Good faith does not exempt taxpayers from paying understatement penalties to SARS

The Tax Administration Act, 28 of 2011 (the TAA) contains an understatement penalty regime which could, at times, result in severe penalties for taxpayers. Broadly speaking, where a taxpayer has understated its tax liability (as a result of a failure to submit a return, an omission from a return, an incorrect statement in a return or the failure to pay the correct amount of tax if no return was required) which lead to any prejudice to the South African Revenue Service (SARS) or the fiscus, it will be liable for an understatement penalty as calculated in terms of the understatement penalty percentage table in section 223 of the TAA (in addition to the underlying tax due). However, relief from the understatement penalty is provided if the understatement arose as a result of a bona fide inadvertent error made by the taxpayer.

The TAA does not define the phrase bona fide inadvertent error and, prior to SARS’ Guide to Understatement Penalties, which was first issued by SARS’ legal counsel on 29 March 2018 (the Guide), taxpayers frequently relied on the judgment of the tax court in ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service (IT113772) for the correct interpretation of the phrase. The tax court held as follows at paragraph 45:

“... 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.”
In the Guide, SARS states that it disagrees with, and will not follow, the application of the law in *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* (ITI13772), "which it is entitled to do as tax court judgements, although often instructive, have no binding effect.” SARS is of the view that the tax court lost sight of the fact that an error cannot have good or bad faith and cannot have the intention to deceive.

SARS interprets the phrase in light of the Supreme Court of Appeal’s (the SCA) judgment in *Natal Joint Municipal Pension Fund v Endumeni Municipality*, where the SCA held that the proper approach to the interpretation of documents is to read the words used in the context of the document as a whole and in the light of all relevant circumstances. Taking into account the purpose and context of the understatement penalty regime, SARS concludes that the only errors that could constitute *bona fide* inadvertent errors are involuntary typographical mistakes. SARS further notes that a lack of reasonable care by a taxpayer in completing its return will not excuse a taxpayer from being liable to pay understatement penalties.

Although the Guide is not binding on taxpayers, SARS or the courts, and is merely of persuasive value, SARS has recently started implementing the narrow interpretation of *bona fide* inadvertent error as set out in the Guide, as opposed to the tax court’s interpretation of the phrase in *ABC Holdings (Pty) Ltd v The Commissioner for the South African Revenue Service* (ITI13772).

Accordingly, in the event that a taxpayer’s interpretation of a provision in a tax act is contrary to that of SARS’, and this interpretation leads to an understatement as defined in the TAA, it is expected that SARS will levy an understatement penalty notwithstanding that the taxpayer might have acted in good faith and without the intention to deceive.

Although SARS’ interpretation of the phrase *bona fide* inadvertent error in the Guide is, in our view, too restrictive, we expect SARS to continue to only provide relief from understatement penalties if the understatement arose as a result of an involuntary typographical mistake by the taxpayer in its return.
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