

Exploring key considerations when determining bona fide inadvertent errors resulting in understatements

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ABSTRACT

Chapter 16 of the Tax Administration Act (28 of 2011) (the TA Act) deals with understatement penalties, which replaced the penalty provisions included under section 76 of the Income Tax Act (58 of 1962) and section 60 of the Value-Added Tax Act (89 of 1991). In the event of an ‘understatement’, in terms of Section 222 of the TA Act, a taxpayer must pay an understatement penalty as determined by the understatement penalty table which is contained in Section 223 of the TA Act, unless the understatement results from a *bona fide* inadvertent error.

In the Draft Response Document presented by National Treasury and SARS to the Committee on Finance (SCOF) on 11 September 2013, it was stated that SARS would develop guidance in this regard for the use of taxpayers and SARS officials (SARS, 2013d:42).

The determining of a *bona fide* inadvertent error on taxpayers’ returns as stipulated in Section 222 of the TA Act, as amended in 2013, is a totally new concept in the tax fraternity. It is of utmost importance that this section is applied correctly based on sound evaluation principles and not on professional judgement when determining if the error was indeed the result of a *bona fide* inadvertent error.

This research study focuses on exploring key considerations when determining *bona fide* inadvertent errors resulting in understatements. The role and importance of tax penalty provisions is explored and the meaning of the different components in the term ‘*bona fide* inadvertent error’ critically analysed with the purpose to find a possible definition for the term ‘*bona fide* inadvertent error’. The study also compares the provisions of other tax jurisdictions with regards to errors made resulting in tax understatements in order to find possible guidelines on the application of *bona fide* inadvertent errors as contained in Section 222 of the TA Act. The term ‘*bona fide* inadvertent error’ is evaluated by comparing the term with the characteristics of a good tax system and improvements for the practical execution of the new amendment to the TA Act are suggested.

A literature review is used to gain an in-depth understanding of the role and importance of tax penalty provisions. Doctrinal research is also carried out to perform a critical analysis on the meaning of the different components in the term '*bona fide* inadvertent error'. A comparative analysis between different countries regarding errors being made when dealing with understatements is performed and a normative research approach is followed to critically evaluate the term '*bona fide* inadvertent error'.

The findings of the research study revealed that the term '*bona fide* inadvertent error' contained in Section 222 of the TA Act should be defined urgently and that guidelines must be provided by SARS on the application of the new amendment. SARS should also clarify the application of a *bona fide* inadvertent error in light of the behaviours contained in Section 223 of the TA Act to avoid any confusion.

Keywords: *Bona fide* inadvertent error, Tax Administration Act, Tax Administration Laws Amendment Bill, Understatement, Understatement penalties.

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LIST OF ABBREVIATIONS

AICPA	- American Institute of Certified Public Accountants
ATO	- Australia Tax Office
AU TAA	- Australia Tax Administration Act
CH	- Compliance Handbook
HMRC	- Her Majesty's Revenue & Customs
IT Act	- Income Tax Act
IFS	- Institute for Fiscal Studies
MT	- Miscellaneous Taxation Ruling
NZ TAA	- New Zealand Tax Administration Act
NZIR	- New Zealand Inland Revenue
OECD	- Organization for Economic Cooperation and Development
PSLA	- Practice Statement Law Administration
SARS	- South Africa Revenue Service
SCOF	- Standing Committee on Finance
SIR	- Secretary for Inland Revenue
TA Act	- Tax Administration Act
TIB	- Tax Information Bulletins

VAT Act

- Value Added Tax Act

CHAPTER ONE

1.1. INTRODUCTION

1.1.1. Background

The Tax Administration Laws Amendment Act (39 of 2013) (the 2013 Amendment Act) was promulgated on 16 January 2014 and one of the fundamental changes, amongst others, to the TA Act was that taxpayers, especially those who complete their tax returns themselves, would not be penalised for *bona fide* mistakes made on submitted tax returns.

The amendments to the understatement penalty provisions contained in Chapter 16 of the TA Act now provide relief to taxpayers in more than one way. Firstly, it executed the announcement that no penalty would be charged if the understatement had resulted from a *bona fide* inadvertent error (National Treasury, 2013a:63). Secondly, it refined the understatement penalty percentages as contained in the table under section 223 of the TA Act. This is in line with the Memorandum on Objects of the Taxation Administration Laws Amendment Bill (2013) (Memorandum) which stated that the new percentages were more in line with comparative tax jurisdictions where largely similar penalty regimes apply (SARS, 2013c:40).

The current area of concern is that there appears to be no specific guidelines and/or guidance from the South African Revenue Service (SARS) regarding the definition and application of the phrase *bona fide* inadvertent error. This could be attributed to the fact that the provision in the TA Act is still a very new act. What adds to the problem is that, according to the Memorandum, it would be backdated and enforced from 1 October 2012 (SARS, 2013c:40). That, in itself, creates immense problems and concerns in that everybody is awaiting new unambiguous guidelines and assessment factors that would clarify for both SARS and the taxpayers how assessment would be done and what criteria would be used in the process. As stated by the

Memorandum, SARS now has the responsibility to develop and implement a set of guidelines and evaluation factors so that the 2013 Amendment Act can be implemented and executed in the most effective and efficient manner (SARS, 2013c:40).

1.1.2. Motivation of topic actuality

The significance of this research is that it could provide a practical solution as to what could be considered by SARS when defining particular tax understatements as *bona fide* inadvertent errors and what factors should be used when determining if this is applicable to a taxpayer or not.

SARS' Strategic Plan 2013/14 - 2017/18 states that developments in the international tax sphere have implications for the manner in which SARS collects the revenue required to meet the responsibilities of government. These developments will also have an impact on the perceived fairness of the country's tax system in general. SARS must keep up with these constant changes and develop the expertise and collaborations needed to ensure that wearing away of the South African tax base is prevented from happening and that everyone that enjoys the benefits of the country's public resources pays their reasonable share of taxes they owe (SARS, 2013a:18).

Guidelines and key factors to be considered by SARS officials are needed when determining whether understatements would fall under *bona fide* inadvertent errors or not. It is imperative that due process is followed in order to minimize the inclusion of undeserving cases and ensure the inclusion of deserving cases.

The purpose for drafting the TA Act as stated by the Minister of Finance in the 2005 Budget Review (National Treasury, 2005:98) was to provide a combined piece of legislation to set out the requirements for administering tax laws in South Africa and to ensure timely and adequate tax collection. The TA Act was implemented through proclamation with effect from 1 October 2012 (Proclamation 51 of 2012:4). One of the strategic goals of SARS is to expand the tax register and widen the South African tax base by way of, amongst other things, increasing the level of tax compliance which was also achieved by the provisions of the TA Act (National Treasury, 2013b:13).

1.2. PROBLEM STATEMENT

As is evident from above, the problem statement is that no definition or guidelines currently exist on how to classify or treat a *bona fide* inadvertent error for purposes of Section 222 of the TA Act.

The purpose of this study will therefore be to explore key considerations as to what should be taken into account by SARS when classifying particular tax understatements as *bona fide* inadvertent errors.

1.3. OBJECTIVES

1.3.1. Main objective

To develop key considerations to take into account when determining *bona fide* inadvertent errors resulting in understatements.

1.3.2. Secondary objectives

- To explore the role and importance of tax penalty provisions and to critically analyse the meaning of the different components in the term '*bona fide* inadvertent error'. (Refer to Chapter Two.)
- To analyse and compare the provisions of other tax jurisdictions with regards to errors made resulting in tax understatements in order to find a possible definition as well as guidelines on the application of *bona fide* inadvertent errors as contained in Section 222 of the TA Act. The tax jurisdictions referred to are those of Australia, New Zealand and the United Kingdom. (Refer to Chapter Three.)

- To critically evaluate the term ‘*bona fide* inadvertent error’ by comparing the term with the characteristics of a good tax system and suggest improvements for the practical execution of the new amendment to the TA Act. The Meade Report (IFS, 1978) as well as the report from the American Institute of Certified Public Accountants (AICPA, 2005) will be used. (Refer to Chapter Four.)

1.4. RESEARCH PARADIGM, DESIGN AND METHODOLOGY

1.4.1. Research paradigm

According to Grix, all researchers conduct research within a certain paradigm, even though it might not always be stated (Grix, 2004:171). The term paradigm has its origin in the Greek language and stems from the word *paradeigma* which means pattern. Kuhn (as quoted by Flick, 2009:69) defines a paradigm as “an integrated cluster of substantive concepts, variables and problems attached with corresponding methodological approaches and tools...” Three main categories exist in the research field namely positivism, interpretivism and critical theory (Mouton, 2001:139). The interpretive legal research paradigm was chosen for this study because the meaning and the application of the new provision regarding a *bona fide* inadvertent error in terms of Section 222 of the TA Act will be analysed.

1.4.2. Research design

Research designs are mainly classified into two broad types, namely empirical and non-empirical studies. Examples of empirical studies will be historical studies, content analysis and textual studies, whereas examples of non-empirical studies will be conceptual studies, theory and model building (Mouton, 2001:144). The non-empirical research design will be used for this study due to the conducting of a literature review.

1.4.3. Research methodology

A literature review is a written document that presents a logically argued case founded on a comprehensive understanding of the current state of knowledge about a topic of study. This case establishes a convincing thesis to answer the study's question (Machi & McEvoy, 2009:4).

A thorough, sophisticated literature review is the foundation and inspiration for substantial, useful research (Boote & Beile, 2005:3). A literature review can also be defined as “a systematic, explicit, and reproducible design for identifying, evaluating and interpreting the existing body of recorded documents” (Fink, 1998:205).

Doctrinal research can be described as the traditional approach and is typified by the systematic process of identifying, analysing, organising and synthesising statutes, judicial decisions and commentary. It is typically a library-based undertaking, focusing on reading and conducting intensive, scholarly analysis (McKerchar, 2008:18-19).

Routio defines normative research as “the theory of practice for a professional activity, such as design, which can consist of recommendations, rules, standards, algorithms, advices or other tools for improving the object of study” (Routio, 2005:1).

The first secondary research objective will be achieved by performing a literature review to gain an in-depth understanding of the role and importance of tax penalty provisions in the tax system. Doctrinal research will also be carried out to perform a critical analysis on the meaning of the different components in the term ‘*bona fide* inadvertent error’.

The second secondary objective will be achieved by performing a comparative analysis between different countries regarding errors being made when dealing with understatements. Australia, New Zealand and the United Kingdom will be used due to the fact that they are part of the Organization for Economic Cooperation and Development (OECD) English speaking countries. The levying of understatement (shortfall) penalties has already been successfully rolled out and implemented by the above-mentioned countries. Guidelines regarding the understatement

penalties are communicated to the general public in each country by communiqués and standardised question tables. The levying of understatement penalties in all of these countries is comparable to the legislative framework brought about by the TA Act. The penalty procedures of these countries also specifically provide for greater fairness in penalty percentages as compared to the maximum 200 per cent penalty that could have been levied in terms of Section 76 of the Income Tax Act (58 of 1962) (Feuth, 2013:49).

The third secondary objective will be achieved by following a normative research approach to critically evaluate the term ‘*bona fide* inadvertent error’ and to determine which key factors ought to be considered when executing the amendments of the TA Act with regard to the correct classification of an understatement due to a *bona fide* inadvertent error. It will ensure not only the consistent interpretation and classification of all *bona fide* inadvertent errors but also contribute immensely to the credibility and reliability of tax assessment pertaining to this legislation. The Meade Report (IFS, 1978) from the United Kingdom and the report from the American Institute of Certified Public Accountants (AICPA, 2005) will be used as it contains foundational characteristics of a good tax system.

1.5. INTERPRETATION

When fiscal legislation is considered, one of the cornerstones on which revenue authorities can determine and receive taxes is interpretation. This will also be the starting point on which a taxpayer will build his or her rights (Goldswain, 2008:107). When interpreting fiscal legislation, the key rule is to apply the normal grammatical meaning to words (R Koster & Son (Pty) Ltd & Another, 1985; Goldswain, 2008:111).

This key rule, however, may be deviated from if the normal grammatical meaning will result in uncertainty or absurdity, in which case the court must establish the “intention of the legislature” (Glen Anil Development Corporation Ltd v SIR, 1975; Goldswain, 2008:112).

Due to the fact that the term '*bona fide* inadvertent error' has not been defined by SARS, the normal grammatical meaning will be explored in this study.

1.6. DELINEATIONS AND INHERENT RESEARCH LIMITATIONS OF THE STUDY

1.6.1. Delineations

The research study only addresses the term '*bona fide* inadvertent error' under the TA Act in a South African context and is therefore South African specific. For this reason, it provides limited use to other tax jurisdictions. Other tax jurisdictions selected for the comparative analysis were limited to Australia, New Zealand and the United Kingdom. This study will therefore not deal with penalty provisions relating to errors of other tax jurisdictions. For purposes of comparing the term '*bona fide* inadvertent error' with the characteristics of a good tax system, only two reports were used, namely the Meade Report (IFS, 1978) as well as the report from the American Institute of Certified Public Accountants (AICPA, 2005).

1.6.2. Inherent research limitations

The 2013 Amendment Act was promulgated in January 2014 and is therefore still very untested in the tax fraternity. The impact of the amendments regarding the *bona fide* inadvertent errors on taxpayers and SARS can only be effectively (whether it was successful in producing the intended result) and efficiently (whether it is working in a well-organised and structured way) evaluated over a period of time involving more than one tax year. It is for purposes of this study regarded as a limitation on the scope.

1.7. CHAPTER OUTLINE

The lay-out of the research is as follows:

Chapter One

In this chapter the background to the research, the problem statement, the research objectives for this study and the research paradigm, design and methodology will be presented. The delineations and inherent research limitations of the study will also be discussed.

Chapter Two

This chapter will look at the role and importance of tax penalty provisions. An in-depth literature review will also be performed to gain an understanding of the provisions of Section 222 in the TA Act pertaining to the meaning of a *bona fide* inadvertent error and to critically analyse the meaning of the different components in the term '*bona fide* inadvertent error'.

Chapter Three

This chapter will explore how other tax jurisdictions treat understatements as a result of honest mistakes or errors. The tax jurisdictions referred to are those of Australia, New Zealand and the United Kingdom.

Chapter Four

In this chapter the term '*bona fide* inadvertent error' will be critically evaluated against criteria that good tax law should meet. Improvements and key considerations will also be suggested. The Meade Report (IFS, 1978) from the United Kingdom and the report from the American Institute of Certified Public Accountants (AICPA, 2005) will be used.

Chapter Five

This chapter will contain a summary of the findings of Chapters Two, Three and Four as well as recommendations for future research. A conclusion for the problem statement will also be presented.

CHAPTER TWO

2.1. INTRODUCTION

What motivates taxpayers to comply with tax laws? Is it the fear of being penalised when not complying or is it personal and social morals that drive taxpayers to comply? How harsh should tax penalties be in order to maximise compliance to tax laws? And under which circumstances would taxpayers choose not to comply?

The starting point is to gain an understanding of the provisions of Section 222 in the TA Act, as amended in 2013, and specifically the definition and meaning of a *bona fide* inadvertent error in order to ascertain the role and importance of tax penalty provisions in the tax system. Thereafter, the meaning of the different components in the term ‘*bona fide* inadvertent error’ will be explored. This chapter will thus address the first secondary objective in paragraph 1.3.2.

Through a literature review, two main views on the role and importance of tax penalties were identified and will be discussed below.

2.2. VIEWS ON THE ROLE AND IMPORTANCE OF TAX PENALTIES

In the Strategic Plan of 2013/2014 – 2017/2018 SARS established four core outcomes, increased tax compliance being one of them. SARS states that it operates on the basis of voluntary compliance and a ground rule is that balance must exist between education, service and enforcement. Enforcement is a critical component to establish objective and fair treatment of all taxpayers and to simplify the process for all taxpayers willing to comply voluntarily (SARS, 2013a:42). The aspiration of SARS “to consistently increase voluntary compliance across a broader taxpayer base through targeted and informed outreach, superior service and enforcement

interventions” will be accomplished by a couple of initiatives. One such initiative already implemented is the SARS Compliance Programme which contain strategies to systematically improve compliance over a multi-year period (SARS, 2013a:42).

2.2.1 Voluntary compliance

Compliance with all tax laws by taxpayers will ensure an effective tax system. Tax penalties and appropriate guidelines, therefore, should be in place to encourage amongst taxpayers a habit of compliance. Tax penalty provisions should be crafted and administered in such a way that it will ensure that tax penalties discourage bad practice without discouraging good practice or taking punitive measures against innocent taxpayers. Clearly defined penalties that will correspond to certain standards of behaviour and will be fairly administered encourage voluntary compliance to tax laws. The other side of the coin will be that unreasonable, vaguely defined penalties will result in a negative paradigm where taxpayers will feel being treated unfairly and might undermine voluntary compliance. This can specifically be the case where there are no safeguards built into the provisions or where the tax system automatically imposes tax penalties (AICPA, 2013:1).

The main aim for the provisions of tax penalties is therefore voluntary compliance and all the measures taken should be taken to the accomplishment of this as penalties are a vital part of tax administration.

In America, Congress enacted comprehensive penalty reform legislation in 1989. The Subcommittee on Oversight made the following statements regarding penalties:

- The purpose of tax penalties should be to encourage voluntary compliance with tax laws.
- The main purpose of tax penalties should not be the raising of revenue.
- Tax penalties and the required standard of behaviour should be clear and easily understood by all taxpayers.
- Tax penalties should only be targeted toward culpable conduct by taxpayers.
- Multiple tax penalties should not apply to the same misconduct.

- Tax penalties should be proportionate to the degree of misconduct.
- Tax penalties should not treat taxpayers who make an honest effort to comply as harshly as those taxpayers who deliberately violate the tax laws (AICPA, 2009:3).

Administrative procedures for imposing tax penalties should ensure that all taxpayers are treated in a fair and reasonable manner (AICPA, 2009:3).

Doran (2009:131-133) also refers to the norms model where taxpayers comply with tax laws through adherence to personal as well as social standards. This model accepts that there will be non-compliant taxpayers, and therefore acknowledge that tax penalties remain imperative to punish those taxpayers in order to prevent tax compliance from weakening. Too much dependence on tax penalties, on the other hand, might have a negative impact on norms and therefore a fine balance should exist.

The same approach should be taken when drafting South African penalty legislation to ensure voluntary compliance to the South African tax laws by all taxpayers.

2.2.2. Audit lottery

Another view on the role that tax penalties play in the tax system is that taxpayers are expected to violate tax laws if the benefits gained from the violation of the law will exceed the expected punishment and by that playing the so-called “audit lottery” (Keinan, 2006:388). If taxpayers only comply with tax laws when the punishment of non-compliance exceeds the benefits gained from not complying, the accurate crafting and administering of the tax penalty provisions are crucial.

Robert Cooter, the Herman F. Selvin Professor of Law at the University of California, Berkeley, School of Law and a pioneer in the field of law and economics refers to Justice Holmes’s “bad man” theory in the context of economic analysis of deterrence and explains that a rational bad man will decide to break the law when his own benefit will be greater than the risk of being punished. For the “bad man” the law is outside of his personal values (Cooter, 2000:1591).

Another important aspect to consider is the fact that penalties should not be too harsh or disproportionate, because this might discourage economic activity. Only tax-motivated transactions without economic substance need to be reduced (Keinan, 2006:397). The balance should therefore be found between rigid penalties to deter non-compliance, but at the same time avoiding over-deterrence.

Analysing the cost-benefit equation of tax penalties will assist in determining the best ways to deter non-compliance with tax laws. Keinan uses the following equation to explain a taxpayer's rationale (Keinan, 2006:407 – 419):

$M - C > Z \times (F + M)$, where

M = the taxpayer's expected tax savings, or gain.

C = the taxpayer's lump-sum costs associated with the transaction, for example lawyers' and accountants' costs as well as court fees.

Z = the probability of being subject to penalties for a given transaction. This probability is divided into four components:

Z1 = the probability of being audited, Z2 = the probability that the Revenue Services will detect the transaction on an audit, Z3 = the probability that the Revenue Services will win its subsequent case against the taxpayer, Z4 = the probability that the taxpayer will not be able to escape the penalty.

F = penalty rate x M

Therefore, as long as the expected gain on the left side of the equation (M – C) will exceed the cost on the right side of the equation (Z x (F + M)), the rational taxpayer will violate tax laws under this view. Increasing the rate of the penalty as well as increasing the probability that the taxpayer will be subject to the penalty will deter non-compliance to tax laws.

Two elements that were ignored in this equation are the taxpayer's aversion to risk and the social costs the taxpayer might suffer when found liable (Keinan, 2006:407 – 419).

Illustration: The rate of the penalty is 25% and the probability of being subject to it is 40%. (F = 0.25M and Z = 0.4):

$$M - C > Z \times (F + M)$$

$$M - C > 0.4(0.25M + M)$$

$$M - C > 0.4(1.25M)$$

$$C < 0.5M$$

Conclusion: As long as the taxpayer's lump-sum costs associated with the transaction (C) is less than 0.5M, the taxpayer will have incentive not to comply with tax laws.

With this in mind, it is important to consider whether the amendments to Sections 222 and 223 of the TA Act, specifically the inclusion of the term '*bona fide* inadvertent error', will be successful in finding the balance between voluntary compliance on the one side, and preventing the benefits from non-compliance to exceed the punishment on the other. The next step will therefore be to explore Sections 222 and 223 of the TA Act before and after the amendments contained in the 2013 Amendment Act promulgated on 16 January 2014 and which are deemed to have come into operation on 1 October 2012 except where otherwise stated in the 2013 Amendment Act.

2.3. UNDERSTATEMENT PENALTY UNDER SECTIONS 222 AND 223 OF THE TA ACT

Under the previous Section 76 of the IT Act (58 of 1962) and Section 60 of the VAT Act (89 of 1991), additional tax and penalties were charged to taxpayers, but too much discretion were given to SARS officials. No rules or guidelines stipulated how the Commissioner should exercise his powers. Previously under Section 76 a taxpayer had to prove the existence of mitigating conditions and motivate the downward remission from the 200% maximum penalty percentage, which turned into somewhat of a lottery for taxpayers as well as advisers (Hofmeyr, 2011:1).

The introduction of an understatement penalty contained in Chapter 16 of the TA Act seeks to rectify some of these shortcomings. According to the TA Act ‘understatement’ means any prejudice to SARS or the *fiscus* as a result of –

- (a) a default in rendering a return;
- (b) an omission from a return;
- (c) an incorrect statement in a return; or
- (d) if no return is required, the failure to pay the correct amount of ‘tax’.

The provisions in the TA Act on understatement penalties will hopefully result in more transparency, objectivity and predictability. In terms of the TA Act, the onus to prove the grounds for the charging of an understatement penalty and the applicable percentage will now be on SARS, and the imposition of an understatement penalty will be subject to the normal objection, appeal and dispute resolution procedures (Hofmeyr, 2011:1). Section 222 of the TA Act that specifically deals with a *bona fide* error will now be explored, both before and after the amendments in the 2013 Amendment Act. The table in Section 223 of the TA Act will also be included for ease of reference as it is referred to in Section 222 of the TA Act.

2.3.1. Sections 222 and 223 of the TA Act before the amendment in the 2013 Amendment Act

Before the amendment in 2013, Sections 222 and 223 of the TA Act read as follows:

222. (1) In the event of an ‘understatement’ by a taxpayer, the taxpayer must pay, in addition to the ‘tax’ payable for the relevant tax period, the understatement penalty determined under subsection (2).

(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 the shortfall determined under subsections (3) and (4).

(3) The shortfall is the sum of—

(a) the difference between the amount of ‘tax’ properly chargeable for the tax period and the amount of ‘tax’ that would have been chargeable if the ‘understatement’ were accepted;

(b) the difference between the amount properly refundable for the tax period and the amount that would have been refundable if the ‘understatement’ were accepted; and

(c) the difference between the amount of an assessed loss or any other benefit to the taxpayer properly carried forward from the tax period to a succeeding tax period and the amount that would have been carried forward if the ‘understatement’ were accepted, multiplied by the tax rate determined under subsection (5).

(4) If an ‘understatement’ results in a difference under both paragraphs (a) and (b) of subsection (3), the shortfall must be reduced by the amount of any duplication between the paragraphs.

(5) The tax rate is the maximum tax rate applicable to the taxpayer, ignoring an assessed loss or any other benefit brought forward from a preceding tax period to the tax period.

223. Understatement penalty percentage table.—(1) The understatement penalty percentage table is as follows:

1	2	3	4	5	6
Item	Behaviour	Standard case	If obstructive, or if it is a ‘repeat case’	Voluntary disclosure after notification of audit or investigation	Voluntary disclosure before notification of audit or investigation
(i)	‘Substantial understatement’	25%	50%	5%	0%
(ii)	Reasonable care not taken in completing return	50%	75%	25%	0%

(iii)	No reasonable grounds for 'tax position' taken	75%	100%	35%	0%
(iv)	Gross negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

(2) An understatement penalty for which provision is made under this Chapter is also chargeable in cases where—

- (a) an assessment based on an estimation under section 95 is made; or
- (b) an assessment agreed upon with the taxpayer under section 95 (3) is issued.

(3) SARS must remit a 'penalty' imposed for a 'substantial understatement' if SARS is satisfied that the taxpayer—

- (a) made full disclosure 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; and
- (b) was in possession of an opinion by a registered tax practitioner that—
 - (i) was issued by no later than the date that the relevant return was due;
 - (ii) took account of the specific facts and circumstances of the arrangement; and
 - (iii) confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court.

2.3.2. Sections 222 and 223 of the TA Act after the amendment in the 2013 Amendment Act

After the amendment in 2013, Sections 222 and 223 of the TA Act read as follows:

222. (1) In the event of an ‘understatement’ by a taxpayer, the taxpayer must pay, in addition to the ‘tax’ payable for the relevant tax period, the understatement penalty determined under subsection (2) unless the ‘understatement’ results from a *bona fide* inadvertent error.

(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 in a return.

(3) The shortfall is the sum of—

(a) the difference between the amount of ‘tax’ properly chargeable for the tax period and the amount of ‘tax’ that would have been chargeable for the tax period if the ‘understatement’ were accepted;

(b) the difference between the amount properly refundable for the tax period and the amount that would have been refundable if the ‘understatement’ were accepted; and

(c) the difference between the amount of an assessed loss or any other benefit to the taxpayer properly carried forward from the tax period to a succeeding tax period and the amount that would have been carried forward if the ‘understatement’ were accepted, multiplied by the tax rate determined under subsection (5).

(4) If there is a difference under both paragraphs (a) and (b) of subsection (3), the shortfall must be reduced by the amount of any duplication between the paragraphs.

(5) The tax rate applicable to the shortfall determined under subsections (3) and (4) is the maximum tax rate applicable to the taxpayer, ignoring an assessed loss or any other benefit brought forward from a preceding tax period to the tax period.

223. Understatement penalty percentage table.—(1) The understatement penalty percentage table is as follows:

1	2	3	4	5	6
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Item	Behaviour	Standard case	If obstructive, or if it is a 'repeat case'	Voluntary disclosure after notification of audit or investigation	Voluntary disclosure before notification of audit or investigation
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	Gross negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

(2) An understatement penalty for which provision is made under this Chapter is also chargeable in cases where—

- (a) an assessment based on an estimation under section 95 is made; or
- (b) an assessment agreed upon with the taxpayer under section 95 (3) is issued.

(3) SARS must remit a 'penalty' imposed for a 'substantial understatement' if SARS is satisfied that the taxpayer—

- (a) made full disclosure 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; and
- (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 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.

2.3.3. Reason for inclusion of the term 'bona fide inadvertent error'

Considering the above, the main differences between Sections 222 and 223 before and after the amendments in the 2013 Amendment Act are as follows:

- After the amendment in the 2013 Amendment Act a taxpayer will not pay an understatement penalty if the understatement results from a *bona fide* inadvertent error.
- The understatement penalty will be applied to each shortfall (instead of 'the' shortfall before the amendment) in relation to each understatement. If a return contains more than one understatement, the relevant behaviour in respect of each understatement must be determined individually.
- The percentages in the penalty percentage table contained in Section 223 of the TA Act were updated.

The amendments to the understatement penalty provisions contained in Sections 222 and 223 of Chapter 16 of the TA Act therefore provide relief to taxpayers in that it executed the announcement that no penalty would be charged if the understatement had resulted from a *bona fide* inadvertent error (National Treasury, 2013a:63). At this stage of the research it appears that this amendment will encourage voluntary compliance with tax laws because taxpayers will feel that only culpable conduct will be punished and that all taxpayers will be treated in a fair and reasonable manner, which are two very important objectives according to the AICPA report in order to increase voluntary compliance to tax laws (AICPA, 2009:3).

The importance of the responsibility of SARS to provide guidelines when determining whether an understatement will be classified as a *bona fide* inadvertent error is also highlighted when the view is considered that taxpayers might only comply with tax laws when the cost of punishment exceeds the benefits of not complying. If any possibility exists that an understatement can wrongly be classified as a *bona fide* inadvertent error, the risk of being punished will decrease and this will have a definite impact on compliance with tax laws.

Due to the fact that the term '*bona fide* inadvertent error' has not yet been defined by SARS, the next step to consider will be to critically analyse the meaning of the different components in the term '*bona fide* inadvertent error'. Only after the definition is clear will it be possible for SARS to develop guidelines and ensure the correct application and execution of the amendment to Section 222 of the TA Act.

2.4. DICTIONARY DEFINITIONS OF THE COMPONENTS IN THE TERM '*BONA FIDE* INADVERTENT ERROR'

2.4.1. Introduction

As mentioned under paragraph 1.5., the key rule when interpreting fiscal legislation is to apply the normal grammatical meaning to words (R Koster & Son (Pty) Ltd & Another, 1985; Goldswain, 2008:111). The normal grammatical meaning will be explored next. The following dictionaries will be used: Black's Law Dictionary, Burton's Legal Thesaurus, The Merriam-Webster Dictionary, The Oxford Dictionary and The West's Encyclopaedia of American Law.

2.4.2. *Bona fide*

According to the West's Encyclopaedia of American Law the term '*bona fide*' is a Latin term and means "in good faith; honest; genuine; actual; authentic; acting without the intention of defrauding".

The Oxford Dictionary states that the origin is Latin, and literally means "with good faith". The term is also defined as "genuine; real; without intention to deceive".

Black's Law Dictionary defines '*bona fide*' as "in or with good faith; honestly, openly, and sincerely; without deceit or fraud. Truly; actually; without simulation or pretence. Innocently; in the attitude of trust and confidence; without notice of fraud".

2.4.3. *Inadvertent*

Burton's Legal Thesaurus defines 'inadvertent' as "accidental, blind, careless, disregarding, heedless, imprudent, inattentive, neglectful, negligent, oblivious, regardless, thoughtless, undersigned, undiscerning, unheedful, unheeding, unintended, unmeant, unmindful, unnoticing, unobservant, unpremeditated, unseeing, unthinking". It also states that associated concepts are "neglect, negligence".

The Oxford Dictionary defines 'inadvertent' as "not resulting from or achieved through deliberate planning". It also gives the following synonyms: "unintentional, unintended, accidental, unpremeditated, unplanned, unmeant, innocent, uncalculated, unconscious, unthinking, unwitting, involuntary, chance, coincidental, careless, thoughtless".

According to the Merriam-Webster dictionary 'inadvertent' means "not intended or planned". Synonyms given are: "casual, chance, fluky, fortuitous, accidental, incidental, unintended, unintentional, unplanned, unpremeditated, unwitting".

2.4.4. Error

Burton's Legal Thesaurus defines 'error' as "aberrance, aberrancy, aberration, delusion, deviation, distorted conception, erratum, erroneous statement, error, false conception, false impression, fault, flaw, inaccuracy, incorrect belief, injustice, lapse, malapropism, misbelief, miscarriage of justice, miscomputation, misconception, misconjuncture, miscount, misguidance, misinterpretation, misjudgement, misprint, misreckoning, misstatement, mistaken belief, mistaken judgment, mistranslation, misunderstanding, misuse of words, oversight, peccatum, poor judgment, slip, untruthfulness, wrong course, wrong impression, wrongness".

The Oxford Dictionary defines 'error' as "a mistake". It also gives the following synonyms: "The state or condition of being wrong in conduct or judgement".

Black's Law Dictionary defines 'error' as "a mistaken judgment or incorrect belief as to the existence or effect of matters of fact, or a false or mistaken conception or application of the law".

2.4.5. Conclusion on dictionary definitions of the components in the term 'bona fide inadvertent error'

From the preliminary research evidence, it can be concluded that the grammatical definition of a *bona fide* inadvertent error in the context of Section 222 of the TA Act is the innocent misstatement of a taxpayer on his return that led to an understatement, while the taxpayer acted in good faith and without the intention to deceive.

An area of concern will be the definition linked to the word 'inadvertent'. As seen from the Burton's Legal Thesaurus, included in the definition are the following words: "blind, careless, disregardful, heedless, imprudent, inattentive, neglectful, negligent, oblivious, regardless, thoughtless, undersigned, undiscerning, unheedful, unheeding, unmindful, unnoticed, unobservant, unseeing, unthinking." It also states that associated concepts are "neglect, negligence".

The synonyms given by the Oxford dictionary of “careless, thoughtless” also raise concern. Is it SARS’ intention to include negligent behaviour under the definition of a *bona fide* inadvertent error? This might result in taxpayers, making errors on their tax returns due to careless, negligent behaviour, not paying any tax penalties when such errors are classified as *bona fide* inadvertent errors.

Also, as seen in Section 223 of the TA Act above, one of the behaviours is “reasonable care not taken in completing return” and another is “gross negligence”. How will the definition and application of a *bona fide* inadvertent error fit into the tax penalty system without creating confusion when looking at the behaviours of Section 223 of the TA Act? For example, if an honest mistake was made by a taxpayer but the taxpayer did not take reasonable care and the mistake leads to an understatement, will the understatement be classified as a *bona fide* inadvertent error and not be penalised, or will the understatement be penalised under Section 223 of the TA Act?

2.5. CONCLUSION

The amendment to Section 222 of the TA Act which states that no tax penalty will be charged to an understatement if it results from a *bona fide* inadvertent error, meets the objective to encourage voluntary compliance by not taking punitive measures against innocent taxpayers. (Refer to paragraph 2.2.1.) If SARS can fairly administer this amendment, voluntary compliance to tax laws should increase.

It was also found that, as long as the expected gain by the non-compliance with tax laws will exceed the cost of being punished, the rational taxpayer might violate tax laws. It is therefore imperative that the amendment to Section 222 of the TA Act will be defined and administered effectively and efficiently to prevent taxpayers trying to argue an understatement into being classified as a *bona fide* inadvertent error, even if it is not. This will result in the probability of being subject to penalties decreasing and in turn will lead to taxpayers violating tax laws.

SARS should also shed some light on what exactly is meant by the word ‘inadvertent’. Is it SARS’ intention to also include negligent behaviour under the definition of a *bona fide* inadvertent error? This might result in taxpayers, making errors on their tax returns due to careless, negligent behaviour, not paying any tax penalties when such errors are classified as *bona fide* inadvertent errors, and will also lead to confusion in the application of behaviours contained in Section 223 of the TA Act due to the fact that the understatement can fall into more than one category.

By exploring the role and importance of tax penalty provisions in paragraph 2.2., and the meaning of the different components in the term ‘*bona fide* inadvertent error’ in paragraph 2.4., the first secondary objective in paragraph 1.3.2. has been met.

The next chapter will explore how other tax jurisdictions treat understatements as a result of honest mistakes or errors.

CHAPTER THREE

3.1. INTRODUCTION

This chapter will explore how other tax jurisdictions outside the perimeters of South Africa treat understatements as a result of honest mistakes or errors. The tax penalty provisions contained in Sections 222 and 223 of the TA Act will be compared to tax penalty provisions in Australia, New Zealand and the United Kingdom in order to find a possible definition and guidelines on the application of *bona fide* inadvertent errors as contained in Section 222 of the TA Act. These tax jurisdictions will be used as they are part of the OECD English speaking countries. Another reason is the fact that the measures regarding penalty provisions of all these countries are comparable to the understatement penalty provisions contained in the TA Act (28 of 2011) (Feuth, 2013:49). This chapter will thus address the second secondary objective in paragraph 1.3.2.

3.2. AUSTRALIAN PENALTY PROVISIONS RELATING TO ERRORS

Practice Statement Law Administration 2012/5 (PSLA 2012/5) explains under which conditions a taxpayer will be liable for a tax penalty in making a false or misleading statement which results in an understatement and how the tax penalty will be assessed (ATO, 2012:1).

PSLA 2012/5 states that, in terms of Subsection 284-75 of the Australian Taxation Administration Act (1 of 1953) (the AU TAA), a taxpayer is liable to an administrative penalty if:

- The taxpayer or his agent makes a statement to the Commissioner or another entity applying powers or performing duties under a taxation law which results in a shortfall amount, and

- The statement is misleading or false in a significant particular, whether because of things included in it or excluded from it.

A taxpayer is also liable to an administrative penalty if:

- The taxpayer or his agent makes a statement to an entity other than the Commissioner and an entity applying powers or performing duties under a taxation law which results in a shortfall amount, and
- The statement is, or has the intention to be, one required by a taxation law, and
- The statement is misleading or false in a significant particular, whether because of things included in it or excluded from it (ATO, 2012:5).

PSLA 2012/5 further explains that subsection 284-75 of the AU TAA contains three exceptions to a shortfall penalty which will avoid or decrease liability for statements made on or after 4 June 2010, namely:

- The taxpayer and his agent (if relevant), took reasonable care in connection with making the statement
- ‘safe harbour’ applies to the statement, or
- The taxpayer and his agent (if relevant), applied the law in an accepted way (ATO, 2012:8).

No penalty will therefore be charged if a taxpayer and its agent (if relevant) took reasonable care when making the statement as referred to above. The definition of the term ‘reasonable care’ is explained in Miscellaneous Taxation Ruling MT 2008/1: Penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard (MT 2008/1) as making “a reasonable and genuine attempt to comply with obligations imposed under a taxation law” (ATO, 2008:8). It also states that a false or misleading statement does not automatically mean that reasonable care was not taken. Assessing whether reasonable care was taken, the personal circumstances of the taxpayer, level of skill and experience as well as the taxpayer’s knowledge of tax laws must be taken into account and the evidence gathered must support the finding that reasonable care had not been taken. In determining whether reasonable care was taken, it should be considered what the taxpayer was supposed to do or not supposed to do in order to mitigate the risk of

making a mistake. When dealing with transactions with large amounts, it would be expected that a higher degree of care will be exercised when making a statement (ATO, 2008:11-12, 29).

A genuine attempt means that a taxpayer indicates that he is dedicated by actively striving to comply with his tax obligations. An important criterion to determine whether a taxpayer is making a genuine attempt to comply is whether the taxpayer is making reasonable attempts to mitigate risks associated with his tax obligations and demonstrates this approach when submitting a tax return (ATO, 2012:9).

The following must be taken into account when considering the personal circumstances of the taxpayer to determine whether reasonable care was taken:

- Whether there was an inadvertent error such as an arithmetical error or an overlooked document.
- Whether realistic and sound enquiries were made, which may be indicated by whether:
 - The taxpayer just concluded the handling of the transaction was correct and signed a document without examining the content.
 - The degree of the enquiry carried out by the taxpayer was appropriate in relation to the risk associated with the decision and his resources, or
 - The effort and consideration was appropriate in relation to the size of the transaction.
- Whether the taxpayer was aware, or should have been aware, of the accurate treatment of the tax law.
 - A taxpayer should not put reliance on advice given where a reasonable person would be expected to know that the advice is not trustworthy.
 - A taxpayer is not compelled or allowed to just accept assurance by his or her professional advisor.
- Whether it was a new, uncommon or exceptional transaction – such transactions should have proportionally higher levels of care related to them.
- Whether reasonable efforts were made to keep records and to implement processes and systems, including staff-training.
- Whether anything hindered the taxpayer from reporting, reporting correctly, obtaining advice or understanding the requirements of the tax law, and

- The taxpayer's level of knowledge or understanding of the tax system, with reference to:
 - Whether a registered agent was used.
 - The taxpayer's level of education, knowledge and tax expertise, and
 - The taxpayer's age, health and background (ATO, 2012:9).

In the Australian case, *Chowdary and Commissioner of Taxation* (2013), the applicant sought review by the Small Taxation Claims Tribunal of an objection decision made by the respondent to disallow his claim for a remission of penalties. The penalties had been imposed at the rate of 25% for failing to take reasonable care in preparation of his income tax returns for the 2010 and 2011 financial years. The applicant claimed dividend deductions in relation to interest charged on monies borrowed for purchasing shares and also claimed the costs of managing his tax affairs for the 2010 and 2011 financial years. After an income tax audit, the applicant was requested to provide further information regarding the deductions claimed but failed to do so by the due date. The respondent then disallowed the deductions for the 2010 and 2011 financial years. The audit also determined that the applicant had claimed the dividend deductions in respect of interest incurred on an amount borrowed to purchase shares in his wife's name. The applicant therefore did not derive income from these shares and was not entitled to claim the deductions. The applicant was also unable to substantiate the amount claimed in respect of costs incurred in managing his tax affairs. The applicant was issued with a Notice of Amended Assessment for both financial years which increased his taxable income. Apart from a higher tax liability, the shortfall also resulted in a shortfall interest charge as well as a shortfall penalty in both the 2010 and 2011 financial years. After the applicant lodged a notice of objection, the respondent remitted the shortfall interest charges for the 2010 and 2011 financial years. The only issue then before the Tribunal was the question of the shortfall penalties.

The applicant acknowledged that he made a mistake when completing his e-tax returns, and described it as a true and honest mistake. He also said he had done his best to follow the instructions on the e-tax help pages. The applicant has an engineering degree as well as an MBA degree and has been a general manager for a US company since 2008. The applicant did not seek specific advice to determine whether he could claim a deduction in his name where the shares were held in his wife's name. The applicant also did not seek professional advice prior to completing his tax returns for the 2010 and 2011 financial years. In relation to the deduction

claimed for the cost of managing his tax affairs, the applicant said he interpreted the e-tax help pages as meaning he could claim up to this amount without the requirement to produce evidence. The applicant was, however, unable to clarify where he derived the cost from, as it did not appear on the screen shots of the e-tax help pages. The respondent contended that the applicant had made false or misleading statements for the purposes of section 284-75(1) of the AU TAA by claiming the dividend deductions and the cost of managing his taxation affairs. As a result, a shortfall amount was recorded for the 2010 and 2011 financial years. A penalty of 25% of the shortfall amount was applied due to the fact that the applicant failed to take reasonable care when preparing his tax returns.

The respondent contended that the test was not whether a person had tried to act with reasonable care but whether, objectively, reasonable care had been taken in the circumstances, and reasonable care would require the taxpayer to make appropriate enquiries to arrive at the correct treatment of taxation.

The respondent argued that it was clear, when following the e-tax modules, that dividend deductions could not be claimed where the expenses were not incurred in the production of the taxpayer's assessable income. A reasonable person would therefore not have come to the conclusion that the dividend deductions would be claimable. The respondent also emphasised that the applicant was experienced in completing his own and his wife's tax returns. He was a well-educated individual with senior management responsibilities. It would be expected from him to have an awareness of rules regarding the ability to claim deductions. The deductions claimed were also sizeable in relation to his assessable income.

The e-tax help pages states that a taxpayer has a right to deduct interest incurred on money borrowed to purchase shares and other related investments from which he/she derived assessable dividend income. It also states that a taxpayer has a right to deduct expenses incurred in managing his/her own tax affairs. However, there is no reference to the right to claim an amount without substantiation as alleged by the applicant.

The Tribunal considered that the respondent was correct in applying the 25% penalty. There was no reason to doubt the integrity and the honesty of the applicant, and the Tribunal accepted his explanation that an honest mistake had been made. The good intentions and good character of

the applicant were, however, not sufficient to negate the effect of an error in completing his tax returns. As an intelligent person, the applicant could have been expected to understand that a deduction could not be claimed for shares in his wife's name, and the costs of managing his tax affairs without appropriate substantiation. Both the law and the e-tax help pages are clear in this regard.

The applicant described the mistake as "true and honest". This is in line with the definition for 'bona fide'. (Refer to paragraph 2.4.2.)

3.3. NEW ZEALAND PENALTY PROVISIONS RELATING TO ERRORS

Understatements (or tax shortfalls) are dealt with in Section 141 of the New Zealand Taxation Administration Act (166 of 1994) (the NZ TAA). The specific sections of interest regarding a *bona fide* inadvertent error are Sections 141A(1), 141A(3) and 141A(4) as well as Sections 141B(1) and 141B(1B).

The relevant sections of the NZ TAA (166 of 1994) read as follows:

141A(1) A taxpayer is liable to pay a shortfall penalty if the taxpayer does not take reasonable care in taking a taxpayer's tax position (referred to as not taking reasonable care) and the taking of that tax position by that taxpayer results in a tax shortfall.

141A(3) A taxpayer who takes an acceptable tax position is also a taxpayer who has taken reasonable care in taking the taxpayer's tax position.

141A(4) Subsection (3) and section 141B(1B) do not exclude a taxpayer who makes a mistake in the calculation or recording of numbers in a return from being liable for a penalty for not taking reasonable care.

141B(1) A taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct.

141B(1B) A taxpayer does not take an unacceptable tax position merely by making a mistake in the calculation or recording of numbers used in, or for use in preparing, a return.

Tax Information Bulletins (TIBs) are issued by the New Zealand Inland Revenue (NZIR) and contain details and particulars regarding changes to legislation related to tax, proposed legislation, judgments, rulings and other specialist tax topics. TIB Vol 15, No 5 explains the intention of Sections 141A(4) and 141B(1B) as follows: "... Sections 141A(4) and 141B(1B) clarify that a taxpayer has not taken an unacceptable tax position if a tax shortfall is the result of a calculation mistake or by mis-recording numbers in a return. It was never intended that the unacceptable tax position penalty apply to calculation or processing mistakes. Rather, this penalty applies when a tax shortfall arises because a tax position is not as likely as not to be correct, whether or not the taxpayer actually interpreted the law. If a mistake is of such a magnitude that the mistake breaches the reasonable care standard, that shortfall penalty applies" (IR, 2003:49).

Interpretation Statement (IS0055) of the NZIR clarifies that the relevant definition of a mistake for purposes of Section 141B(1B) is "something that is not correct" and the intention of the legislature is not to include "error of judgment" in this definition as an error of judgment that will lead to an understatement was in effect a tax position taken by choice. Where amounts have been transposed by mistake, the mistake was not intentional and not an error of judgment, the taxpayer will not be considered to have taken an unacceptable tax position. The taxpayer might still be liable for the penalty, however, for not taking reasonable care (IR, 2005:34-35).

The NZIR states that a tax statement is not required to be free from any mistake or error, but it will consider whether the same care was taken which is expected from a reasonable person under the same circumstances. An arithmetical error does not in all circumstances indicate that reasonable care was not taken. The following factors will be considered to determine whether reasonable care was taken by the taxpayer (IR, 2008:1):

- the difficulty of the transaction and the law, and the complexity of interpreting the law
- the amount and severity of the tax shortfall

- the complexity and cost to prevent a shortfall from occurring
- taxpayer's age, background and health condition

Other factors to consider for a taxpayer operating a business:

1. The nature and size of the business.
2. Internal controls implemented in the business.
3. How the business operates the record-keeping.
4. What happens in case of failure of the system, and the reason for the failure (IR, 2008:1).

3.4. UNITED KINGDOM PENALTY PROVISIONS RELATING TO ERRORS

Schedule 24 to the Finance Act 2007 introduced a single penalty regime for errors in documents. Schedule 40 of the Finance Act 2008 extended the list of taxes and duties to which Schedule 24 applies. For purposes of this study, the focus will be on Schedule 24, which reads as follows:

1. (1) A penalty is payable by a person (P) where—
 - (a) P gives HMRC a document of a kind (listed in schedule 24), and
 - (b) Conditions 1 and 2 are satisfied.
- (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to—
 - (a) an understatement of a liability to tax,
 - (b) a false or inflated statement of a loss, or
 - (c) a false or inflated claim to repayment of tax.
- (3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.

(4) Where a document contains more than one inaccuracy, a penalty is payable for each inaccuracy.

3. (1) For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is—

- (a) “careless” if the inaccuracy is due to failure by P to take reasonable care,
- (b) “deliberate but not concealed” if the inaccuracy is deliberate on P’s part but P does not make arrangements to conceal it, and
- (c) “deliberate and concealed” if the inaccuracy is deliberate on P’s part and P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure).

Her Majesty Revenue & Customs (HMRC) provides technical as well as operational guidance to taxpayers on how to apply and understand the penalty provisions. This is done in a form of a manual called the Compliance Handbook (CH).

CH81120 states that HMRC will consider each taxpayer’s circumstances and ability in order to determine whether reasonable care was taken. Not the same level of competence and understanding will be expected from a self-employed individual as from a multinational company (HMRC, 2014a:1).

CH81130 goes further to state that no penalty will be charged to a taxpayer where an inaccuracy has been made despite the taxpayer having taken reasonable care to submit a correct return. One of the examples when a penalty will not be charged is “an arithmetical or transposition inaccuracy that is not so large either in absolute terms or relative to overall liability, as to produce an obviously odd result or be picked up by a quality check” (HMRC, 2014b:1).

A taxpayer will take reasonable care if:

- Policies and processes with specific reference to tax areas are in place that are expected to produce an accurate foundation for the calculation of tax liability, and
- Notwithstanding the above, inaccuracies arise through the accounting system of the taxpayer that leads to a misstatement of tax due, and

- The results of the inaccuracies are not material in relation to the taxpayer's overall tax liability (HMRC, 2014b:1).

3.5. COMPARING SOUTH AFRICA TO OTHER TAX JURISDICTIONS

Considering the above information, it is clear from all three tax jurisdictions that a lot of emphasis is placed on whether the taxpayer took reasonable care concerning his tax affairs when determining whether an error will be subject to a shortfall penalty. In Australia it is evident from the PSLA 2012/5 that an inadvertent error does not mean that reasonable care was not taken. The personal circumstances of the taxpayer, level of skill and experience as well as the taxpayer's knowledge of tax laws must be taken into account, and from the case, Chowdary and Commissioner of Taxation (2013), it can be seen that the good intentions and good character of the taxpayer will not be sufficient, but what could have been expected from a reasonable intelligent person.

The NZIR states that a tax statement is not required to be free from any mistake or error, but it will consider whether the same care was taken which is expected from a reasonable person under the same circumstances. An arithmetical error does not in all circumstances indicate that reasonable care was not taken. Again the personal circumstances of the taxpayer will be taken into account.

In the United Kingdom, CH81130 states that no penalty will be charged to a taxpayer where an inaccuracy has been made despite the taxpayer having taken reasonable care to submit a correct return.

When looking at the term '*bona fide* inadvertent error' contained in Section 222 of the TA Act, SARS should consider explaining in which circumstances an error will not lead to a shortfall penalty and in which circumstances an error will lead to a shortfall penalty. It should be taken into account whether the taxpayer took reasonable care when calculating his tax liability.

3.6. CONCLUSION

From the comparison above, it is clear that the primary aim of the tax penalty provisions in Australia, New Zealand and the United Kingdom is to influence taxpayers' behaviour towards compliance in a positive way. The objective is to protect those taxpayers with the intention to comply with tax laws, but at the same time punish taxpayers who try to benefit from non-compliance. To execute this, no penalties are charged for honest mistakes made where the taxpayer took reasonable care in their tax affairs.

Firstly, one of the important factors SARS should consider when providing guidelines regarding the definition and application of '*bona fide* inadvertent error' will be to clarify whether an error of judgment will be considered a *bona fide* inadvertent error for purposes of Section 222 of the TA Act. As noted above, under the New Zealand tax legislation, an error of judgment is specifically excluded from the definition of 'mistake' for purposes of Section 141A(4) of the NZ TAA (166 of 1994).

Secondly, SARS need to clarify whether a mistake, e.g. an arithmetical error made in a tax return, leading to a substantial understatement will be classified as a *bona fide* inadvertent error under Section 222 of the TA Act and consequently no penalty will apply, or whether it will fall under Section 223 of the TA Act in which case the taxpayer can be liable for an understatement penalty.

Thirdly, SARS should clarify how a mistake or error will be dealt with when the taxpayer did not take reasonable care. If an arithmetical error, leading to an understatement, was made by a person submitting a return of a multinational company and the return was not reviewed or double-checked, how will the mistake be considered in terms of the definition of a *bona fide* inadvertent error? Will it, for purposes of Section 222 of the TA Act, not be penalised, or will the understatement be liable for a penalty under Section 223 of the TA Act?

By exploring how other tax jurisdictions treat understatements as a result of honest mistakes or errors under paragraphs 3.2. to 3.5., the second secondary objective in paragraph 1.3.2. has been met.

In the next chapter, the current status of the term '*bona fide* inadvertent error' will be evaluated by comparing it with desirable characteristics of a good tax system.

CHAPTER FOUR

4.1. INTRODUCTION

The next important consideration in this study will be to evaluate the term ‘*bona fide* inadvertent error’ against the characteristics of a good tax system. Vague definitions and the absence of guidelines will lead to confusion and that, in turn, will have a negative impact on voluntary compliance. In order to do this evaluation, a normative research approach will be followed by exploring the desirable characteristics of a good tax system. For this evaluation, two reports will be used. Firstly, the Meade Report (IFS, 1978) from the United Kingdom will be used as a norm because clear objectives of a good tax system were produced by the committee chaired by Professor Meade after many implemented tax reforms led to the lack of a sound tax base and the help of the committee was called in. Secondly, the report from the American Institute of Certified Public Accountants (AICPA) will be used due to the fact that the AICPA has extensive history of assisting legislators with tax policy matters (AICPA, 2005:10). Improvements for the practical execution of the new amendment to the will also be suggested. This chapter will thus address the third secondary objective in paragraph 1.3.2.

4.2. THE MEADE REPORT (IFS, 1978)

The Institute for Fiscal Studies (the Institute) established a committee chaired by Professor Meade with the task to take an essential look at the tax structure of the United Kingdom. This was necessitated by the many tax reforms that were implemented randomly and which led to the lack of a sound base in the United Kingdom tax system. The Institute felt that this lack of a sound base in the tax system as a whole had the effect that certain objectives were pursued in contradictory ways and that conflicting objectives arose and therefore requested the Committee to look at the tax system and produce a statement of the objectives of taxation. They were also requested to comment on the present tax system in the light of these objectives and to make the necessary recommendations (IFS, 1978:9). These were published in a report titled ‘The structure and reform of direct taxation’ (the Meade Report).

The committee explained what the desirable characteristics of a good tax structure will be under the following six headings:

1. Incentives and economic efficiency.
2. Distributional effects.
3. International aspects.
4. Simplicity and costs of administration and compliance.
5. Flexibility and stability.
6. Transitional problems (IFS, 1978:25).

For purposes of this study, only the last three headings will be discussed in detail as it is directly applicable to the inclusion of the term '*bona fide* inadvertent error' as contained in Section 222 of the TA Act.

4.2.1. Simplicity and costs of administration and compliance

A good tax system should be consistent, logical and uncomplicated. In a democratic country one of the critical aspects of a good tax system is that the taxation authority should be accountable to the electorate of that country. This will only be the case if the reasonable man in the street can clearly understand and determine the nature of the taxpayer's liability. Complexities in the formulations or the administration of the tax and uncertainties in the application thereof do not meet the criterion of simplicity. The taxpayer should clearly know the difference between taxable and non-taxable income (IFS, 1978:36). In the case of income tax, for example, difficulties exist to clearly define income of a capital nature. Another aspect that can create problems is the difficulty to determine in which tax year to include gross income or deduct allowable expenses.

Closely linked to the importance of clearly defining taxable and non-taxable income is the certainty of the taxable amount on each taxable transaction. Valuation problems are essential in this regard. Taxpayers should also understand the purpose of each particular form of tax. The principle on which the tax base is chosen should be straightforward and easy to understand. A

tax system will only be simple and easy to understand when it makes a coherent whole, which is the fundamental building block of a good tax system. Taxpayers should also accept the tax system, and simplicity is necessary for acceptability (IFS, 1978:37).

A further requirement for a simple tax system is the ease of its administration, and in this regard a difference must be drawn between difficulty of administration and costs of administration. Even though these two things frequently go together it is not always the case. A large scale operation might be straightforward and uncomplicated, but due to the size it might result in a costly operation, for example the expenses incurred in providing large scale administrative staff. Not only must the official administrative costs be taken into account, but also the costs for the taxpayer. These private costs are often heavier than the official administrative expenses and can significantly be reduced if the tax system is clear and straightforward. The easier the tax system is to understand, the less costs will be spent on preparing tax returns and appeals. Very importantly, an uncomplicated tax system will provide less scope for the expenditure of time and resources to search for complex ways to lessen tax liabilities (IFS, 1978:38).

4.2.2. Flexibility and stability

Flexibility is an important requirement for a good tax system for both economical as well as political reasons. For economical purposes, total tax burdens need to be adjustable reasonably fast and regularly to/in the benefit of demand management. For political purposes, flexibility will be needed in a democratic society, because different political parties represent different philosophies and broad consensus must be reached. At the same time, where one government succeeds another, there must be room for changes of emphasis in the economic policy (IFS, 1978:39).

Simultaneously, the need for stability in the tax system exists in order for taxpayers to plan ahead. Taxpayers who are uncertain about their tax affairs will lose confidence which will then hinder production and prosperity. Clearly there will be a degree of conflict between the requirements of flexibility and that of stability, but for the intended degree of stability, regular disruption in the whole tax structure should be avoided (IFS, 1978:39 – 40).

4.2.3. Transitional problems

An important measure in evaluating a new tax proposal is therefore not only the value of the implemented system, but also the ease or complexity with which the conversion from the old to the new structure can be made. A key factor in this process of transition will be the training of all role players in the new system. Whether a change in a tax system should be made will therefore not only depend on the effectiveness of the new system once it is in operation, but also on how complex and complicated the transitional process will be (IFS, 1978:40 – 41).

4.3. THE MEADE REPORT (IFS, 1978) AND SECTION 222 OF THE TA ACT

From the above it is clear that several important aspects must be taken into consideration when critically evaluating the term ‘*bona fide* inadvertent error’.

Firstly, the definition of the term ‘*bona fide* inadvertent error’ is not simple and straightforward for the reasonable man in the street to understand. There is no clarity as to what type of errors will be regarded as *bona fide* inadvertent errors and not be liable for an understatement penalty.

Secondly, the inclusion of the term ‘*bona fide* inadvertent error’ in Section 222 of the TA Act and the penalty table contained in Section 223 of the TA Act do not make a coherent whole in terms of understatement penalties. Some of the behaviours listed under Section 223 of the TA Act are ‘substantial understatement’, ‘reasonable care not taken in completing return’ and ‘gross negligence’.) (Refer to paragraph 2.3.2.) How will a *bona fide* inadvertent error fit into these behaviours? For example, in case a taxpayer made an honest arithmetical mistake which led to a substantial understatement, will there be no understatement penalty because of the fact that a *bona fide* inadvertent error had been made, or will the taxpayer be liable for an understatement penalty according to the percentages of a ‘substantial understatement’ contained in Section 223

of the TA Act? Another example will be where a *bona fide* inadvertent error had been made in a complex transaction, but the taxpayer did not seek professional advice. Will the taxpayer be liable for a penalty due to 'reasonable care not taken in completing return' as contained in Section 223 of the TA Act, or will the fact that a *bona fide* inadvertent error had been made be given priority? As mentioned in the Meade report (IFS, 1978), taxpayers should accept the tax system, and simplicity is necessary for acceptability. SARS will have to clarify these matters as a matter of urgency.

Thirdly, SARS will also have to consider the administration process that will be involved to determine whether an understatement will fall into the category of a *bona fide* inadvertent error or not. The official administration costs as well as the compliance costs to the taxpayer should be considered in this regard. How complex and time consuming will it be to prove that a taxpayer indeed made a *bona fide* inadvertent error that led to an understatement? As seen in the Meade report (IFS, 1978), the more complicated the tax system, the more scope for possible loopholes to lessen tax liabilities and the more costs will be involved to solve the matter.

Fourthly, the balance between flexibility and stability will be of cardinal importance. Due to the nature of the amendment to include *bona fide* inadvertent errors and the fact that each case will be treated individually by individual SARS employees, taxpayers might perceive the amendment as very flexible and might try to argue an understatement to be classified as a *bona fide* inadvertent error even if it is not. Stability as to exactly what will be defined as a *bona fide* inadvertent error is urgently needed.

Lastly, when transitional problems are considered, the transition from the old Section 222 of the TA Act to the new Section 222 of the TA Act might create problems due to the fact that the amendment will be backdated and enforced from 1 October 2012. Guidelines and an uncomplicated administration process will be key to ensure an effective transition process.

4.4. THE AICPA REPORT (AICPA, 2005)

The American Institute of Certified Public Accountants (AICPA) is the national professional association of Certified Public Accountants with approximately 350 000 members. The AICPA has an extensive history of assisting legislators with tax policy matters, and promoting sound tax policy is one of their goals. The AICPA has engaged in developing a report to consider developments and serve as a resource in the tax reform debate. The intention with the report is to furnish member of AICPA, policymakers and interested individuals with a clear understanding of the matters under question and alternatives involved in federal tax reform (AICPA, 2005:10).

The AICPA report (AICPA, 2005) refers to the following ten tax policy objectives:

1. Simplicity
2. Fairness
3. Economic growth and efficiency
4. Neutrality
5. Transparency
6. Minimising non-compliance
7. Cost-effective collection
8. Impact on government revenues
9. Certainty
10. Payment convenience

4.4.1. Simplicity

Tax laws which are simple and straightforward will ensure proper and cost-effective compliance because taxpayers will understand how to apply them. In addition, the amount of mistakes will be reduced significantly with a simple and clear tax system and respect for the system will also be increased. A really easy tax system may not be possible, but the level of difficulty should be in relation to the type of taxpayer and the transaction. Simplicity is the cornerstone of the other

nine tax policy objectives. The less complicated tax laws are, the better taxpayers will be able to anticipate the tax implications of their financial choices (AICPA, 2005:25 – 26).

4.4.2. Fairness

To ensure tax system fairness, taxpayers in the same position should be taxed similarly. This can be a difficult task because taxpayers have different views on what constitutes a fair income tax system (AICPA, 2005:26).

4.4.3. Economic growth and efficiency

A country's productive economical capacity should not be hindered by the tax system. Instead, the tax system should support goals such as economic growth and international competitiveness. By identifying the economic effects when deciding which transaction to tax and at what rate, legislators can work toward planned economic results and avoid unintended consequences (AICPA, 2005:26).

4.4.4. Neutrality

The economic decisions of taxpayers about if and how a transaction should be entered into must not be materially influenced by tax considerations. Where neutrality has been reached, the tax implications of a transaction will neither encourage nor discourage the decision of the taxpayer to go ahead with the transaction. The system should be neutral when deciding on how to measure the amount on which tax will be paid, the tax rate and the financial ability of the taxpayer to pay the tax (AICPA, 2005:26).

4.4.5. Transparency

Taxpayers should be aware of all the different taxes that exist and how and when they will be taxed. Transparency allows taxpayers to know the true financial impact of their transactions and goes hand in hand with simplicity. The more complex the tax system, the harder it will be for taxpayers to understand if and how they will be taxed (AICPA, 2005:27).

4.4.6. Minimising non-compliance

A definite goal of the tax system and the administration thereof should be to minimise non-compliance. The difference between the amount of tax payable by taxpayers and the amount received by the tax authorities can be reduced by increasing the ease of compliance and using suitable practical rules and enforcement procedures. The balance between the preferred compliance level and the costs and interference of enforcement should be found (AICPA, 2005:27).

4.4.7. Cost-effective collection

Tax collection costs should be kept to a minimum for all parties involved. Different factors should be considered like the number of staff to administer the tax and also the cost of compliance for taxpayers. This objective is also linked to simplicity (AICPA, 2005:27).

4.4.8. Impact on government revenues

The amount and timing of tax revenue collection from all the different tax sources should be accurately predicted by government. Legislators need to consistently reach the desired level of

revenue within a reasonable period. In general, a tax system combining different tax sources will result in a stable source of revenue (AICPA, 2005:27).

4.4.9. Certainty

Taxpayers should be able to determine the amount of tax owed as well as when and how to pay it without any uncertainty. The more complex the system, the more uncertain taxpayers will be, which in turn will result in decreased tax compliance and increased costs (AICPA, 2005:27 – 28).

4.4.10. Payment convenience

Convenient and simple tax payment processes increases compliance. The most suitable payment method would take into consideration the liability amount, the best tax collection point, and the frequency of collection (AICPA, 2005:28).

4.5. THE AICPA REPORT (AICPA, 2005) AND SECTION 222 OF THE TA ACT

Looking at the objectives above, there are two ways to apply them to Section 222 of the TA Act. The first way is to understand the need for penalty provisions in order to reach the abovementioned objectives when considering tax laws, and the second way is to also apply the objectives directly to Section 222 of the TA Act. For purposes of this study, the objectives will be applied to Section 222 of the TA Act, and specifically to *bona fide* inadvertent errors.

Standing out is the need for simplicity, fairness and transparency. The term '*bona fide* inadvertent error' should be defined in such a way that taxpayers will clearly understand when an understatement will be the result of an error and when not. Fairness will be achieved when the same process will be followed by all tax officials to determine whether an understatement will fall into the category of a *bona fide* inadvertent error, and this process should be transparent to the taxpayers. The concept of not penalising taxpayers on honest mistakes will definitely contribute to the objective of fairness which will in turn increase voluntary compliance (AICPA 2009:3).

Again, as can also be seen from the Meade report (IFS, 1978), the costs of administering the new amendment to the TA Act can have a huge impact on the revenue of SARS. Training to SARS officials on the implementation of the amendment as well as the onus of proof that an error is not a *bona fide* inadvertent error are just two examples of the cost implications to SARS.

4.6. CONCLUSION

By comparing the objectives of a good tax system contained in the abovementioned reports, it can be concluded that although the inclusion of the term '*bona fide* inadvertent error' might increase voluntary compliance, SARS urgently needs to provide a clear definition and guidelines to simplify the amendment to the TA Act in order to be understandable and transparent to the reasonable taxpayer. Clarification as to where and how a *bona fide* inadvertent error will fit into the penalty table contained in Section 223 of the TA Act is also necessary.

A normative approach was followed to explore the desirable characteristics of a good tax system. The Meade report (IFS, 1978) as well as the AICPA report (AICPA, 2005) was used for this purpose and from there improvements for the practical execution of the new amendment to the TA Act were also suggested. This chapter thus achieved the third secondary objective in paragraph 1.3.2.

Chapter Five will contain a summary of the findings of Chapters Two, Three and Four as well as recommendations for future research. A conclusion for the problem statement will also be presented.

CHAPTER FIVE

5.1. INTRODUCTION

The 2013 Amendment Act was promulgated on 16 January 2014 and one of the fundamental changes to the TA Act was that taxpayers would not be penalised for *bona fide* mistakes made on tax returns.

The changes to the understatement penalty regime to include *bona fide* errors were not only welcomed by tax experts, but are also seen as long overdue. The amendment is necessary because it has not been clear how an out-and-out error would be treated when a taxpayer faced an understatement penalty (Visser, 2013:1).

The problem, however, is that it is not clear what the definition of a ‘*bona fide* inadvertent error’ is, and no guidelines have been developed by SARS yet. The main purpose of this research was to develop key considerations to take into account when determining *bona fide* inadvertent errors resulting in understatements. (Refer to paragraph 1.3.1.) Secondly, the purpose was to explore the role and importance of tax penalty provisions and to critically analyse the meaning of the different components in the term ‘*bona fide* inadvertent error’. (Refer to paragraph 1.3.2.) The third purpose for this study was to analyse and compare the provisions of other tax jurisdictions with regards to errors made resulting in tax understatements in order to find a possible definition as well as guidelines on the application of *bona fide* inadvertent errors as contained in Section 222 of the TA Act. (Refer to paragraph 1.3.2.) Lastly, to critically evaluate the current status of the term ‘*bona fide* inadvertent error’ and suggest improvements for the practical execution of the new amendment to the TA Act. (Refer to paragraph 1.3.2.)

This chapter draws conclusions from the research objectives and provides recommendations to address the problem statement. (Refer to paragraph 1.2.) Suggestions for future research are also offered.

5.2. ACHIEVEMENT OF RESEARCH OBJECTIVES

In order to achieve the research objectives of this study, a literature review was performed to gain an in-depth understanding of the role and importance of tax penalty provisions in the tax system. Doctrinal research was also carried out to perform a critical analysis on the meaning of the different components in the term '*bona fide* inadvertent error'. A comparative analysis between different countries regarding errors being made when dealing with understatements was then performed and lastly a normative research approach was followed to evaluate the current status of the term '*bona fide* inadvertent error' and to determine which key factors ought to be considered when executing the amendments of the TA Act with regard to the correct classification of an understatement due to a *bona fide* inadvertent error.

In order to determine if the main objective, which is to develop key considerations to take into account when determining *bona fide* inadvertent errors resulting in understatements, has been addressed, there must firstly be determined if the secondary objectives have been met, which are as follows:

- (i) To explore the role and importance of tax penalty provisions and to critically analyse the meaning of the different components in the term '*bona fide* inadvertent error'.
 - It was found that the amendment to Section 222 of the TA Act which states that no tax penalty will be charged to an understatement if it results from a *bona fide* inadvertent error, meet the objective to encourage voluntary compliance by not taking punitive measures against innocent taxpayers. If SARS can fairly administer this amendment, voluntary compliance to tax laws should increase.
 - It was also found that, as long as the expected gain by the non-compliance with tax laws will exceed the cost of being punished, the rational taxpayer might

violate tax laws. It is therefore imperative that the amendment to Section 222 of the TA Act will be defined and administered effectively and efficiently to prevent taxpayers trying to argue an understatement into being classified as a *bona fide* inadvertent error, even if it is not. This will result in the probability of being subject to penalties decreasing and in turn will lead to taxpayers violating tax laws.

- SARS should also shed some light on what exactly is meant by the word ‘inadvertent’. Is it SARS’ intention to also include negligent behaviour under the definition of a *bona fide* inadvertent error? This might result in taxpayers, making errors on their tax returns due to careless, negligent behaviour, not paying any tax penalties when such errors are classified as *bona fide* inadvertent errors, and will also lead to confusion in the application of behaviours contained in Section 223 of the TA Act.
- (ii) To analyse and compare the provisions of other tax jurisdictions with regards to errors made resulting in tax understatements in order to find a possible definition as well as guidelines on the application of *bona fide* inadvertent errors as contained in Section 222 of the TA Act.
- It was found that the primary aim of the tax penalty provisions in Australia, New Zealand and the United Kingdom is to influence taxpayers’ behaviour towards compliance in a positive way. The objective is to protect those taxpayers with the intention to comply with tax laws, but at the same time punish taxpayers who try to benefit from non-compliance. To execute this, no penalties are charged for honest mistakes made where the taxpayer took reasonable care in their tax affairs.
 - Firstly, one of the important factors SARS should consider when providing guidelines regarding the definition and application of ‘*bona fide* inadvertent error’ will be to clarify whether an error of judgment will be considered a *bona fide* inadvertent error for purposes of Section 222 of the TA Act.
 - Secondly, SARS need to clarify whether a mistake, e.g. an arithmetical error made in a tax return, leading to a substantial understatement will be classified as a

bona fide inadvertent error under Section 222 of the TA Act and consequently no penalty will apply, or whether it will fall under Section 223 of the TA Act in which case the taxpayer can be liable for an understatement penalty.

- Thirdly, SARS should clarify how a mistake or error will be dealt with when the taxpayer did not take reasonable care.
- Lastly, the personal circumstances of the taxpayer should be taken into account to determine whether the taxpayer took reasonable care. Factors to consider should be the level of skill and experience as well as the taxpayer's knowledge of tax laws. The age and health condition of the taxpayer should also be considered.

(iii) To critically evaluate the term '*bona fide* inadvertent error' by comparing the term with the characteristics of a good tax system and suggest improvements for the practical execution of the new amendment to the TA Act.

- It was found that several important aspects must be taken into consideration when evaluating the current state of the term '*bona fide* inadvertent error'. Firstly, the definition of the term '*bona fide* inadvertent error' is not simple and straightforward for the reasonable man in the street to understand. There is no clarity as to what type of errors will be regarded as *bona fide* inadvertent errors and not be liable for an understatement penalty.
- Secondly, the inclusion of the term '*bona fide* inadvertent error' in Section 222 of the TA Act and the penalty table contained in Section 223 of the TA Act do not make a coherent whole in terms of understatement penalties. As mentioned in the Meade report (IFS, 1978), taxpayers should accept the tax system, and simplicity is necessary for acceptability. SARS will have to clarify these matters as a matter of urgency.
- Thirdly, SARS will also have to consider the administration process that will be involved to determine whether an understatement will fall into the category of a *bona fide* inadvertent error or not. The official administration costs as well as the compliance costs to the taxpayer should be considered in this regard. How complex and time consuming will it be to prove that a taxpayer indeed made a

bona fide inadvertent error that led to an understatement? As seen in the Meade report (IFS, 1978), the more complicated the tax system, the more scope for complex ways to lessen tax liabilities. And the more costs will be involved to solve the matter. In the fourth instance, the balance between flexibility and stability will be of cardinal importance. Due to the nature of the amendment to include *bona fide* inadvertent errors and the fact that each case will be treated individually by individual SARS employees, taxpayers might perceive the amendment as very flexible. Stability as to exactly what will be defined as a *bona fide* inadvertent error is urgently needed.

- Lastly it was found that when transitional problems are considered, the transition from the old Section 222 of the TA Act to the new Section 222 of the TA Act might create problems due to the fact that the amendment will be backdated and enforced from 1 October 2012. Guidelines and an uncomplicated administration process will be key to ensure an effective transition process.

Based on the conclusions from each chapter, the main objective to develop key considerations to take into account when determining *bona fide* inadvertent errors resulting in understatements has been achieved and it can be concluded that the research problem has sufficiently been addressed.

5.3. RECOMMENDATIONS

In order to address certain challenges that were identified in Section 222 and 223 of the TA Act, the following recommendations are put forward:

- It is imperative that the term ‘*bona fide* inadvertent error’ contained in Section 222 of the TA Act will be defined urgently and that guidelines are provided to ensure an effective and efficient administration process and to prevent taxpayers trying to argue an understatement into being classified as a *bona fide* inadvertent error, even if it is not. The definition and guidelines should be simple and straightforward for the reasonable taxpayer to understand.

- SARS should also shed some light on what exactly is meant by the word ‘inadvertent’. Is it SARS’ intention to also include negligent behaviour under the definition of a *bona fide* inadvertent error?
- SARS should clarify whether an error of judgment will be considered a *bona fide* inadvertent error for purposes of Section 222 of the TA Act.
- SARS need to clarify whether a mistake, e.g. an arithmetical error made in a tax return, leading to a substantial understatement will be classified as a *bona fide* inadvertent error under Section 222 of the TA Act and consequently no penalty will apply, or whether it will fall under Section 223 of the TA Act in which case the taxpayer can be liable for an understatement penalty.
- SARS should clarify how a mistake or error will be dealt with when the taxpayer did not take reasonable care.

5.4. SUGGESTIONS FOR FUTURE RESEARCH

The following topics have been identified for future research:

- Evaluation of the future guidelines from SARS on how to interpret and apply a *bona fide* inadvertent error.
- Another area for future research when dealing with *bona fide* inadvertent errors is to determine how many errors made in submitted tax returns resulted in understatements and how many resulted in overstatements. This will give an indication on how “honest” the mistakes are that taxpayers make. If, for example, 85% of the errors resulted in understatements whereas only 15% resulted in overstatements, it will definitely rather point to tax evasion than *bona fide* errors.
- The study can also be extended by comparing South Africa’s penalty provisions relating to errors with more tax jurisdictions.

5.5. CONCLUSION

The amendment to the understatement penalty provisions contained in Section 222 of the TA Act that has the effect that no penalty will be charged if the understatement results from a *bona fide* inadvertent error are welcomed by taxpayers and will increase the fairness of the tax system. The 2013 Amendment Act is still a very new act and currently there are no guidelines regarding the definition and application of the term '*bona fide* inadvertent error'.

The focus of this study was to explore key considerations as to what should be taken into account by SARS when classifying particular tax understatements as *bona fide* inadvertent errors. It was found that the term '*bona fide* inadvertent error' contained in Section 222 of the TA Act should be defined urgently and that guidelines must be provided by SARS on the application of the new amendment to increase voluntary compliance. SARS should ensure that the expected gain from non-compliance to the new amendment do not exceed the cost of being punished.

A consideration to take into account might be to exclude the word 'inadvertent' from the term '*bona fide* inadvertent error' in order to avoid confusion. An error of judgement is another consideration SARS should take into account when defining the term '*bona fide* inadvertent error'. The correct definition and application will be imperative to ensure taxpayers will not try to argue an understatement into being a *bona fide* inadvertent error when in fact it is not.

SARS should also clarify the application of a *bona fide* inadvertent error in light of the behaviours contained in Section 223 of the TA Act to avoid any confusion. For example, how will an understatement be treated when the understatement was the result of a mistake, but the mistake was made due to the fact that the taxpayer did not take reasonable care when submitting the tax return? SARS should consider the personal circumstances of the taxpayer to determine whether reasonable care was taken by the taxpayer. Factors like the level of skill and experience, the taxpayer's knowledge of tax laws, age and health conditions of the taxpayer should be taken into account.

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