could "*conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned*", the same does not apply "*where the practice is unilaterally established by one of the litigating parties*".[140] In the latter scenario, the CC found it "*difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionally compliant precepts*".[141] Therefore, such evidence is, the CC concluded, "best avoided".[142]

As such, the SARS USP Guide is merely indicative of SARS' interpretation of the meaning of *bona fide* inadvertent error and is not binding on taxpayers or SARS. The SARS USP Guide does not usurp the courts' constitutional function to interpret the law. This duty remains with the courts. It is the legislature's role to make the law and this law is binding on taxpayers and SARS.

Recently, there have been a number of cases which considered SARS' onus to prove the understatement penalties that it imposes. The main issues in these cases have been what would constitute proof of a "*bona fide* inadvertent error" and under what circumstances SARS may assume *male fides*.

In *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service*,[143] the tax court held that:

> "… *the 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*."[144]

[138] *The Commissioner for the South African Revenue Service v Marshall NO* 2019 (6) SA 246 (CC) at 10.
[139] *The Commissioner for the South African Revenue Service v Marshall NO* 2019 (6) SA 246 (CC) at 10.
[140] *The Commissioner for the South African Revenue Service v Marshall NO* 2019 (6) SA 246 (CC) at 10.
[141] *The Commissioner for the South African Revenue Service v Marshall NO* 2019 (6) SA 246 (CC) at 10.
[142] *The Commissioner for the South African Revenue Service v Marshall NO* 2019 (6) SA 246 (CC) at 10.
[143] *ABC (Pty) Ltd v The Commissioner for the South African Revenue Service* (ITI13772) [2016] ZATC 7 (4 November 2016).
[144] *ABC (Pty) Ltd v The Commissioner for the South African Revenue Service* (ITI13772) [2016] ZATC 7 (4 November 2016) at 45.

The High Court in the matter of *Lance Dickson Construction CC v Commissioner for the South African Revenue Service*[145] confirmed the principle that SARS bears the onus of proving the behaviour which it alleges. As discussed in Chapter 2 of this study, the High Court found that the Tax Court had erred in confirming the USP imposed by SARS of 25 per cent for the reason that SARS could not prove the factual basis for the imposition of the penalty when the taxpayer challenged its determination in the Tax Court. The High Court found that SARS could not prove behaviour (ii) and that the court was not competent to make a determination on behaviour (iii) because SARS did not allege this behaviour.[146] The case highlights the following important principles:[147]

i. SARS must prove the absence of an inadvertent error.
ii. SARS must prove the presence of the relevant behaviour.
iii. The taxpayer has the burden of rebuttal (this does not translate to a shift in the burden of proof)

There are a number of rules which are, generally, accepted by courts and jurists regarding the burden of proof. One such rule is that the one who alleges must prove the allegations. Importantly, for the current discussion, is that where a party bears the burden of proof, and the other party bears the burden of rebuttal, the burden of rebuttal does not translate to a shift in the burden of proof. In other words, the burden of proof still lies with the party who originally bears it.[148] The other party, then has a right to rebut.

In the matter of *Commissioner for the South African Revenue Service v Thistle Trust,*[149] a judgment by the Supreme Court of Appeal ("**SCA**"), SARS conceded that the understatement by the Thistle Trust was as a result of a "*bona fide* inadvertent error". This was because the Thistle Trust had relied on an independent legal opinion and believed, in good faith, that its view was correct. The Thistle Trust was, thus, alleviated from paying the USP. The court found that SARS had correctly conceded that the understatement was as a result of a "*bona fide* inadvertent error" and for this reason, SARS had no basis to impose the USP.[150] The SCA, thus, confirmed that where a taxpayer places reliance on legal advice which is later proven to

[145] *Lance Dickson Construction CC v The Commissioner for the South African Revenue Service* (A211/2021) [2023] ZAWCHC 12 (31 January 2023).
[146] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[147] *Lance Dickson Construction CC v The Commissioner for the South African Revenue Service* (A211/2021) [2023] ZAWCHC 12 (31 January 2023) at 13.
[148] Schmidt "Feit, Reg en Bewyslas" THRHR at p 115.
[149] *The Commissioner for the South African Revenue Service v The Thistle Trust* (516/2021) [2022] ZASCA 153; 2023 (2) SA 120 (SCA).
[150] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.

be incorrect, such reliance can serve as evidence that the understatement was as a result of a *bona fide* inadvertent error. This is in contrast to SARS' view that the only errors that constitute as "*bona fide* inadvertent errors" are involuntary typographical mistakes.[151] It was unclear in the matter whether the legal opinion was an opinion in terms of section 223 of the TAA, however, because this fact was not made clear in the judgment it stands to reason that legal advice which does not meet the requirements of section 223 could still serve as evidence against the imposition of a USP.

Within the USP regime, the defence of a "*bona fide* inadvertent error" is the first line of defence available to a taxpayer, even before a taxpayer's behaviour is scrutinised to see if it falls within one of the listed behaviours in section 223, and regardless of whether the taxpayer obtained a legal opinion or if the opinion complies with section 223 of the TAA.[152] The finding by the SCA in the *Thistle Trust* case, thus, materially broadens the ambit of the first line of defence.[153]

In a recent SCA matter of *Commissioner for the South African Revenue Service v Coronation Investment Management SA (Pty) Ltd,*[154] the taxpayer placed reliance on an independent legal opinion which it did not disclose to SARS. Due to the non-disclosure of the opinion, SARS drew a negative inference that the opinion was not in support of the position taken by the taxpayer. For this reason, SARS contended that the understatement was not as a result of a *bona fide* inadvertent error. The SCA held that for SARS to speculate that a tax opinion does not align with the taxpayer's position for the mere reason that the taxpayer did not disclose the opinion to SARS, is not sufficient to attribute *male fides* on the part of the taxpayer.[155] The court, therefore, held that SARS' claim for USPs must fail.[156]This judgment raises the question as to who bears the onus to prove that a taxpayer's actions were *bona fide*.

Section 102 of the TAA states that the onus of proving the facts on which SARS bases the imposition of a USP, rests upon SARS.[157] Therefore, it stands it reason that SARS is obliged to prove the bad faith or intent to claim an undue tax benefit as part of its burden to prove the

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[151] SARS Guide to Understatement Penalties (issue 2) dated 18 April 2018 at p 17.
[152] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[153] Gad & Solomon, 2023 "The Supreme Court of Appeal weighs in on the meaning of "bona fide inadvertent error"" available at: https://www.ensafrica.com/news/detail/6511/the-supreme-court-of-appeal-weighs-in-on-the-.
[154] *The Commissioner for the South African Revenue Service v Coronation Investment Management SA (Pty) Ltd* (1269/2021) [2023] ZASCA 10.
[155] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[156] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[157] Armstrong, 2017 "Understatement Penalties: What Is A Bona Fide Inadvertent Error?" available at: https://www.werksmans.com/wp-content/uploads/2018/10/16829-August-Legal-Brief_Tax-FA.pdf.

USP it imposes.[158] It seems as though it is in a taxpayer's best interest to put forward a case in support of a *bona fide* inadvertent error (if the circumstances so allows), however, this should not be construed as a shift of the onus of proof as set out in *Lance*.

The cases as mentioned above, illustrate the principle that the onus of proving USPs lies on SARS. SARS is required to prove the factual basis for the determination of USPs and should it fail to do so, it will have no basis, either in fact or law, to levy USPs.[159] However, it seems as though the courts' recent interpretations of the meaning of *bona fide* inadvertent error will only be useful to a taxpayer in the litigation stage of a dispute as SARS has made no indication of a change in its interpretation of the phrase.

In the 2013 Memorandum on the Objects of the Tax Administration Laws Amendment Bill,[160] SARS stated as follows:

> *"Paragraph (a): Amendment of subsection (1): The proposed amendment clarifies when an 'understatement' will not result in a penalty by excluding bona fide inadvertent error. This gives effect to the announcement in this regard in the 2013 Budget Review. The proposed amendment will apply with effect from 1 October 2012, but will also apply to understatements made in a return before 1 October 2012. Due to the broad range of possible errors, the proposal to define the term 'bona fide inadvertent error' has the potential to inadvertently, exclude deserving cases and include undeserving cases. SARS will, however, develop guidance in this regard for the use of taxpayers and SARS officials."* (own emphasis)

SARS acknowledges that the term "*bona fide* inadvertent error" is not clear and as such will lead to inconsistent application of the exclusion of USPs, however, to date, there has been no definition of the term in the legislation nor by the superior courts to provide guidance as to what the term entails. The interpretation of this term is, thus, still susceptible to the inconsistent discretion of SARS.[161]

Croome and Olivier in Tax Administration make reference to a workshop held by SARS to discuss amendments to the USP regime. In this workshop SARS indicated that it has no

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[158] Armstrong, 2017 "Understatement Penalties: What Is A Bona Fide Inadvertent Error?" available at: https://www.werksmans.com/wp-content/uploads/2018/10/16829-August-Legal-Brief_Tax-FA.pdf.

[159] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.

[160] Memorandum on the Objects of the Tax Administration Laws Amendment Bill (2013) at p 40.

[161] Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 18.

intention to subject a taxpayer to a USP where the taxpayer makes a *bona fide* mistake.[162] At the time this statement was made, the 2013 Draft Memorandum on the Objects of the Tax Laws Amendment Bill[163] explained what conduct would quality as a *bona fide* inadvertent error. The circumstances in which a *bona fide* inadvertent error was initially envisaged to be made are as follows:[164]

"*In the context of factual errors -*

i. *If the standard of care taken by the taxpayer in completing the return is commensurate with the taxpayer's knowledge, education, experience and skill and the care of a reasonable person in the same circumstances would have exercised;*

ii. *The size or quantum, nature and frequency of the error;*

iii. *Where a similar error was made in a return submitted during the preceding year; or*

iv. *In the case of an arithmetical error, whether the taxpayer had procedures in place to detect arithmetical errors.*

In the case of a legal interpretive error -

i. *the complexity of the relevant provisions of the relevant Act;*

ii. *whether the taxpayer took steps to understand it, including following available explanatory material or making reasonable enquiries; or*

iii. *whether the taxpayer relied on information, that although incorrect or misleading, came from reputable sources and a reasonable person in the same circumstances would be likely find the relevant information to be complex."*

The final version of the memorandum on the 2013 amendments to the TAA removed the abovementioned criteria. SARS has indicated that it will develop guidance regarding the meaning of the phase "*bona fide* inadvertent error" and will publish that for the use of taxpayers

[162] Croome & Olivier (2015) Tax Administration (2 Ed.) at p 476.
[163] Draft Memorandum on the Objects of the Tax Administration Laws Amendment Bill (2013).
[164] Draft Memorandum on the Objects of the Tax Administration Laws Amendment Bill (2013) at p 11 - 12.

and SARS officials.[165] To date, the only guidance is the narrow definition of the term in the USP Guide. Furthermore, a published interpretation of a tax provision is not inherently binding on SARS and a taxpayer.[166]

As a result of the absence of a clear definition of the meaning of the phrase "*bona fide* inadvertent error", taxpayers are subjected to an inconsistent application of the criteria by SARS officials that could result in subjectivity and the imposition of understatement penalties in situations where it is not applicable. Although the recent case law (including binding judgments by the High Court and the SCA) provides some insight into the interpretation of the term, a clear definition of the meaning remains lacking. A clear definition as to the scope and meaning of the phrase is necessary to ensure objective and consistent application of the USP provisions.[167]

3.4. Suspension of payment

In SA tax law, even if a taxpayer has lodged an objection against an assessment or has noted an appeal against the disallowance of an objection to an assessment, he/she must still pay the tax due before the dispute is resolved.[168] This is colloquially referred to as the "pay now argue later rule". In *Metcash Trading Ltd v Commissioner, South African Revenue Service, and Another*[169] the constitutional validity of the pay-now-argue-later principle was confirmed.[170]

In terms of section 164(2) the TAA, a taxpayer may request that a senior SARS official suspend the payment of tax or a portion thereof due under an assessment if the taxpayer intends to dispute or disputes the liability to pay that tax under Chapter 9 of the TAA.[171] In terms of section 164(3) of the TAA, a senior SARS official may suspend payment of a disputed tax debt having regard to the following relevant factors:

i. "*whether the recovery of the disputed tax will be in jeopardy or there will be a risk of dissipation of assets;*

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[165] Draft Memorandum on the Objects of the Tax Administration Laws Amendment Bill (2013) at p 13; Croome & Olivier (2015) Tax Administration (2 Ed.) at p 476.
[166] See discussion above on *Bosch* and *Marshall* cases.
[167] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80; Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 20.
[168] Croome & Croome (2017) Street Smart Taxpayers A Practical Guide to Your Rights in South Africa (Juta) at p 49.
[169] *Metcash Trading Ltd v The Commissioner for the South African Revenue Service, and Another* 2001 (1) SA 1109 (CC).
[170] See chapter 4 for a more in-depth discussion regarding the constitutionality of the pay-now-argue-later principle.
[171] de Lange & van Wyk "The Right to Just Administrative Action in the Context of Suspending the Payment of Disputed Tax" (2017) Potchefstroom Electronic Law Journal, vol. 20 at p 2.

ii. *the compliance history of the taxpayer with SARS;*

iii. *whether fraud is prima facie involved in the origin of the dispute;*

iv. *whether payment will result in irreparable hardship to the taxpayer not justified by the prejudice to SARS or the fiscus if the disputed tax is not paid or recovered; and*

v. *whether the taxpayer has tendered adequate security for the payment of the disputed tax and accepting it is in the interest of SARS or the fiscus*."

Having regard to the factors listed in section 164(3), SARS will not grant a request for suspension of payment if there is a burning reason for SARS to collect the disputed tax immediately.[172]

Should SARS decide not to grant a taxpayer a full suspension or decides to only grant a partial suspension of payment, the taxpayer may potentially take this decision on review to the High Court in terms of the Promotion of Administrative Justice Act 3 of 2000 ("**PAJA**").[173]

3.5. Section 223 Tax opinion

Section 223(3) provides that SARS must remit a penalty imposed for a "substantial understatement" if SARS is satisfied that the taxpayer:

> "*(a) made <u>full disclosure</u> to SARS of the arrangement, as defined in section 34, that gave rise to the prejudice to SARS or the fiscus by no later than the date that the relevant return was due; <u>and</u>*
>
> *(b) was in possession of an opinion by an independent registered tax practitioner that—*
>
> *(i) was issued by no later than the date that the relevant return was due;*
>
> *(ii) was based upon full disclosure of the specific facts and circumstances of the arrangement and, in the case of any opinion regarding the applicability of the substance over form doctrine or the anti-avoidance provisions of a tax Act, this requirement cannot be met unless the taxpayer is able to demonstrate that all of the steps in or parts of the*

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[172] *The Commissioner for the South African Revenue Service v Agrizzi* case number 45008/2021 at 49.

[173] Regard must be had to the principles as set out in *The Commissioner for the South African Revenue Service v Absa Bank Limited and Another* (596/2021) [2023] ZASCA 125 (29 September 2023); *The Commissioner for the South African Revenue Service v Rappa Resources (Pty) Ltd (*1205/ 2021) [2023] ZASCA 28; *United Manganese of Kalahari (Pty) Ltd v The Commissioner for the South African Revenue Service* (1231/ 2021) [2023] ZASCA 29; *Metcash Trading Limited v The Commissioner for the South African Revenue Service and Another* 2001 (1) SA 1109 (CC) and *The Commissioner for the South African Revenue Service v Langholm Farms* [2019] ZASCA 163 regarding the jurisdictions of the High Court to adjudicate tax matters.

arrangement were fully disclosed to the tax practitioner, whether or not the taxpayer was a direct party to the steps or parts in question; and

(iii) *confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court... "*(own emphasis)

The above remittance in terms of section 223(3) is, thus, only available where the behaviour alleged is "substantial understatement". Therefore, if a USP is levied in terms of any other behaviour, the taxpayer would have no remedy in terms of section 223(3).[174]

The term "more likely than not" indicates a higher degree of likelihood than the normative term "should". Tax advisors are notoriously, and understandably, reluctant to try to quantify their prospects of success, however, it is hard not to accede that "more likely than not" means a greater than 50 per cent chance.[175]

3.6. Remittance of payment

Section 224 of the TAA provides that the imposition of a USP under section 222 or a decision by SARS not to remit a USP under section 223(3), is subject to objection and appeal under Chapter 9. However, remittance in terms of section 223(3) is only available in limited circumstances.[176]

3.7. Conclusion

The abovementioned possible responses from a taxpayer upon the imposition of an understatement penalty should not be construed as the onus of proof shifting to a taxpayer to prove that he/she is not guilty of the USP which SARS imposes.

Due to the absence of a clear definition in the legislation on the meaning of the phrase "*bona fide* inadvertent error", taxpayers are subjected to an inconsistent application of the criteria by SARS officials that could result in subjectivity and the imposition of understatement penalties in situations where it is not applicable. The legislator should include a definition of the term in the TAA to ensure that SARS exercises its discretion with objectivity and consistency when understatement penalties are imposed.[177]

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[174] Arendse & Williams "Beware of the new additional tax regime: techtalk" (2012) TAXtalkVol. 2012, no. 36 at p 32.
[175] Rothman "Tax Opinion Practice" 2011 The Tax Lawyer at p 20 – 21.
[176] Stiglingh *et al* (2022) Silke: South African Income Tax (LexisNexis South Africa 2022) at 18.240.
[177] SARS Short Guide to the Tax Administration Act, 2018 (Act No. 28 of 2011) dated 29 March 2018 at p 80; Martitz, "Tax Administration: The Discretion of the Commissioner for the South African Revenue Services When Understatement Penalties are Imposed" Masters dissertation, University of Pretoria, Pretoria 2016 at p 20.

Chapter 4: The Constitutionality of the USP Regime

4.1 Introduction

The powers granted to SARS must conform to the requirements set out in the Constitution of the Republic of South Africa, being the supreme law of the Republic.[178] In particular, South African law requires that SARS, as an organ of state,[179] exercises its powers in a manner that is reasonably and fair, without violating the fundamental rights of taxpayers.[180] Croome is of the opinion that taxpayers are more likely to comply with the tax laws when they have the perception of fair treatment.[181] The imposition of tax is acceptable in any open and democratic society that is subject to the safeguards contained in the Bill of Rights.[182] Taxes are for the greater good of the community. In exchange for the tax paid by taxpayers, the government is expected to provide public goods and services for the shared benefit of the public.[183]

The National Revenue Fund is created in terms of section 213 of the Constitution and its purpose is to, *inter alia*, collect of all money paid to the national government.[184] The provisions of the Constitution imply that the State may impose taxes.[185] The fiscal statutes of South Africa confer certain powers on SARS which are necessary to ensure the proper and efficient collection of taxes. As set out in chapter 2 of this study, penalties are a deterrent for tax evasion and non-compliance. Included in SARS' collection powers is SARS' limited discretion to levy USPs and the power for a tax debt (which includes a USP) to become due and payable as soon as an assessment is issued. This chapter considers the constitutionality of the 'right of SARS' to imposes a USP and the procedure to be followed by SARS. In this respect, I consider:

i. whether a USP constitutes a deprivation of the right to property as contained in section 25 of the Constitution;
ii. the right to just administrative action as contained in section 33 of the Constitution; and

[178] This study does not focus on the Bill of Rights as a whole but merely considers particular rights as contained in the Bill of Rights which are relevant to the USP regime.
[179] Section 2 of the SARS Act.
[180] Section 33 of the Constitution of the Republic of South Africa.
[181] Croome & Croome (2017) Street Smart Taxpayers A Practical Guide to Your Rights in South Africa (Juta) at p 6.
[182] Chapter 2 of the Constitution of the Republic of South Africa.
[183] Steyn, Franzsen, and Stiglingh "Conceptual framework for classifying government imposts relating to the tax burden of individual taxpayers in South Africa" (2013) International Business and Economics Research Journal, vol. 12, no.2 at p 241.
[184] Croome "Taxpayers "Rights in South Africa: An analysis and evaluation of the extent to which the powers of the South African Revenue Service comply with the Constitutional rights to property, privacy, administrative justice, access to information and access to courts" Doctoral thesis, University of Cape Town, Cape Town 2008.
[185] Croome (2010) Taxpayer's Rights in South Africa (1st Ed.) at p 8.

iii. the right to access to courts as contained in section 34 of the Constitution.

4.2. Constitutional considerations

1. The right to property

Weber if of the view that "[*t]he imposition of tax is inherently in conflict with the right not to be deprived of one's property as guaranteed by [section] 25 of the Constitution*."[186] A generally lawful deprivation of property does not violate the taxpayers constitutional right to property. A tax system that does not cause undue hardship to taxpayers and is used for proper objectives by the state to meet its obligations to the people, justifies this lawful deprivation of property.[187]

The question that arises here is, does the USP regime lawfully deprive a taxpayer of property? The argument for tax is simple – it is for the greater good, but does this argument apply to penalties equally? USPs are levied to encourage tax compliance and deter non-compliance. If one breaks the law, one must be punished. Some punishments take a monetary form, for example, a traffic fine. However, penalties for breaking the law are, generally, enforceable after the perpetrator has been found guilty, or, after an admission of guilt. In the current USP regime, SARS simply imposes a penalty where it is of the view that there has been an 'understatement' and the absence of a "*bona fide* inadvertent error". It is only when the penalty is disputed by the taxpayer by way of objection and appeal that SARS must prove their case. In this regard, it can be argued that the imposition of the understatement penalty by issuing an assessment is, *prima facie*, a deprivation of property because SARS has, at this stage, not yet proven its case – that is, that SARS is entitled to impose the understatement penalty.

2. The right to just administrative action

SARS, generally, raises a USP when it issues an additional assessment. The assessment serves as a notification to the taxpayer of the taxes and penalties that is due. The total of the tax due, interest and penalties levied constitutes the total tax debt which becomes due and payable when the assessment is issued. At this stage, SARS has not yet proven its case in respect of the penalties. The taxpayer may request reasons for the penalties.[188] Any

[186] Weber "Tax and the Constitutional Court – do they ever meet?" (2020) De Rebus – The SA Attorneys' Journal at p 30.
[187] Croome & Croome (2017) Street Smart Taxpayers A practical Guide to Your Rights in South Africa (Juta) at p 42.
[188] See section 5 of PAJA and rule 6.

dispute in respect of a USP primarily falls under the provisions in section 105 of the TAA that must be resolved through the internal dispute resolution procedures set out in Chapter 9 of the TAA.[189] However, neither the request for reasons nor the lodging of a dispute suspends the taxpayer's payment obligation.[190]

The question arises as to whether the current process of imposing a USP constitutes unjust administrative action as SARS merely needs to allege an understatement and absence of a *bona fide* inadvertent error by issuing the assessment containing the USP. Put differently, SARS merely has to issue an assessment in which the USP is levied for it to enforce the collection of the tax debt which includes the USP.

3. <u>The right to access to courts</u>

Taxpayers have the right to have any dispute that can be resolved by the application of law decided in a fair public hearing[191] before a court or, where appropriate, another independent and impartial tribunal or forum.[192] Where a taxpayer does not agree with a USP, the taxpayer can dispute the USP through the objection and appeal process. However, justice is delayed where SARS imposes a USP due to the 'pay-now-argue later' principle. Despite this fact, this delay does not result in a violation of the right to access to courts. In this instance, justice delayed is not justice denied.[193]

Based on the above, there is a *prima facie* infringement of the right to property and right to just administrative action.

4.3 The burden of proof and the "pay now, argue later" rule

As discussed in Chapter 3 of this study, section 102 of the TAA states that the onus of proving the facts on which SARS bases the imposition of a USP, rests upon SARS.[194] The question arises as to whether, having regard to the purpose of the USP regime as well as the burden of proof, it is reasonable and justifiable for SARS to levy USPs which become due and payable when an assessment is issued before SARS can actually satisfy its burden of proof?

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[189] *SARS v Rappa Resources (Pty) Ltd* (1205/ 2021) [2023] ZASCA 28; *United Manganese of Kalahari (Pty) Ltd v The Commissioner for the South African Revenue Service* (1231/ 2021) [2023] ZASCA 29.
[190] Section 164(1) of the TAA.
[191] Take note of section 124 of the TAA that states that the sitting of a tax court is not public.
[192] Section 34 of the Constitution of the Republic of South Africa.
[193] *Metcash Trading Limited v The Commissioner for the South African Revenue Service and Another* 2001 (1) SA 1109 (CC).
[194] Armstrong, 2017 "Understatement Penalties: What Is A Bona Fide Inadvertent Error?" available at: https://www.werksmans.com/wp-content/uploads/2018/10/16829-August-Legal-Brief_Tax-FA.pdf.

In SA tax law, SARS does not automatically suspend a taxpayer's obligation to pay outstanding taxes while the taxpayer objects to or appeals its tax liability.[195] In terms of section 164(1) of the TAA, "*…unless a senior SARS official otherwise directs […] the obligation to pay tax; and the right of SARS to receive and recover tax, will not be suspended by an objection or appeal or pending the decision of a court of law pursuant to an appeal under section 133*". The taxpayer is, thus, required to 'pay now' and 'argue later'.

In *Metcash Trading Ltd v Commissioner, South African Revenue Service, and Another,*[196] the constitutional validity of the so-called "pay now, argue later" principle was confirmed. This principle's fairness and reasonableness has been questioned due to its obvious fundamentally offensiveness to ordinary conceptions of justice.[197] The "pay now, argue later" rule was held in *Capstone 556 (Pty) Ltd v Commissioner for SARS* to be in the public interest because it ensures the speedy collection of outstanding taxes.[198] The Davis Tax Committee declared that the "pay now, argue later" rule infringes on a person's right not to be deprived of property arbitrarily as entrenched in section 25(1) of the Constitution. The Davis Tax Committee, thus, recommends that the legislator reconsiders the "pay now, argue later" rule.[199]

Fritz and Brits evaluate whether the "pay now, argue later" rule meets the requirements of a valid deprivation of property and conclude that the rule does not infringe upon taxpayers' property rights.[200] The authors show that the statutory provisions surrounding the "pay now, argue later" principle "*…imposes a deprivation of property, but that the deprivation is neither procedurally nor substantively arbitrary*."[201]

Section 1 of the TAA defines 'tax' to include a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act. A penalty is, thus, revenue that goes to the central revenue fund. In the strict sense of the word, a penalty is not a tax, however, the TAA seemingly defines a tax as to include penalties so that it becomes due and payable when an assessment is issued. The collection method for tax and penalties are,

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[195] Fritz and Brits "Does the 'pay now, argue later' approach in the Tax Administration Act 28 of 2011 infringe on a taxpayer's right not to be deprived of property arbitrarily?" (2020) South African Journal on Human Rights, vol. 36, no. 2–3 at p 200.
[196] *Metcash Trading Limited v The Commissioner for the South African Revenue Service and Another* 2001 (1) SA 1109 (CC).
[197] Fritz and Brits "Does the 'pay now, argue later' approach in the Tax Administration Act 28 of 2011 infringe on a taxpayer's right not to be deprived of property arbitrarily?" (2020) South African Journal on Human Rights, vol. 36, no. 2–3 at p 200.
[197] *Metcash Trading Limited v The Commissioner for the South African Revenue Service and Another* 2001 (1) SA 1109 (CC).
[198] *Capstone 556 (Pty) Ltd v Commissioner for SARS* 2011 (6) SA 65 (WCC) at 9.
[199] Fritz "Reconsidering the "pay now, argue later" approach of South Africa in relation to disputed taxes – lessons from Canada and Australia" (2019) Journal for Juridical Science, vol. 44, no. 2 at p 28 – 29.
[200] Fritz and Brits "Does the 'pay now, argue later' approach in the Tax Administration Act 28 of 2011 infringe on a taxpayer's right not to be deprived of property arbitrarily?" (2020) South African Journal on Human Rights, vol. 36, no. 2–3 at p 216.
[201] Fritz and Brits "Does the 'pay now, argue later' approach in the Tax Administration Act 28 of 2011 infringe on a taxpayer's right not to be deprived of property arbitrarily?" (2020) South African Journal on Human Rights, vol. 36, no. 2–3 at p 216.

therefore, the same. In other words, the "pay now, argue later" principle applies for tax penalties too. This is arguably unfair because, in the case of taxes, the burden of proof is on the taxpayer.[202] Yet, in the case of USPs, the burden of proof is on SARS. The unfairness lies in the fact that the taxpayer is required to pay the USP even though SARS has not yet proven its case, and it remains payable where the taxpayer disputes SARS' allegations of an understatement. Perhaps a more equitable system would be for USPs to be excluded from the definition of 'tax' in the TAA so that the "pay- now- argue later" rule does not apply to USPs. In this way, a USP does not become due and payable when a taxpayer disputes it.

The prominent case law on the "pay now, argue later" principle, including *Metcash, Capstone* and *Singh v Commissioner for SARS,*[203] were all heard before the USP regime came into effect. At the time these cases were heard, SARS was entitled to non-compliance penalties and interest. The courts in *Metcash* and *Singh* ruled that the "pay now, argue later" principle applies to the tax debt, penalties and interest.[204] This is because the tax debt triggers the non-compliance penalties and interest. It is the taxpayer that must prove that SARS is wrong about the tax debt and that SARS is not entitled to the penalties and interest. However, in the case of understatement penalties, the burden of proof lies with SARS.[205] A USP amount forms part of a tax debt and is, thus, subject to section 164 of the TAA i.e., the "pay now, argue later" rule. This raises a different question to that posed in *Metcash* and *Capstone 556.*

The constitutionality of the USP regime is yet to be raised and disputed by a taxpayer in the Constitutional Court. Despite the courts' rulings that section 164 of the TAA does not impose an arbitrary deprivation of property, the court has not specifically addressed the constitutionality of USPs being due and payable upon an assessment being issued, having regard to the burden of proof lying with SARS.

4.4. Is the infringement irrational or arbitrary?

As stated above, there is a *prima facie* infringement of the right to property and just administrative action. A legitimate and rational government purpose is required where there is

[202] Section 102 of the TAA.
[203] *Singh v The Commissioner for the South African Revenue Service* 2003 4 SA 520 (SCA) 65 SATC 203.
[204] *Metcash Trading Limited v The Commissioner for the South African Revenue Service and Another* 2001 (1) SA 1109 (CC); *Singh v The Commissioner for the South African Revenue Service* 2003 4 SA 520 (SCA) 65 SATC 203.
[205] Section 102(2) of the TAA.

an infringement of a right to save it from unconstitutionality.[206] A right is violated where the infringement of the right is irrational or arbitrary. Van Zyl & Fritz state that:

> "*A rationality review is concerned with the evaluation of a relationship between means and ends: the relationship, connection or link between the means employed to achieve a particular purpose on the one hand, and the purpose or end itself on the other. The aim of the evaluation of the relationship is not to determine whether a particular means will achieve the purpose better than others, but only whether the means employed are rationally related to the purpose for which the power was conferred*."[207]

An infringement is arbitrary where no sufficient reason for the particular infringement in question is provided or it is procedurally unfair.[208] I consider below if the *prima facie* infringement of the right to property and just administrative action is irrational or arbitrary:

i. The Right to Property

The purpose behind the USP regime is to deter tax evasion and non-compliance. The means employed is the imposition of a percentage-based penalty (which increases with the severity of the offence) to achieve the purpose of deterring tax evasion and non–compliance. The evaluation is not concerned with whether this is the most effective means, but only that it is rationally employed to achieve a purpose.[209] This infringement, thus, does not lack a legitimate and rational government purpose.

The infringement is, however, arbitrary as it is procedurally unfair. A USP amount forms part of a tax debts and is, thus, subject to section 164 of the TAA. SARS has, however, not discharged the burden of proof at this point, and, therefore, it can be argued that it is arbitrary for the "pay now, argue later" rule to apply to USPs.

ii. The Right to Just Administrative Action

As stated above, SARS is only required to provide reasons if it is requested to do so by a taxpayer and SARS only needs to prove its case if a taxpayer lodges a dispute. This

[206] *Harksen v Lane* 1997 (11) BCLR 1489 (CC) at 53.
[207] van Zyl & Fritz "Different cities, different propertytax-rate regimes: Is it fair in an open and democratic society?" (2022) Law, Democracy & Development, vol. 26, no.1 at p 314; *Zuma v Democratic Alliance* 2018 (1) SA 200 (SCA) 674 (CC).
[208] *First National Bank of SA Ltd t/a Wesbank v The Commissioner for the South African Revenue Service; First National Bank of SA Ltd t/a Wesbank v Minister of Finance* 2002 (4) SA 768 (CC); 2002 (7) BCLR 702 (CC) at 92.
[209] van Zyl & Fritz "Different cities, different propertytax-rate regimes: Is it fair in an open and democratic society?" (2022) Law, Democracy & Development, vol. 26, no. 1 at p 314; *Zuma v Democratic Alliance* 2018 (1) SA 200 (SCA) 674 (CC).

amounts to a *prima facie* infringement of the right to just administrative action as it is seemingly a procedurally unfair system. In this regard, as the burden of proof in the case of USPs is on SARS, surely the same powers afforded to SARS in the collection of taxes – where the burden of proof is on the taxpayer – cannot be the same.

Yet, if SARS had to prove all of its cases before it is entitled to impose a USP, the resources of SARS would be wasted in instances where a taxpayer would have admitted guilt and paid the penalty anyway. Similarly, some taxpayers may dispute the USP simply to frustrate SARS. This would be contrary to SARS' obligation of proper and efficient collection of taxes. Thus, the means employed is rationally related to the purpose for which the power is conferred. SARS is allowed to impose a USP before it proves its case to dispose of its duty to collect taxes efficiently. However, the infringement of the right to just administrative action is arguably arbitrary as SARS is not required to provide reasons for its decision to levy a USP until it is requested to do so by a taxpayer. Furthermore, SARS is entitled to enforce its decision without having first proven its case. SARS is required to prove its case only when the taxpayer disputes the USP.

Perhaps a better process would be for SARS to first inform the taxpayer of its intention to raise a USP and give the taxpayer the opportunity to make representations. Only where the taxpayer fails to make representations or SARS is not satisfied with the taxpayer's representations, should SARS become entitled to levy the USP. I recommend that it is only at this stage, that the "pay now, argue later" principle is triggered. In this way, SARS is not shifting its onus of proof, but rather gathers more information to make a better-informed decision regarding the USP. In certain instances, SARS conducts an audit or investigation prior to issuing an assessment which contains a USP. As part of this audit or investigation, SARS may request that the taxpayer make representations before SARS issues an additional assessment in which it also levies a USP.[210] This is, however, not a statutory duty imposed on SARS to, during audit investigations, allow the taxpayer to make representations before SARS may levy a USP.

[210] Refer to S80J of the ITA; *Absa Bank Limited and Another v The Commissioner for the South African Revenue Service* (2019/21825) [2021] ZAGPPHC 127; 2021 (3) SA 513 (GP) (11 March 2021) and *The Commissioner for the South African Revenue Service v Absa Bank Limited and Another* (596/2021) [2023] ZASCA 125 (29 September 2023).

A process that requires SARS to first request representations from a taxpayer before it imposes a USP is a middle ground between SARS completely abandoning its onus, on the one hand, and placing an administrative burden on SARS to prove its case before levying a USP, on the other hand. However, this process does still place an administrative burden on SARS, albeit not as intrusive as SARS having to prove its full case before the imposition of a USP.

4.5 Section 36 of the Constitution

Section 36 of the Constitution is known as the limitation clause as it lays down a test that any limitation is required to meet.[211] As established above, the USP regime arbitrarily infringes on the right to property and the right to just administrative action. The question to be considered next is can the arbitrary infringement be justified in terms of section 36 of the Constitution? If it is not justifiable in terms of section 36, the infringement is unconstitutional.

Section 36(1) of the Constitution provides as follows:

> "*The rights in the Bill of Rights may be limited only in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, taking into account all relevant factors, including -*
>
> *(a) the nature of the right;*
>
> *(b) the importance of the purpose of the limitation;*
>
> *(c) the nature and extent of the limitation;*
>
> *(d) the relation between the limitation and its purpose; and*
>
> *(e) less restrictive means to achieve the purpose."*

The Constitutional Court of South Africa states that:[212]

[211] The Constitutional Court of South Africa "The Limitation Clause" available at: https://www.concourt.org.za/index.php/59-the-bill-of-rights/the-limitation-clause#:~:text=If%20the%20Bill%20of%20Rights,test%20are%20reasonableness%20and%20proportionality.

[212] The Constitutional Court of South Africa "The Limitation Clause" available at: https://www.concourt.org.za/index.php/59-the-bill-of-rights/the-limitation-clause#:~:text=If%20the%20Bill%20of%20Rights,test%20are%20reasonableness%20and%20proportionality.

> "*The two central concepts in this test are reasonableness and proportionality. Any restriction on a right must be reasonable and must be proportional in that the impact or extent of the restriction must match the importance of the aim served by the limitation of the right*."

The TAA and the Constitution do not define the terms "reasonable" and "proportional". Black's Law Dictionary defines "reasonable" to mean "Fair, proper, or moderate under the circumstances."[213] Proportionality requires that the limitation be justified in the light of its adverse consequences. It should be shown that the adverse consequences are discount by the advantages thereof for the public interest.[214]

The USP regime imposes a percentage-based penalty which increases with the severity of the offence to deter tax evasion and non-compliance. However, as set out in Chapter 2 of this study, penalties are not the most efficient method to deter non-compliant behaviour. Despite this, a USP becomes due and payable when SARS issues an assessment, even without SARS discharging its onus of proof or simply giving reasons for its decision to impose a USP. This restricts a taxpayer's rights to property and just administrative action. The impact of this restriction is that SARS may impose a USP without proving its case. This will result in taxpayers having to engage in a dispute process with SARS but first, pay the outstanding tax debt, despite SARS not discharging its onus. The adverse consequences of the regime, including the deprivation of property and violation of the right to just administrative action, are not discounted by the hope that the penalty will deter non-complaint behaviour. The restriction, thus, does not match the importance of the aim. It is seemingly unfair and improper to allow SARS such extensive collection powers for USPs when the onus of proof lies with them.

Furthermore, there are less restrictive ways to obtain the purpose of the USP regime and less restrictive ways to govern the procedure of imposing a USP. For example, SARS could first inform the taxpayer of its intention to levy a USP and give the taxpayer the opportunity to make representations. Only where the taxpayer fails to make representations or SARS is not satisfied with the taxpayer's representations, should SARS become entitled to impose the USP. In my view, in the light of the burden of proof being on SARS, the extension of the "pay now, argue later" principle to apply to USPs is unlikely to muster constitutional scrutiny. Yet,

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[213] Garner (2019) Black's Law Dictionary (11th Ed.) Definition of "reasonable".
[214] Barrie "The application of the doctrine of proportionality in South African courts" (2013) South African Public Law, vol.28, no.1.

administratively, it does not make sense for SARS to have two debt collection processes running parallel – that is, one for the outstanding taxes, and one for USPs.

4.5. What happens when an additional assessment is issued and not objected to

When an additional assessment is not objected to, it becomes final and the tax debt (including any USP levied) becomes due and payable. Should a taxpayer not pay this tax debt, SARS may make use of section 172 of the TAA to apply for a civil judgment for the recovery of tax and may also use the provisions contained in Part D of Chapter 11 of the TAA to recover the tax debt from third parties. This is also the case where a taxpayer objects to an assessment, but where SARS has not granted a full suspension of payment for the outstanding tax debt. The question of fairness arises when the mechanism that SARS may use to recover a tax debt comprising of a USP amount which it has not as yet proven, is considered. SARS is entitled to enforce the USP without having proven its case. In the current system, a taxpayer needs to lodge a dispute if it does not agree with a USP that is imposed. However, if the cost of lodging a dispute with SARS exceeds the amount of the USP then it would be more practical for the taxpayer to simply pay the USP amount even if it does not agree with the imposition of the penalty. This weakness in the system may lead to an abuse of powers when SARS preys on vulnerable taxpayers. This possible abuse of powers can be illustrated further by comparing USPs with traffic fines. Traffic offences involve a mechanical evaluation of whether or not the traffic law has been transgressed. There is, generally, evidence of the offence. The perpetrator can pay an admission of guilt fine, or dispute the punishment through a legal process which, depending on the severity of the violation, involves a court procedure or a form of objection through representation. In general, disputes hinge on the blameworthiness for the traffic offence.

The levying of a USP is different from a traffic offence as the levying of a USP is more complex than the imposition of a traffic fine. Tax laws are complex and the levying of a USP is equally a complex evaluation. It is not a simple matter of photographic evidence, or the taxpayer being caught red-handed like it is the case with traffic offences. As such, an admission of guilt, especially where the USP is low, cannot be brushed off as a win for SARS. Some form of protection of vulnerable taxpayers must be in place.

4.6. Conclusion

Croome is of the opinion that taxpayers are more likely to comply with the tax laws when they have a perception of fair treatment.[215] Therefore, if the USP regime contains fair and reasonable processes, it is possible that taxpayers would be more likely to comply with tax laws which is what the USP regime sets out to achieve.

Despite the infringement of taxpayers' rights being justified by SARS's objectives to collect revenue efficiently and effectively, the fairness and reasonableness of the USP regime is questionable as it relates to SARS not having to discharge its onus before a USP amount becomes due and payable by a taxpayer. There are less restrictive ways in obtaining the aim of the regime. For example, the taxpayer should be afforded an opportunity to make representations before SARS raises USPs. For this reason, it is unlikely that the USP regime will muster constitutional scrutiny.

The matter of constitutionality of the USP regime is yet to be raised in a court of law. Until the regime is declared to be unconstitutional by the Constitutional Court, the USP regime remains valid and enforceable.

[215] Croome & Croome (2017) Street Smart Taxpayers A Practical Guide to Your Rights in South Africa (Juta) at p 6.

Chapter 5: Recommendations and conclusion

5.1. Main findings

The purpose of the USP regime is to encourage voluntary compliance and deter unwanted behaviour such as non-compliance and tax evasion. The purpose of a tax is to raise revenue for government which is intended to be used for the benefit of the public. The rational of the USP regime is, thus, that the threat of punishment deters unwanted behaviour. This study finds that penalties are not the most effective method to encourage compliance and deter non-compliance as various factors impact compliance including (but not limited to) audits, transparency of audits, government spending, the prevalence of corruption, the effectiveness of the administration of the revenue authority, and tax-compliance incentives.

The USP regime is rationally employed to achieve the purpose of deterring tax evasion and non-compliance; however, it arbitrarily infringes on the right to property and the right to just administrative action and the restriction does not match the importance of the aim. Furthermore, there are less restrictive ways to obtain the purpose of the USP regime and less restrictive ways to govern the procedure of imposing a USP. For example, SARS could first inform the taxpayer of its intention to levy a USP and give the taxpayer the opportunity to make representations. Only where the taxpayer fails to make representations or SARS is not satisfied with the taxpayer's representations, should SARS become entitled to impose the USP.

In my view, in the light of the burden of proof being on SARS, the extension of the "pay now argue later" principle to apply to USPs is unlikely to muster constitutional scrutiny. Yet, administratively, it does not make sense for SARS to have two debt collection processes running parallel – that is, one for the outstanding taxes, and one for USPs.

Furthermore, doubt is cast on the implementation of the USP regime as the incentivisation of revenue collection, which includes the imposing and collection of USPs, is enrobed in the high potential for abuse of the discretionary power entrusted in SARS officials. This leads to a concern on the limited discretionary power entrusted on SARS officials to choose the appropriate behaviour and USP rate, and to decide if a USP should be remitted or suspended.

Recent case law, as discussed in this study, illustrates the principle that the onus of proving USPs lies on SARS. SARS is required to prove the factual basis for the determination of USPs and should it fail to do so, it will have no basis, either in fact or law, to levy USPs.[216]

5.2. Recommendations

Based on this study, the following recommendations are made:[217]

i. The USP regime should not be used as the sole or main means to achieve voluntary compliance and deter unwanted behaviour such as non-compliance and tax evasion.

ii. The phrase "*bona- fide* inadvertent error" should be clearly defined in the TAA.

iii. USPs should be excluded from the definition of "tax" in the TAA so that the "pay- now- argue later" rule does not apply to USPs.

iv. SARS should first inform the taxpayer of its intention to raise a USP and give the taxpayer the opportunity to make representations.

v. Only where the taxpayer fails to make representations or SARS is not satisfied with the taxpayer's representations, should SARS become entitled to levy the USP.

vi. The "pay now, argue later" principle should only be triggered for USPs where the taxpayer fails to make representations or SARS is not satisfied with the taxpayer's representations.

vii. The incentivisation of gross tax collections, including the collection of USPs, should exclude the imposition and collection of USPs.

5.3 Conclusion

In the words of Beccaria, "It is better to prevent crimes than to punish them."[218] Good legislation should be centered around this point. The world is dynamic and as such, tax laws

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[216] Camay & Chetty, 2023 "Another Reminder That SARS Bears The Onus Of Proving Understatement Penalties" available at: ENSafrica - News - Another reminder that SARS bears the onus of proving understatement penalties.
[217] This study does not endeavour to provide an exhaustive list of recommendations.
[218] Beccaria, 2012 "Of Crimes and Punishments" available at: https://www.laits.utexas.edu/poltheory/beccaria/delitti/delitti.c41.html#:~:text=Cesare%20Beccaria%20Of%20the%20Means%20of%20preventing%20Crimes.,expression%20to%20the%20good%20and%20evil%20of%20life.

should be too. Despite the USP regime being a method to combat tax non-compliance and evasion, it is not the most effective tool.

The issue of burden of proof of USPs is now settled law. However, the meaning of a "*bona fide* inadvertent error" remains uncertain. If the term is not defined in the legislation or by a superior court, taxpayers will continue to be subjected to an inconsistent application of the criteria by SARS officials that could result in subjectivity and the imposition of understatement penalties in situations where it is not applicable.

Potentially, a USP infringes on a taxpayer's right to property and the procedure to levy and collect USPs could be considered unjust administrative action. Although access to courts is not denied, justice is delayed until such time that the taxpayer disputes the USP. SARS does not always provide sufficient proof of the behaviour it alleges, but merely imposes a USP as it deems fit which becomes due and payable upon the issuance of an additional assessment. The Constitutional Court is yet to rule on the Constitutionality of the USP. In the light of the findings of this study, it seems unlikely that a court will rule that the application of the "pay now, argue later" principle in respect of USPs is fair and justifiable, having regard to the burden of proof lying with SARS. Despite the infringement of taxpayers' rights being justified by SARS's objectives to collect revenue efficiently and effectively, the fairness and reasonableness of the USP regime is questionable as it relates to SARS not having to discharge its onus before a USP amount becomes due and payable by a taxpayer as there are less restrictive ways in obtaining the aim of the regime.

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