IN THE TAX COURT OF SOUTH AFRICA

HELD AT HIGH COURT: KWAZULU-NATAL LOCAL DIVISION, DURBAN

CASE NOs: IT13725 & VAT1426
IT13727 & VAT1096

In the matter between:

MR. A **1ST APPELLANT**

XYZ CC **2ND APPELLANT**

and

THE COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE **RESPONDENT**

J U D G M E N T
Delivered on: THURSDAY, 08 FEBRUARY 2018

OLSEN J

[1] These tax appeal proceedings involve two appellants and four appeals, two relating to income tax assessments and two relating to VAT assessments. All four of the appeals flow from the affairs of a business known as "XYZ". Until the close of the 2010 tax year the first appellant, Mr A, was the sole proprietor of XYZ. Thereafter, and certainly until the end of the 2012 tax year, the second appellant, XYZ CC was the sole proprietor of XYZ. However, the first appellant is the sole member of the second appellant. There was accordingly continuity of control over the affairs of XYZ for all of the tax periods involved in the present proceedings, that is to say

(a) in relation to income tax, the tax years from 2007 to 2010 (in the case of the first appellant), and 2011 and 2012 (in the case of the second appellant) ;

(b) in relation to VAT, from the period 4/2006 to period 2/2010 (in the case of the first appellant), and from period 9/2010 to 1/2013 (in the case of the second appellant).

[2] It is common cause that the first appellant failed to submit income tax returns and VAT returns for the tax years and VAT periods attributed to him in the paragraph immediately above. It is common cause that the second appellant failed to submit an income tax return for the 2011 tax year and the VAT periods attributed to it in the paragraph immediately above. These circumstances led to audits of the tax affairs of both tax payers in connection with their conduct of the business of XYZ. (In the case of the first appellant there was an interrupted earlier and apparently incomplete audit; the interruption having been caused by an application by the first appellant for voluntary disclosure relief, which was denied.) The assessments which resulted from the audit included substantial penalties. The appellants accept that the taxes reflected in the assessments are correctly calculated and raised. Only the penalties are challenged in these appeals.

[3] In the case of the first appellant, he was first notified of the “current” audit relating to income tax in June 2012, and of the audit relating to VAT in October 2012. In the case of the second appellant it was first notified of audits relating to both income tax and VAT by letter dated 29 January 2013. The letter made no reference to the 2012 income tax year. The second appellant’s income tax liability for the 2012 year was nevertheless investigated during the course of the audit and became part of the audit findings. For that reason that tax year also features in these appeal proceedings. The circumstances in which the audit was expanded in that fashion were not explained in evidence during this appeal. The phenomenon was only discussed during the course of argument when it appeared that whilst notification of the audit of the

second appellant's tax affairs pre-dated the final date for submission of the 2012 income tax return, audit work was undertaken (or was still being undertaken) after February 2013 by which time the 2012 income tax return had become due, but had not been submitted. The second appellant has recorded no objection to the fact that the audit was extended to cover the 2012 tax year.

[4] Two auditors were appointed in respect of the affairs of each of the taxpayers. A Ms T was the auditor common to both audits and she was the only witness who testified in the appeal proceedings.

[5] Most of Ms T's evidence had to do with the history of the investigation of the tax affairs of the two appellants, much of which is documented in the dossier and the appeal bundles. Her evidence ran up to the alternative dispute resolution proceedings which took place after the appellants had signified an intention to appeal. What followed to crystallise the issues to be decided in this appeal is undisputed, and indeed some of the battle lines were redrawn during the course of the appeals.

THE MAIN FACTS OF THE MATTER

[6] The periods in respect of which returns were not submitted by the appellants have already been mentioned above. In the case of the first appellant the first one not rendered was for the tax year ending 2007. A fact mentioned more than once in evidence by Ms T is the first appellant's application for a tax amnesty in respect of the 2006 tax year made in terms of the Small Business Tax Amnesty and Amendment of Taxation Laws Act 9 of 2006. That application was approved. Ms T's view, which is hard to fault, is that given the amnesty application, there is really no room for the appellants to argue that they were burdened with an imperfect understanding of their obligations with regard to the rendition of returns.

[7] Unbeknown to the first appellant, after his application for relief under Act 9 of 2006 had been processed XYZ was deregistered for VAT. He nevertheless continued to issue VAT invoices and collect VAT. It is undisputed that the deregistration was made in error, and the error was corrected as soon as it was discovered during 2009.

[8] Ms T's evidence was to the effect that, certainly at the outset, she did not receive co-operation from the appellants or from the accountant of XYZ. She obtained bank statements from the bankers of XYZ and using those documents generated her initial audit findings. In the case of the first appellant's income tax this exercise generated a very much higher estimate of income than the amounts assessed in accordance with the final audit findings. The original estimate, generated through an examination of the bank statements, suggested that the taxable income not declared during the years 2007 through to 2010 amounted to some R6,6 million. Ms T insisted during her evidence that her final audit figures, which generated the assessments, and which were very much lower than the initial estimates, were not reached with the assistance of annual financial statements supplied by the first appellant. (The sum of those final figures was some R2,3 million.) She made this assertion saying that the references to the first appellant's financial statements in her own correspondence were erroneous. During the course of argument counsel for SARS formally conceded that "there is a possibility that SARS did get annual financial statements from the taxpayers after the audit finding letters were delivered to the taxpayers". One understands the concession; but equally, given the attention paid to this issue on behalf of the first appellant during the course of the appeal proceedings, it is surprising that such financial statements were not produced in the extensive bundles provided for each of the appellants by their accountant, Mr K, who represented them during the proceedings. I am satisfied after taking into account Ms T's evidence, the challenges to it in cross-examination, and the decision of the first appellant not to give evidence, that the following can be said concerning this issue:

(a) If financial statements for the tax years in question existed when the first appellant was first informed of the audit, then they were withheld from SARS.

(b) The initial audit findings letter relating to the first appellant's income tax reflected amounts which were estimated otherwise than with reference to any annual financial statements produced by the first appellant.

(c) The questions as to whether financial statements were withheld from Ms T, and as to when she received such statements if her recollection that she never received any is faulty, need not be resolved.

(d) The fact of the matter is that there were exchanges which followed the audit findings letters, and that all of the ordinary taxes raised in the assessments which feature in the present appeal are agreed. The question as to whether or not the first appellant was obstructive does not affect the outcome of this appeal, given the basis upon which SARS ultimately advanced its case. (Indeed, it is not clear at all that it was ever relevant.)

[9] Ms T submitted the audit findings to the committee dealing with penalties, and that generated a decision that understatement penalties should be charged under Chapter 16 of the Tax Administration Act 28 of 2011 at 150%, upon the basis that the behaviour of the first and second appellants fell to be classified as "intentional tax evasion". Each of the cases was classified as "standard". That meant that it fell under the third column of the table of understatement penalty percentages appearing in section 223 of the Tax Administration Act. In the case of both appellants, the income tax years which followed the first one which was the subject of the audit, and the Vat periods which followed the first one which was the subject of the audit, were not classified as "repeat cases". If they had been such years and periods

would have fallen within the fourth column of the table, generating understatement penalties of 200%.

[10] For reasons which Ms T was unable to explain in evidence, small amounts of disallowed medical expenses continued to be reflected in the final audit (and assessments) as subject to the same penalties as income not declared. The amounts were R14 265 in 2008, R10 636 in 2009 and R13 924 in the 2010 income tax year. The correspondence issued by Ms T suggests that claims for the deduction of such medical expenses were made in the financial statements submitted by the first appellant; but her evidence was that she never received such financial statements. There is no evidence before the court of any wrongful inclusion of medical expenses in any tax return submitted by the first appellant in the years in question. The complaint made by SARS is that in fact there were no such returns. The only returns which appear in the papers before the court are those generated, as far as one can see, simply to reflect the final tax positions after the audits. These may very well have been completed by SARS itself, but that question was not canvassed in evidence. The penalties raised in respect of these medical expenses must be set aside as no foundation for the imposition of them has been laid in evidence. Nothing more will be said in this judgment on that subject.

[11] The finalisation of the audit generated assessments in respect of income tax and penalties thereon for both the first and second appellants, and assessments in respect of VAT and penalties thereon in respect of the second appellant. Objections were made thereto and dismissed. Both appellants notified an intention to appeal. For some reason, which was not disclosed in evidence and is not readily apparent on the papers, the assessments with regard to VAT payable by the first appellant were delayed.

[12] There was a referral to alternative dispute resolution of the appealed assessments (that is to say appeals by both appellants against the penalties imposed on income tax, and the appeal by the second appellant against penalties imposed on VAT).

[13] Of course this court is not privy to the representations which were made on behalf of the appellants when an alternative resolution of the dispute was being investigated. All we know is that the result was a reclassification by the respondent of the conduct, and accordingly a reconsideration of the penalties to be imposed. The respondent decided that this was not a case of intentional tax evasion, but one of gross negligence. It also sought to reclassify each income tax year except the first, and each VAT period (in the case of the second appellant) except the first, as a "repeat case", as set out in the fourth column of the table in section 223 of the Tax Administration Act. These decisions are alleged to be the correct ones in the respondent's statement of grounds of assessment and opposition to the appeal. In effect, therefore, at the commencement of the appeal hearing the respondent contended for reduced penalties in respect of the so-called first offences of 100%; and in the case of the so-called "repeat cases", of 125%.

[14] During the course of the appeal the respondent abandoned the contention that this appeal concerned any "repeat cases", and stated that it would argue for penalties of 100% for gross negligence under the "standard case" column of the table in section 223. In my view that concession was correctly made, if for no other reason than that the attempt to move the so-called repeat cases to column 4 of the table to secure higher penalties appears to me to fall foul of Rule 31(3).

[15] As mentioned earlier the assessment of the VAT and penalties thereon payable by the first appellant was delayed as a result of which, after it was issued, it had to undergo its own objection process in order to join this appeal. It was not referred for alternative dispute resolution; as a result of which, when this appeal started, the penalties in issue relating

to the first appellant's VAT were still penalties of 150% based on a contention that the first appellant's behaviour was properly classified as intentional tax evasion. Recognising that there was no rational basis upon which to distinguish the penalties raised on the first appellant's VAT obligations from the others, save for the fact that the former were inadvertently assessed and imposed too late to participate in the alternative dispute resolution process, the respondent stated during argument that the claim for these penalties is reduced to 100%.

[16] Notwithstanding the concessions made prior to the commencement of the appeal hearing, the respondent did not issue amended assessments. It is therefore common cause that at the least the penalties presently reflected in the assessments must be adjusted to reflect those concessions and the ones made in the course of the hearing.

[17] In their statements of grounds of appeal the appellants pleaded that the worst categorisation of their conduct or behaviour is that they failed to take reasonable care, which in terms of section 223 results in a penalty of 25%. As I understand their statement of grounds, this submission is based on the proposition that as a matter of fact the administrative capacity of XYZ was not up to standard; as a result of which XYZ could not render returns, being uncertain as to whether they would be correct (or accurate). That, according to the grounds of appeal, is why the returns were not rendered. The statement of grounds of appeal speaks of the "late" rendition of returns, presumably intending thereby to show consistency with the proposition that there was no intention to evade tax altogether.

[18] As mentioned earlier, no witness was called by the appellants. There was no attempt through evidence either to state or support the alleged factual proposition that XYZ lacked the administrative capacity necessary to render its VAT returns once every two months, and to state its contribution to the income of its sole proprietor once a year. Section 102(2) of the Tax Administration Act is to the effect that the

burden of proving the facts on which SARS bases the imposition of an understatement penalty under Chapter 16 is upon the respondent, as the appellants sought to remind this court more than once. However, the question of the administrative capacity of XYZ during the years in question is a matter peculiarly within the knowledge of the two appellants, its first and second sole proprietors. Without in any way wishing to suggest that I accept the proposition that an absence of administrative capacity justifies not submitting tax returns, it seems to me that the respondent has established a *prima facie* case from which the only inference to be drawn is that these tax returns were withheld intentionally throughout, and that without any discernible excuse. In the absence of evidence tendered by the appellants to counter the respondent's *prima facie* case, it ripens into evidence sufficient to discharge the burden of proof placed upon the respondent. (See *Ex Parte: The Minister of Justice: in re Rex v Jacobson and Levy* 1931 AD 466 at 478–479.) In the circumstances it must also be found as a fact that no shortfall in administrative capacity on the part of XYZ caused or justified the failures of the two appellants to submit income tax or VAT returns.

THE APPELLANTS' CONTENTIONS

[19] The appellants have made a number of contentions which I propose to deal with under four headings. I propose to start with the contention that gross negligence was not proved, as this follows directly on the statement of facts proved just dealt with.

WAS GROSS NEGLIGENCE PROVED

[20] The onus on the respondent in this case was to prove the facts upon the basis of which the penalties are said to be justified. To say of conduct that it is grossly negligent is to classify it on a scale of blameworthiness. The onus is on SARS to prove the conduct in question. Having done that, SARS must classify it, for the purposes of

Chapter 16, selecting the appropriate description of the behaviour from the options provided in section 223 of the Tax Administration Act.

[21] In my view there is no reason to suppose that this court sitting under the Tax Administration Act is no longer a "court of revision with power to investigate the matter before it", as was the case under earlier legislation. (See *Bailey v Commissioner for Inland Revenue* 1933 AD 204 at 220.) The duty of this court is to consider whether the conduct of the appellants, proved by SARS, is properly classified by SARS under the table. The question in this case is whether SARS was correct in branding the conduct of the appellants grossly negligent.

[22] In resisting the conclusion of gross negligence, the appellants have found it unavoidable to fall back on the proposition that administrative incapacity on the part of the appellants justifies a lesser form of blameworthiness being attached to the failure of the appellants to render their returns. I have already dealt with the issue, and found that there was no such administrative incapacity.

[23] In paragraph 7 of the judgment of Scott JA in *MV Stella Tingas: Transnet Limited t/a Portnet v Owners of the MV Stella Tingas and Another* 2003 (2) SA 473 (SCA) the learned judge observed that the concept of gross negligence is not capable of precise definition. He examined a number of authorities which provide guidance. His conclusion was as follows:

> "It follows, I think, that to qualify as gross negligence the conduct in question, although falling short of *dolus eventualis*, must involve a departure from the standard of the reasonable person to such an extent that it may properly be categorised as extreme; it must demonstrate, where there is found to be conscious risk-taking, a complete obtuseness of mind or, where there is no conscious risk-taking, a total failure to take care. If something less were required, the distinction between ordinary and gross negligence would lose its validity."

[24] Save for the case of the second appellant's 2012 income tax return, which must be dealt with separately for more than one reason, I have no difficulty in concluding that the failures of the two appellants to render their returns is properly classified as grossly negligent. The application made by the first appellant for a tax amnesty in the 2006 year of assessment illustrates that he undoubtedly knew what his obligations were with regard to the submission of VAT and income tax returns. This knowledge may safely be attributed also to the second appellant as the first appellant was it's sole member. The only conclusion to be drawn is that the withholding of the returns in this matter was intentional. (Indeed, the contention that they were withheld for want of administrative capacity to render them implies that they were withheld intentionally.) In my view the best that can be said regarding the first appellant's culpability is that it was characterised by a "complete obtuseness of mind". In his case some R930 000 of income tax and a little over R1 million in VAT went unpaid because of his failure to submit returns. Including 2012 in the calculation, a similar amount in income tax incurred by the second appellant went unpaid, as did just short of R1 million in VAT. It is difficult to imagine what different state of mind on the part of the first appellant could have subsisted, which would justify a conclusion other than that he in his personal capacity, and in his capacity as the directing mind of the second appellant, was grossly negligent, or worse.

WHAT DOES "A DEFAULT IN RENDERING A RETURN" MEAN?

[25] Chapter 16 of the Tax Administration Act provides for understatement penalties. The term "understatement" is defined for the purpose of the chapter. It 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."

[26] The appellants argue that the failure to render a return when it is required by law to be done is not "default in rendering a return", and that accordingly no understatement penalties could be charged in the present matters. Whilst I appreciate that one or two aspects of other arguments raised by the appellants, which still need to be dealt with, may be regarded as relevant to this issue of interpretation, I say now that I see no merit in the proposition that a failure to submit a return is not a default in rendering a return. The language of, and the intention behind, the definition reproduced above is clear. Items (*a*), (*b*) and (*c*) of the definition deal with the case of returns. If you omit something from the return (paragraph (*b*)), or make a false statement in it (paragraph (*c*)), there is no doubt that you have made an "understatement" (assuming that the requirement of prejudice is satisfied). No other default with respect to a return appears to me to be possible except that embodied in the failure to submit the return at all. A default in rendering a return (paragraph (*a*)) must be a failure to render one when it is due.

[27] Any residual doubt about what the term "default in rendering a return" means appears to me to be cleared up by section 223(2)(*a*) read with section 95 of the Tax Administration Act. The former provision reads as follows:

> "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; …"

Section 95(1) empowers SARS to make assessments based in whole or in part on an estimate, not only when a taxpayer has submitted a return or information that is incorrect or inadequate, but when the taxpayer "fails to submit a return as required". There is accordingly no room to misinterpret the term "default in rendering a return" as not covering a failure to submit a return which is due (i.e. "as required").

IS THERE A "SHORTFALL" WHEN A RETURN IS WITHHELD?

[28] Section 222 read with section 223 of the Tax Administration Act provides for how an understatement penalty is to be computed. Section 222(1) reads as follows:

> "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 sub-section (2) unless the understatement results from a *bona fide* inadvertent error."

Section 222(2) then provides that 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".

[29] The appellants argue that there is no understatement "in a return" when the understatement is constituted by a default in rendering a return; and that accordingly their conduct does not qualify for the imposition of understatement penalties.

[30] Subsection 222(3)(*a*) is employed by SARS in this particular case, and it is to the effect that the shortfall is

> "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".

[31] The appellants argue that SARS never "accepts" a failure to submit a return. It is argued that for that reason also there cannot be a shortfall as defined, with the result that no understatement penalty need be paid for a default in rendering a return. (The argument that SARS does not "accept" a failure to submit a return is premised upon the proposition that a registered tax payer will inevitably be pursued. Of course the position of a person who ought to be registered, but is not, is different. The legislature chose to draw no distinction between the two cases.)

[32] The appellants have identified apparent anomalies in the wording employed in both subsections (2) and (3) of section 222 of the Tax Administration Act. The proper approach to interpretation when anomalies are apparent is set out as follows in *Panamo Properties (Pty) Limited and Another v Nel and Others NNO* 2015 (5) SA 63 (SCA) at paragraph 27:

> "When a problem such as the present one arises the court must consider whether there is a sensible interpretation that can be given to the relevant provisions that will avoid anomalies. In doing so certain well-established principles of construction apply. The first is that the court will endeavour to give a meaning to every word and every section in the statute and not lightly construe any provision as having no practical effect. The second and most relevant for present purposes is that if the provisions of the statute that appear to conflict with one another are capable of being reconciled then they should be reconciled."

[33] If, as is concluded above, "a default in rendering a return" means a failure to render a return that is due, then in terms of section 222(1), save for the case of a *bona fide* inadvertent error, the default must attract a penalty (to be derived, in terms of section 222(2), from the table which appears in section 223).

[34] A conclusion that section 222(2) can only operate with respect to an understatement "in a return", but not when there is a failure to submit a return at all, logically leads to the conclusion that the term "a default in rendering a return" has no place in the definition of an "understatement", and is without any purpose.

[35] The apparent anomaly arising from section 222(2) is solved if one reads the word "in", where it appears in the phrase "in a return", to denote an understatement "in or in connection with" a return. In my view a reading of the whole of Part A of Chapter 16 (the sections in question all form part of Part A) justifies the resolution of the apparent anomaly in that fashion.

[36] Insofar as the use of the word “accepted” in section 222(3)(*a*) is concerned, the appellants err in isolating a failure to submit a return as the only “understatement” (as defined) which SARS does not “accept”. The position is that SARS may not accept understatements of any kind. It cannot overlook an understatement by regarding as true what it knows to be false. The word “accepted” in the context of section 222(3)(*a*) means the circumstance that SARS proceeds upon the assumption that there has been no “understatement” as defined. It “accepts” as correct the apparent position, whether that involves a mis-stated return or the absence of one altogether. Once the understatement is discovered and acted upon, the resultant tax position must be compared to the one which would have obtained if the “understatement” (as defined) had not been acted upon. In the case of a return not rendered when it was due, the shortfall on which the penalty is charged is the difference between the tax found due and the position which would have obtained if SARS had not realised and acted upon the fact that the taxpayer failed to render a return at all: i.e. a zero tax position.

[37] That is what has occurred in the present case and in my view SARS has proceeded upon a correct understanding of the legislation, imperfect as it may be.

PREJUDICE TO SARS OR THE *FISCUS* AND ADMINISTRATIVE PENALTIES

[38] In dealing with the definition of the term “understatement” in section 221 of the Tax Administration Act, I have hitherto focused on the three items listed in paragraphs (*a*) to (*c*) of the definition. However, the primary feature of an understatement is that it is prejudice to SARS or the *fiscus*. The definition bears repeating.

> “ **‘understatement’** means any prejudice to SARS or the *fiscus* as a result of—
>
> (a) a default in rendering a return;
>
> …”

[39] The appellants raise two arguments with regard to the question of the prejudice which is necessary in order for an understatement penalty to arise.

(a) Firstly, it is argued that the application of administrative penalties under Chapter 15 of the Tax Administration Act, coupled with the charging of interest, extinguishes any prejudice which might otherwise be caused by failing to submit a return.

(b) Secondly, it is argued that SARS has failed to discharge the onus of establishing that prejudice to SARS or the *fiscus* has occurred as a result of the appellants' defaults in rendering their returns.

[40] Chapter 15 (comprising sections 208 to 220) deals with the subject of administrative non-compliance penalties. Such penalties are defined in section 208 to exclude understatement penalties imposed under Chapter 16. It appears likely that such penalties will be lower than understatement penalties in most cases.

[41] The first argument advanced by the appellants is without merit. A penalty is by definition punishment; it may also be compensatory in effect, but that is not why it exists. The quantum of an understatement penalty is determined by the nature of the wrongdoing for which the taxpayer is responsible; expressed as a percentage, that factor is then applied to the amount of tax concerned. For a given amount of tax in effect withheld, the penalty will be higher or lower, depending not on the prejudice suffered by SARS or the *fiscus*, but on the level of blameworthiness attributed to the conduct. There is no room for an argument that monetary compensation, sufficient to compensate for the financial prejudice caused by the default (assuming such a calculation could be made), and provided through interest augmented by an administrative penalty, would render conduct originally constituting an "understatement" something other than what is hit by Chapter 16.

[42] Mr K has pointed out on behalf of the appellants that there is one assessment before this court in which an administrative non-compliance penalty of R600,00 has been applied, apparently in terms of section 210 of the Tax Administration Act. This is imposed in addition to the understatement penalty, notwithstanding section 210(2)(*b*), which does not allow for the imposition of both. It is conceded by the respondent that the administrative penalty must be set aside.

[43] Turning to the question of proof of prejudice, I take the view that, save in regard to the second appellant's income tax return for the 2012 tax year, prejudice to SARS and the *fiscus* is implicit in the failure of the appellants to render returns, and the consequent failure of the appellants to pay the tax due under those returns at the time when it was supposed to be paid. The State's budgeting process is based upon the proposition that taxes will be paid at the time when they are due to be paid. In the case of a failure to render a return upon which tax would have been assessed as payable, the State (using that term loosely to encompass SARS and the *fiscus*) is prejudiced by being kept out of the contribution to its year's expenditure which would have been available if there had been no default in the rendition of the return in question.

[44] Mr K referred the court to the judgment of the Tax Court, Gauteng, in case number IT14247 in a context other than the present one. However, it is of assistance in understanding the concept of prejudice with which we are concerned. In that case the taxpayer was responsible for an omission from, or an incorrect statement in, the taxpayer's return. (A so-called "nil return" was submitted by the taxpayer.) At the time SARS held funds which were due to be refunded to the taxpayer. Those funds exceeded the shortfall in the assessment based on the nil-return. In that context the question arose as to whether SARS had suffered the prejudice which is the criterion for

liability for understatement penalties under Chapter 16. The following passages in the judgment of *Nkosi-Thomas AJ* are of assistance:

> "[41] The uncontroverted evidence before us is that SARS suffered prejudice in the form of the opportunity cost occasioned by its delayed recovery of the income tax and VAT amounts due to it. Although SARS had the funds in its possession, throughout, it was not entitled to the use thereof as the funds were reflected as a credit in the account of the taxpayer. …
>
> [42] Public funds are derived mainly from two sources, namely, contributions by citizens through taxation and public borrowings whose repayment is borne by taxpayers.
>
> [43] Taxes are a compulsory contribution to the *fiscus* to finance government activities. Taxes are computed with rates established by law and are the primary source of government income. The funds thus collected by SARS through taxation are, through a Parliamentary budgetary process, allocated to various departments at national, provincial or local government. It is through these allocations that departments secure and use [appropriate] government money.
>
> [44] *In casu* the taxpayer's provisional tax refund could not form part of the budgetary process as it was held by SARS for the benefit of the taxpayer.
>
> [45] Accordingly, although SARS was in possession of the funds, it could not use the funds to fund government activities in the manner set out above.
>
> [46] It is thus difficult to fathom the contention that SARS, and indeed the *fiscus*, was not prejudiced by the taxpayer's conceded "*omission*" and "*default*". The view that we take of this matter is that SARS and the *fiscus* were prejudiced by the taxpayer's actions, and that that prejudice includes the resource allocation flowing from the taxpayers aforesaid "*omission*" and "*default*" as well as opportunity cost to SARS occasioned by its delayed recovery of the income tax and VAT amounts due to it (which while it stood to the credit of the taxpayer SARS could not use it to fund government activities)."

I am in respectful agreement with the views expressed in IT14247.

[45] Although it was not debated in argument it does strike me that the application of resources to audits of the affairs of taxpayers like the appellants is in itself prejudice to SARS. In terms of section 221 'understatement' means **any** prejudice to SARS or the *fiscus*. The word "any" is "a word of wide and unqualified generality. It may be restricted by the subject-matter or the context, but *prima facie* it is unlimited." (Per Innes CJ in *R v Hugo* 1926 AD 268 at 271). There is nothing in the context of the provisions of the Act relating to understatement penalties to suggest that the word was used in a limited sense in section 221. On the contrary, a comparison of the sense of the words "means ... prejudice to SARS or the fiscus", with and without the insertion of the word "any", suggests that its insertion indicates that the broadest range of prejudice must be taken into account when considering whether any of the stated defaults have resulted in prejudice to SARS or the *fiscus*.

[46] Finally, under the present heading, I must deal with the 2012 income tax return due to have been submitted by the second appellant. It will be recalled that when the audit was commenced that tax return was not yet due. The audit continued after the due date for the submission of the return had arrived, and the 2012 year was drawn into the audit process. It seems to me that it is probable that the failure to submit the 2012 income tax return on time was a product of the audit and its expanded scope, rather than a withholding of the return by the second appellant. It would not be in accordance with the natural order of things for a taxpayer to submit a return with respect to a year being subjected to an audit, when the audit is incomplete. The taxpayer would naturally engage with the auditors in order to settle the contents of the return so that it coincides with the outcome of the audit. Ms T did not deal with the decision to expand the audit to cover the 2012 tax year. In my view it must be assumed in favour of the taxpayer that the late rendition of that return (which was ultimately the product of the audit itself) was not a "default" as contemplated by paragraph (*a*) of the definition of the

word “understatement”; and that as a consequence no understatement penalty can be raised in the income tax assessment for that year.

The following orders are made in these appeals which are upheld in part:

A. Mr. A: Case No. IT 13727

1. Each of the understatement penalties of 150% imposed in respect of the assessed income tax for the tax years 2007, 2008, 2009 and 2010 is set aside and replaced with an understatement penalty of 100%.
2. Each of the understatement penalties imposed in respect of ‘disallowed medical expenses’ in the assessments for the 2008, 2009 and 2010 income tax years is set aside.
3. The assessments are otherwise confirmed.

B. Mr. A: Case No. VAT1096

1. Each of the understatement penalties of 150% imposed in respect of the assessed VAT for the periods 4/2006 to 2/2010 is set aside and replaced with an understatement penalty of 100%.
2. The assessments are otherwise confirmed.

C. XYZ CC: Case No. IT13725

1. The administrative penalty of R600,00 imposed in the income tax assessment for the year 2011 is set aside.
2. The understatement penalty of 150% imposed in respect of the assessed income tax for the 2011 tax year is set aside and replaced with an understatement penalty of 100%.
3. The understatement penalty of 150% imposed in respect of the assessed income tax for the tax year 2012 is set aside.
4. Save as aforesaid the assessments for the 2011 and 2012 income tax years are confirmed.

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1. Each of the understatement penalties of 150% imposed in respect of the assessed VAT for the periods 9/2010 to 1/2013 is set aside and replaced with an understatement penalty of 100%.
2. The assessments are otherwise confirmed.

E. The respondent is directed to issue amended assessments in accordance with paragraphs A to D above.

OLSEN J

I agree:

MR L HLENGWA (ASSESSOR)

I agree

MR G BACON (ASSESSOR)

Date of Hearing: 27, 28 & 30 NOVEMBER 2017

Date of Judgment: Thursday, 08 February 2018