

SUMMARY

The Supreme Court of Appeal (the “SCA”) recently set aside a decision of the Tax Court of South Africa, held in Gauteng (the “Tax Court”), in terms of which the Tax Court increased understatement penalties levied by the South African Revenue Services (“SARS”).

Purlish Holdings (Pty) Ltd (the “Appellant”), having paid provisional tax to SARS, applied for a refund of the amount paid on the basis that it had not yet commenced trading. Furthermore, the Appellant had not registered as a vendor in terms of the Value-Added Tax Act No. 89 of 1981 and, as such, it did not submit value added tax (“VAT”) returns for the periods in question.

SARS conducted an audit of the Appellant’s tax affairs, having particular regard to the Appellant’s corporate income tax (“CIT”) and VAT. Contrary to the Appellant’s filing of a ‘nil return’, the audit revealed that the Appellant had earned substantial income during the periods in issue and, furthermore, the fees payable to the Appellant in respect of such income earned were inclusive of VAT. Pursuant to the tax audit, SARS issued assessments in respect of CIT and VAT and, in addition to issuing the aforementioned assessments; SARS also levied interest plus 100% (one hundred Percent) understatement penalties.

SARS regarded the Appellant’s declaration of zero income and non-remittance of the correct income tax as gross negligence and, similarly, the Appellant’s failure to register for VAT constituted gross negligence. As such, the understatement penalties were levied in respect of both CIT and VAT at the applicable gross negligence rate, being 100% (one hundred Percent), in terms of section 223 of the Tax Administration Act No. 28 of 2011 (the “TAA”).

The Appellant, aggrieved by SARS’ decision, lodged objections thereto in terms of the TAA. On consideration of the Appellant’s objections, SARS confirmed the imposition of the understatement penalties, however, applied lower rates, thereby reducing the quantum of the understatement penalties. Still aggrieved, the Appellant lodged an appeal to the Tax Court.

The only issue argued in the Tax Court was whether or not SARS was justified in levying understatement penalties against the Appellant. The Tax Court found that the Appellant had been grossly negligent in its tax affairs and, accordingly, reverted the understatement penalties to 100% (one hundred Percent).

HELD

The issue before the SCA was whether SARS was entitled to payment of understatement penalties in accordance with the provisions of section 222(1) of the TAA and, if so, the quantum thereof.

The Appellant contended that SARS must not only show that it had committed the conduct envisaged in section 221 of the TAA, but also that such conduct caused SARS or the *fiscus* to suffer prejudice.

The Appellant denied that SARS suffered prejudice on the basis that the Appellant had paid provisional tax due to SARS in excess of its assessed tax liability, and, accordingly, the amount outstanding could simply have been set-off by SARS against the credit on the Appellant's tax account.

The SCA held that in terms of section 221 of the TAA, in order for an understatement to arise, any of the following actions or omissions must result in a form of prejudice to SARS or the *fiscus*:

1. a default in rendering a return;
2. an omission from a return;
3. an incorrect statement in a return; or
4. if no return is required, the failure to pay the correct amount of tax.

The SCA found that it was common cause that the Appellant did not render VAT returns and the Appellant admitted that its failure to do so fell within the category of conduct set out in section 221(a) of the TAA

Having regard to the CIT of the Appellant, SARS submitted that the Appellant's conduct in relation to its filing of 'nil returns' fell within the provisions of sections 221(b) and (c) of the TAA, with which submission the SCA agreed.

The SCA confirmed that in terms of section 102(2) of the TAA, the burden of proving the facts on which SARS based the imposition of understatement penalties rested on SARS. Further, it was confirmed that, in terms of section 129 (3) of the TAA, the Tax Court is enjoined to decide an appeal against an understatement policy on the basis that the burden of proof is upon SARS.

The SCA held that it was satisfied that SARS had proven that there were understatements as contemplated by section 221, which understatements were not as a result of a *bona fide* inadvertent error. Accordingly, the SCA found that the Tax Court had correctly found that SARS had discharged its onus of proving the Appellant's understatement of its CIT and VAT

within the contemplation of section 221 of the TAA. The SCA considered whether the Tax Court was entitled to increase the understatement penalties levied by SARS. The SCA confirmed that section 129(3) of the TAA empowers the Tax Court to increase an understatement penalty in circumstances where the issue has been properly raised for adjudication before that court. It was conceded by counsel for SARS that SARS had never raised the issue of the increase of the reduced penalties for adjudication before the Tax Court. SARS only sought to justify the reduced penalties. Accordingly, and to that extent, the SCA held that the appeal against the decision of the Tax Court must succeed.

VALUE

The Tax Court may only increase understatement penalties in circumstances wherein the issue of increasing understatement penalties is properly raised before the Tax Court, as envisaged by section 129(3) of the TAA, read together with Rule 34 of the Tax Court Rules.

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