

Income Tax Penalties and the Doctrine of Punishment

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ABSTRACT

This dissertation explores the penalty regime provided for in the Tax Administration Act, No 28 of 2011 ('the Admin Act'), and implementation thereof in certain circumstances and behaviour on the part of the taxpayer.

Even though the Admin Act has been in force for some years already, it remains necessary and relevant to explore the penalty regime that is operative to understand and confirm the scope and application thereof in various circumstances. As one discusses the different types of penalties chargeable in terms of the Admin Act it becomes evident how sternly it can be applied. Furthermore, the dissertation investigates how burdensome the regime can be and what remittance regime is available to taxpayers if they are penalised.

This dissertation attempts to define what the objects of the Admin Act's penalty regime are, and to determine whether these objectives are being achieved with the application of the penalty regime that is currently operative in the Admin Act. It also considers whether the identified objects of the Admin Act's penalty regime accord with the doctrine of punishment.

It is imperative that legislation is aligned with the objective of the penalty regime as misalignment will prejudice taxpayers, whilst potentially derogating from the purpose that the legislation seeks to achieve.

In this dissertation, the crux of the penalty regime is investigated and highlighted. It also endeavours to assess the powers entrenched in the Admin Act and the need for clarification on a few uncertainties.

The findings of this research study have revealed that:

- The enactment of the penal provisions in the Admin Act only partially achieves the philosophy of the doctrine of punishment and,
- In instances where the penal provisions do achieve the objects of punishment, it appears that the application thereof is not consistently applied in practice.

The penal levying system in the Admin Act has been an improvement on the past penalty provisions as is evident in Chapter 3. However, despite the more favourable and fair outcome achieved by the penal provisions in the Admin Act, the research concludes that

more specific guidance and measures in respect of the application of the penal provisions are necessary. The behaviours listed in the understatement penalty percentage table are not defined and creates the need for further improvement. Though changes have been made since the implementation thereof it still requires further revisions.

In respect of inconsistent application of the penal provisions in practice it is recommended that the administrators of the legislation be better equipped in respect of the application of the penal provisions or that the processes should be changed to address the misalignment of the application of the penal provisions.

Income Tax Penalties and the Doctrine of Punishment

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GLOSSARY

Paragraph	Paragraphs of the Fourth Schedule to the Act
PAYE	Pay-as-you-earn (Employees tax)
SA	South Africa
SAICA	South African Institute of Chartered Accountants
SARS	The South African Revenue Service
Schedule	Fourth Schedule of the Income Tax Act No.58 of 1962
Sections	Sections of the Income Tax Act No.58 of 1962 ('the Act')
('the Act')	Income Tax Act No.58 of 1962
('the Admin Act')	Tax Administration Act No.28 of 2011
UCT	University of Cape Town

CHAPTER 1:

1.1 Background

To examine the penalty regime that exists in the Tax Administration Act No. 28 of 2011 (“the Admin Act”)¹ of South Africa, it is necessary to examine the meaning and purpose of the doctrine of punishment in general.

Punishment can be defined as a punitive act carried out upon a person for breaching rules or commands enforced by a legal system.²

There are five elements to define a standard case of punishment:³

- It must involve consequences normally considered unpleasant;
- It must be for an offence that breached legal rules;
- It must be for an actual offender for his offence;
- It must be intentionally administered by human beings’ other than the offender;
- It must be imposed and administered by an authority constituted by a legal system against which the offence is committed.

We use the term penalties for the offences that taxpayers commit by not adhering to or breaching the “rules” as laid out in legislation in the tax context, such as late payment of taxes or non-submission of annual income tax returns.

¹ The Tax Administration Act No. 28 of 2011

² Others have defined *punishment* as follows: Flew, A.G.N. 1954. *The Justification of Punishment*. Philosophy. 29 at 291-307 defined punishment as Punishment “... the infliction of hard treatment by an authority on a person for his prior failing in some respect (usually an infraction of a rule or command)”. Grotius, H. *The infliction of an ill suffered for an ill done*. De Jure Belli ac Pacis, ch. Xx, De Poenis. Vol. ii: p. 240. Walker, N. Oxford Paperbacks Oxford University Press defines punishment as “.... infliction of something which is assumed to be unwelcome to the recipient: the inconvenience of a disqualification, the hardship of incarceration, the suffering of a flogging, exclusion from the country or community, or in extreme cases death.” at 1 <https://www.collinsdictionary.com/dictionary/english/punishment> punishment is defined as “**Punishment definition: Punishment** is the act of punishing someone or of being punished.” www.oxfordlearnersdictionaries.com/definition/english/punishment defines *punishment* as “an act or a way of punishing somebody”, Newman, G. 2008. *The Punishment Response*. 2nd ed. at 7-11 defines punishment as “1) Punishment must involve pain or unpleasant consequences. 2) Punishment must be a sanction for an offense against a specific rule or law. 3) Punishment must be executed upon the specific offender who has allegedly or actually committed the crime. 4) It must be administered intentionally by someone other than the offender. 5) It must be imposed and administered by an authority constituted by a legal system against which the offence is committed.”

³ Flew, A.G.N at 291 and following

One might be tempted to interpret penalties as mere “*pricetags*” attached to a certain type of behaviour which are generally objectionable.⁴

In the tax context, punishment and penalties impose deterrents for failures on the part of a taxpayer: Penalties have a miscellaneous character, whereas punishment has an important additional characteristic as a mimetic consequence which is absent from other kinds of penalties.

Certain actions and/or omissions are forbidden by law and are accordingly made offences. This is to announce to humanity that those actions are not allowed and certain remedies are to be taken if they are not adhered to, accordingly to act as a deterrent so that fewer offences occur.

In *punishment* reference is made to “*the wrong-person rule*” and “*the blameless-doer rule*”.⁵ Nobody is to be penalised for an offence which the wrongdoer has not committed, attempted or planned and these falls within the aforementioned rule. In the latter rule, nobody is to be penalised for an offence which the wrongdoer has committed without *mens rea*.⁶

In practice, it often happens that an act or omission by the Taxpayer can be justified; would it then be *fair* to penalise the Taxpayer in such an instance.

1.2 Problem statement

The previous penalty regime provided for in tax legislation has been largely replaced with a new comprehensive penalty regime now contained in the Admin Act.⁷ As one examines the different penalties that can be imposed it will become apparent that the purpose of the penalty regime is not in the pursuance of the doctrine of punishment. It is accordingly in some instances ineffective as a method of punishment, in other words not in pursuance of the goals which the punishment doctrine would ordinarily seek to achieve, or merely incorrectly labelled.

⁴ Tonry, M. 2011. *Why Punish? How Much? A reader on punishment*. South Africa: Oxford University Press. at 111

⁵ Walker, N. 1991. *Why Punish?* South Africa: Oxford University Press. at 88 and following

⁶ An offence committed without intention.

⁷ Promulgated on 1 October 2012.

The commissioner for the South African Revenue Service (“SARS”) has the authority to remit penalties but this is only in certain circumstances and it has become evident that there are deficiencies in this regard which should be addressed. There is a responsibility upon the Commissioner to conduct its business in a fair and just manner.

There are various elements that the Commissioner for SARS considers in determining which penalty is to be imposed. This dissertation will examine some of these elements and related questions, such as whether the “offence” committed has been intentional or as a result of negligence, what constitutes a first offence and a few more.⁸

1.3 Research objective

The two main objectives considered are:

- Identifying the objects of the doctrine of punishment; and
- Whether the above manifests in the Admin Act penalty provisions.

To achieve the objectives of the study the following research questions will be answered:

1. Whether the imposition of certain penalties is incoherent and inadequate for punishment in general? Accordingly, certain representations will be made.
2. Who should be punished and how much punishment is necessary?
3. Whether the current penalty regime is truly an effective deterrent for wrongdoers and whether the penal system offers a just and practicable system for punishing offenders?
4. Whether the Commissioner should have a discretion in the imposition and remission of certain penalties and accordingly to what degree?

1.4 Research method

This dissertation has a doctrinal investigative research approach to examine and determine what the philosophy of punishment is. Historic research has been used to obtain a general understanding of the purpose of punishment and by examining the penalty provisions in an

⁸ Refer to Chapter 4.

income tax context to determine whether the main elements of punishment then coincides with the main purpose of the penalty regime.

Furthermore, it obtains an understanding of the penalty provisions previously contained in the ITA and investigates the current penalty provisions in the Admin Act.

The purpose of this approach involves the obtaining and understanding of the purpose of punishment and its alignment to the application of a penalty regime in an Income tax context.

It is necessary to determine the objects of why someone is punished and how much punishment is necessary. The penalty provisions are examined to determine the true purposes of the penalty regime and the efficacy thereof.

The philosophy of punishment and the distributive principles of criminal law are examined from various law hand books. The Memorandum on the Objects of the Tax Administration Bill, 2011 is also examined to determine the primary purpose of the new provisions and its general application. The efficacy of the penalty regime is examined and accordingly the dissertation attempts to determine whether the philosophy of punishment is achieved with the current tax penalty regime.

1.5 Limitation of Scope

The scope of this dissertation is the exploration and discussion of the purpose of punishment in general and it will be considered within the context of penalties levied by the Commissioner and whether the penalty regime operates in the pursuance of the doctrine of punishment.

The different types of penalties and their application will be examined and what remittance possibilities are available to taxpayers and their efficiency. This study will be limited to the relevant sections in the Admin Act only which sanctions the penalty regime.

The elements of punishment that are applicable will be discussed in the Income Tax Act No 58 of 1962 ("ITA") context. The remittance procedure will be discussed and whether the discretion to remit penalties should rest with the Commissioner of SARS, and whether that discretion is exercised within the philosophy of punishment.

Proportionality of penalties are also very briefly considered.

The imposition of too harsh penalties and penalties incorrectly levied in practice can have constitutional consequences; however, these will not be discussed here.

1.6 Structure of the dissertation

The Dissertation will take on the following structure:

- 1.6.1 Chapter 2: The doctrine of punishment
- 1.6.2 Chapter 3: History of tax penalty provisions
- 1.6.3 Chapter 4: Different types of penalties and remission request
- 1.6.4 Chapter 5: Conclusion

CHAPTER 2: The doctrine of punishment

2.1 Meaning and purpose of punishment

In 1.1 above it was pointed out that punishment is an act of hard treatment inflicted upon a person that does not adhere to preordained legal rules. To exact punishment, one must evaluate whether the five elements⁹ that defines a standard case of punishment are present.¹⁰

The five elements to define a standard case of punishment are:¹¹

- It must involve consequences normally considered unpleasant;
- It must be for an offence that breached legal rules;
- It must be for an actual offender for his offence;
- It must be intentionally administered by human beings' other than the offender;
- It must be imposed and administered by an authority constituted by a legal system against which the offence is committed.

*"Nulla poena sine lege"*¹² is an accepted legal principle that sanctions that one cannot be punished for wrongdoings that are not prohibited by the law. In relation to punishment the principle has at least two implications, one being that the penalties themselves need to be reasonably precisely defined and second that the imposition of such penalties should be governed by clear legal rules. These legal rules must also meet the requirements of the principle of legality.¹³

It is necessary to determine and understand what the main objects of punishment are to determine whether the application of the punishment achieves these objects. The objectives

⁹ Flew, A.G.N. 1954. The Justification of Punishment. Philosophy. Vol. 29, No 111: at 291 and following. Available: <http://www.jstor.org/stable/3748210> [2017, March 6]

¹⁰ 1.1 above

¹¹ Flew, A.G.N. at 291 and following

¹² Grotius, H. 2012. The infliction of an ill suffered for an ill done. De Lure Belli ac Pacis, ch. Xx, De Poenis. Vol. ii: 240. Available: https://www.law.cornell.edu/wex/nullum_crimen_sine_lege [2017, August 20].

¹³ van Zyl Smit, D. 1998. *Sentencing and Punishment*. Available: http://www.chr.up.ac.za/chr_old/centre_publications/constitlaw/pdf/28-Sentencing%20and%20Punishment.pdf [2017, August 20]

of punishment will influence the nature of the punishment so that the appropriate sentence is imposed.¹⁴

Punishment of offences is generally categorized into four justifications namely:

“1) *Retribution*;

2) *Deterrence*;

3) *Rehabilitation*;

4) *Incapacitation (social protection)*”¹⁵

This dissertation will briefly examine these justifications so that one may consider how and why punishment is applied.

In doing so, it becomes evident that punishment is necessary as both a preventative measure as well as a punitive measure as the incorrect application of punishment upon an offender for its wrongdoings could lead to an imbalance for society and cause more harm than anything else. It could also lead to Constitutional¹⁶ issues, however as mentioned these are not discussed in this dissertation.

Punishment is applied to assist and maintain a balance in society, accordingly punishment should benefit society. Society should benefit to the extent that all can live in harmony. We can measure this against the three theories referred to in the case of *Ex Parte United States* (242 U.S., 27, 38). Reference is made to punishment, reformation and deterrence (or the effect upon the offender and the effect on others as a deterrent and on society as a justification of the law).

It is obvious that punishment is applied with the purpose of punishing an offender, however an important aspect of punishment is the determination of the extent of the punishment. I would question whether the extent of the punishment should be determined by the nature

¹⁴Du Toit, E. 1981. *Straf in Suid-Afrika*. South Africa: Juta & Company (Pty) Ltd. at 100

¹⁵Marson, J. 2015. *The History of Punishment. What works for State Crime?* The Hilltop Review: Vol. 7: Iss.2. Article 4. Available: <http://scholarworks.wmich.edu/cgi/viewcontent.cgi?article=1127&context=hilltopreview> at 19 and following, *R v Swanepoel* 1945 AD 444, *S v Whitehead* 1970 (4) SA 424 (A) 436E-F and *S v Rabie* 1975 (4) SA 855 (A) [2018, February 2]

¹⁶ *The Constitution of the Republic of South Africa, of 1996*. 1996.

of the crime or the nature of the offender. No two persons' experience punishment in the same manner. In my view humans are not all alike, therefore the appropriate punishment to be applied should not only be determined by the nature of the crime but also as to the nature of the offender.

The term *mens rea* denotes the individual's state of mind at the time of the offence. This, as pointed out in Chapter 1, is another significant factor to consider. In criminal law the offender will be held liable for its actions if the State can prove that the individual had the intent to act unlawfully.¹⁷ It is also possible for an individual to unintentionally commit an offence, where guilt is represented through negligence rather than intent.

In examining the different categories of punishment, it becomes apparent that punishment should first and foremost benefit society. Having said this, it is evident that the law does not only seek to punish the offender but also attempts to reform the offender and in the process, sets an example for the society of what won't be tolerated, in other words act as deterrent.

All humans are different, some humans are sensitive to physical pain and some are easily humiliated, whilst others are reactive to confinement, we can therefore draw inference from *"What's sauce for the goose may likewise prove sauce for the gander, but not necessarily for the crow."*¹⁸

It is necessary for the state to protect the public from repeated unlawful manifestations, and in the process, to also send warnings out to potential wrongdoers in the attempt to pre-empt further offences from occurring. In South Africa, the most important object of punishment is arguably deterrence.¹⁹ It was highlighted in *R v. Swanepoel*²⁰ when reference was made to *S v Khumalo*²¹ that *"Deterrence has been described as the "essential", "all important", "paramount" and "universally admitted" object of punishment."*

¹⁷ Laws. *A General Guide to Criminal Laws*. Available: <http://criminal.laws.com/criminal-law> [2017, August 20].

¹⁸ Alexander, J.P. 1922. *The philosophy of punishment*. Journal of Offender Law and Criminology. Vol. 13. Issue 2: at 241. Available: <http://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1852&context=jclc> [2018, February 14]

¹⁹ Judge Nicolas J A, *S v Khumalo and Others* 1984 (3) SA 327 (AD)

²⁰ *Swanepoel's* case ibid at 455.

²¹ *Khumalo's* case ibid at 330 D – E.

There is no general legislation that prescribes the approach which the courts must adopt regarding sentencing,²² however the Constitution demands protection against the arbitrary exercise of the power of the courts.²³ There are limitations in respect of sentencing: a maximum imposing sentence and prescribed minimum. In South Africa, courts are granted an exceptionally wide discretion when imposing sentences. The Supreme Court of Appeal however has no general restrictions on its punishment jurisdiction and can impose any sentence which it regards as appropriate in terms of the general principles of punishment as long as the sentence does not include a form of punishment that is specifically restricted to a particular offence.²⁴ The wide discretion of the courts to sentence can be problematic as the same set of facts and circumstances can be presented to two different judges and the outcome of the punishment enforced by the judges could differ.²⁵ There are two institutions which control the exercise of the sentencing discretion, namely relevant legislation and control exercised by the courts of appeal. A court of appeal will only amend a decision of the trial court if it appears that the trial court has exercised its discretion in an improper or unreasonable manner.²⁶

Currently the point of departure in the sentencing process is that of the well-known dictum in *S v Zinn*²⁷: “*What has to be considered is the triad consisting of the crime, the offender and the interests of society.*” The triad has been criticized in that the role of victims of crimes are not emphasized.²⁸ The triad has also been observed in somewhat different terms: Punishment must fit the criminal as well as the crime, be fair to society, and be blended with

²² van Zyl Smit, D. *ibid* at 1.

²³ van Zyl Smit, D. *ibid* at 26.

²⁴ van Zyl Smit, D. *ibid* at 1 and following.

²⁵ Refer to Ashworth, A.J. 1989. *Criminal justice and deserved sentences*. Criminal Law Review, also *S v Young* 1977 (1) SA 602 (A) SACC 189 – 191 and comment by Nairn, R.G when he criticizes current practices as follows: ... “*two learned judges gave careful consideration to the same issues, arising out of a set of agreed facts, but arrived at diametrically opposed conclusions. It seems that the nature of our sentencing procedure makes this type of outcome virtually inevitable, because whereas the course of the trial is determined by clearly defined rules of law, the approach to sentence is left largely to chance. What this means - as the present case demonstrates - is that the point of view of the individual sentencer will largely determine his approach to a given set of facts, and there will therefore be as many different approaches as there are different sentencers... This state of affairs is quite understandable, because judges are human beings: each one is a unique product of a unique combination of social, physical, psychological and economic influences, so each will inevitably go his own way in the absence of clearly articulated guidelines; as a consequence, uniformity in sentencing remains unattainable. The problem of uniformity has not yet been approached seriously and scientifically in our law, and until it is it will remain a murky and uncertain, albeit vital, problem*”

²⁶ *S v Pieters* 1987 (3) SA 717 (A)

²⁷ *Zinn's case* *ibid* at 540 G.

²⁸ *Zinn's case* *ibid* at 540 and following.

a measure of mercy per the circumstances.²⁹ This observation of the triad has been supported:³⁰ Punishment should fit the criminal as well as the crime, be fair to the State and to the accused, and be blended with a measure of mercy.

It becomes evident that much uncertainty and inconsistency is brought into the sentencing process in South Africa due to the failure by the legislature to provide a clear and unambiguous legislative framework for the exercise of the sentencing discretion. More elements that contribute to this uncertainty and inconsistency are the failure by the courts to develop firm rules for the exercise of the sentencing discretion and failure by the courts and the legislature to give firm guidance as to which sentencing theories or aims carry the most weight.

We can therefore see that proper guidance and rules in legislation should play a vital role in measuring and achieving the purpose of punishment.

The various categories of punishment must act collectively as a guard against potential future offences, however it should not be the primary focus of the purpose of punishment.

It is understandable that there is a tendency to measure punishment³¹ by the harm that has been done, quantifying the punishment to fit the crime.³² However, one must not lose sight of the fact that a wrongdoing remains a wrongdoing irrespective of its extent.

This brings us to the next question of how much punishment is necessary and the answer to this question should be: to the degree of the offender's responsibility.³³

The reason for the application of this approach is to determine the offender's accountability. This also puts the state in the position to distinguish and measure the criminal cap of children and mentally challenged persons.

²⁹ *Khumalo's case* ibid at 698A.

³⁰ *S v Sparks* 1972 (3) SA 396 (A) at 410H.

³¹ Joubert, J.J. 2017. *Criminal Procedure Handbook*. 12th ed. South Africa: JUTA and Company (Pty) Ltd. Quote of *WS Gilbert "The punishment must fit the crime"*, also refer to "*Sentencing and Punishment*" above, refers to the principle '*the punishment must fit the crime*' at 5

³² *Rabie's case* ibid; *S v Mjware* 1990 (1) SACR 388 (N) at 389; *S v Baartman* 1997 (1) SACR 304 (E) at 305; *S v Twala* 1979 (3) SA 864 (T)

³³ Alexander, J.P. ibid at 241.

Mentally challenged persons have a different level of accountability than other people, only to the extent of their inexperience's and their incapacity.³⁴

If the effectiveness of punishment is found in its harshness, then such harshness must be increased until it results in the minimising of the offence.³⁵

In considering the death penalty, there are no statistics that prove that the crimes were more frequent in countries which did not have the death sentence³⁶. The death penalty may very well be an effective deterrent however it lacks the reformation element.

When one considers the aims of punishment, the question as to "why" punishment is necessary becomes clear.

It is therefore necessary to consider the aims of punishment individually and it then becomes evident that all the aims need to coincide with each other to have an effective punishment system.

As previously mentioned the aims of punishment should not stand alone or be considered by itself as this could produce an unsound basis of punishment. This was supported when it was stated that: *"All of these methods possess germs of rational punishment, but the very complexity and inconsistency of their application suggest erroneous hypotheses."*³⁷

Judge Holmes JA stated in *S v Rabie*:³⁸ *"The main purpose of punishment is deterrent, preventative, reformative and retributive."*

These four elements form the basic factors of which the punishment doctrine is made up of. The correct application of a "mixture" of these will ensure that punishment in each individual case will be effective and attain the sought-after goals.

³⁴ Flew, A.G.N ibid at 291 and following.

³⁵ Flew, A.G.N ibid at 295 and following.

³⁶ Marson, J. ibid at 20 and following.

³⁷ Alexander, J.P. ibid at 239.

³⁸ *Rabie's case* ibid at 855.

2.2 Categories of punishment

2.2.1 Retribution

Retribution is considered the oldest rationale/reason for punishment.³⁹ Punishment is justified merely because it is deserved. If an offender commits a crime, they deserve to be punished. Retribution strives for justice rather than rehabilitation of the offender. Retribution can be viewed as “*revenge*” upon an offender by society for a moral wrongdoing by the offender.

Bearing in mind the long history of punishment, the best way to describe it was as follows: “*The only aspect of punishment that needs justification is its distribution.*”⁴⁰

The Retributivist stated: “*punishment restores an equilibrium that was upset by the crime*”.⁴¹

It is evident that retribution thinkers are focused on past offences. Punishment should not be considered to be vengeful only, accordingly there are limits to punishment and certain ethics that need to be followed to prevent it.

Accordingly, it can be said that if punishment is in proportion to the crime committed by the offender, then retribution is not relevant. The courts acknowledge retribution as requiring that punishment bears some relation to the seriousness of the offence and the blameworthiness of the offender, and that in this regard the wrongdoer should receive no more and no less than what the wrongdoer justly deserves. Punishment must be humane.⁴²

The retributive nature of punishment contains a deterrent effect, as offenders have certainty of the punishment.

In the case of *R v Swanepoel*⁴³ reference was made to Gordon Criminal Law of Scotland (1967) at 50 that stated: “*The retributive theory finds the justification for punishment in a past act, a wrong which requires punishment or expiation ... The other theories, reformatory,*

³⁹ Marson, J. *ibid* at 20 and following.

⁴⁰ Newman, G. *ibid* at 4 and at 192.

⁴¹ Newman, G. *ibid* at 192 and following.

⁴² *S v Groenemeyer* 1974 (2) SA 542 (K)

⁴³ *Swanepoel's case* *ibid* at 455.

preventative and deterrent, all find their justification in the future, in the good that will be produced as a result of the punishment.”

Therefore, in *R v Karg*⁴⁴ it was not strange that JA Schreiner observed that whilst deterrence remains an important factor, the retributive aspect is committed to yielding ground to the aspect of prevention and correction. He believed it would depend on the circumstances of what importance the component of retribution would be accorded in a sentence and that he would typically consider factors such as the seriousness of the offence and the disposition and attitude of the offender (particularly the attitude towards his victim).⁴⁵

2.2.2 Deterrence

The definition of deterrence is *“The action of discouraging an action or event through instilling doubt or fear of the consequences.”*⁴⁶

The deterrence category or theory is considered to be a more modern approach to punishment.⁴⁷ Punishment should have a preventative function and not only a retributive function.⁴⁸ Deterrence is a means of protecting the society.

Punishment can take many different forms: However, in my view the primary focus should be to deter individuals from committing future wrongdoings. The courts have stated that deterrence should strongly be considered when deciding upon the appropriate punishment.⁴⁹

When we consider deterrence, we are focused on the prevention of future wrongdoings from taking place, accordingly if punishment does not prevent future wrongdoings then it will just add to the suffering of the society.⁵⁰

⁴⁴ *R v Karg* 1961 (1) SA 231 (A) at 236A

⁴⁵ *Karg’s* case *ibid* at 236 following.

⁴⁶ Definition of “deterrence” in English in Oxford Dictionary – (<https://en.oxforddictionaries.com/definition/deterrence>) [2017, August 16]

⁴⁷ Van Zyl Smit, D. *ibid* at 26 and following.

⁴⁸ Beccaria, C. 1764. *On Crimes and Punishments*. United States of America: Jackett Publishing Company.

Available:

https://books.google.co.za/books?id=I_OWHbwVzcEC&printsec=frontcover&dq=On+Crimes+and+Punishments&hl=en&sa=X&ved=0ahUKEwiD4-ea-6fZAhUsC8AKHaAnBmUQ6AEIljAB#v=onepage&q=On%20Crimes%20and%20Punishments&f=false [2018, February 14]

⁴⁹ *S v Du Toit* 1979 (3) SA 846 (A) at 857 H – 858 A

⁵⁰ *Du Toit’s* case *ibid* at 858 and following.

In considering the objects of punishment⁵¹ it is said that the certainty of punishment is the real deterrent and not necessarily the extent of the punishment itself. This opinion is however not shared by all.⁵²

There are two types of deterrence namely a general deterrence and a specific deterrence.⁵³ General deterrence, as the name states, is applied by the state to deter the public that have not committed any offences. Its purpose is to make the public aware of the consequences of the wrongdoings and accordingly puts them off from doing wrong.⁵⁴

On the other hand, individual deterrence was designed to deter only the offender from committing further wrongdoings, for example, revoking of a driver's license where the offender has been convicted for drunk driving.

A powerful factor in deterrence is an offender's age. Research has shown that individuals are naturally more disinclined to offend from the age of 35.⁵⁵ The aging of the offenders naturally decreases the likelihoods of committing a future crime.

There have been many philosophers that propagated the deterrence theory.⁵⁶ In terms of the deterrence theory, there are three important components namely, severity; certainty and celerity (in other words the swiftness of imposing punishment).⁵⁷

These philosophers believed that the more severe the punishment was, the less likely offenders are to commit wrongdoings. In respect of the severity of the punishment one faces two issues namely: The harsher the punishment in comparison to the crime may result in the

⁵¹ LAWSA. Available: <http://www.legallibraryservices.co.za/law-of-south-africa-lawsa/> [2017, March 13].

⁵² Alexander, J.P. *ibid* at 238.

⁵³ Beccaria, C. *ibid*.

⁵⁴ Previously, the death penalty was a good example of attempted general deterrence. It was designed by the state and served to enlighten the public of the consequences of wrongdoings. In this process, the public could view the infliction of pain exercised upon the offender and accordingly the public would be wary from committing such wrongdoings.

⁵⁵ Sampson, R.J., John. L & Eggleston, E.P. 2006. *On the Robustness and Validity of Groups*. Journal of Quantitative Criminology. Vol. 20(1): 37-42. Available: <https://link.springer.com/article/10.1023/B%3AJQOC.0000016698.36239.91> [2018, February 14]

⁵⁶ Hobbes, T. 1889. *The Elements of Law, Natural and Politic*. United States of America: Oxford University Press. Available: <https://books.google.co.za/books?id=M93i2SyX-a0C&printsec=frontcover&dq=The+Elements+of+Law,+Natural+and+Politic&hl=en&sa=X&ved=0ahUKEwjMwYTi-6fZAhVIDMAKHfi1DE0Q6AEIKDAA#v=onepage&q=The%20Elements%20of%20Law%2C%20Natural%20and%20Politic&f=false> [2018, February 15]

⁵⁷ Hobbes, T *ibid*.

punishment being perceived as being unjust and unfair. If the punishment is not severe enough though it would not act as a deterrent.

Research has demonstrated that increasing the severity of punishment does not necessarily have much effect on the wrongdoing, whilst on the other hand increasing the certainty of punishment does have a deterrent effect.⁵⁸

In relation to certainty, the punishment must be carried out as confirmation that such offences will not be tolerated or allowed. It must be certain that the offender will be punished.

It is believed that the swift application of punishment increases the effect of deterrence. Deterrence theorists believe that certain and swift punishment were the most effective elements in preventing crime.⁵⁹ Criminologists are therefore focusing on the expansion of the deterrence theory and more specifically on the specific subcomponents thereof.⁶⁰

To put the above in a South African tax context we look at the facts of some court cases and their outcomes. In *CIR v Da Costa*,⁶¹ the Respondent made use of a company to compile his books and prepare the necessary annual income tax returns. The company shortened the process of the compilation of the revenue and in the process, this resulted in a reduction of the true revenue and thereby understatement of income. The Respondent was unaware of this, and upon review of the calculations the Appellant issued additional assessments which accounted for the amounts that were not declared. Furthermore, a penalty was imposed for the understatement of income. The Respondent objected against the penalty. The Respondent had no intention to deceive or wilfully withhold any income. It was accepted that the above circumstances constituted extenuating circumstances, however the Appellant submitted that the Respondent had to be penalised for the dishonesty of the company he used to calculate his revenue.

⁵⁸ Wright, V. 2010. *Deterrence in Offender Justice: Evaluating Certainty vs Severity of Punishment*. Washington. D.C. Available: <https://www.sentencingproject.org/wp-content/uploads/2016/01/Deterrence-in-Criminal-Justice.pdf> [2017, March 13]

⁵⁹ WordPress: 2010. *Deterrence Theory*. At 236 and following. Available: <https://marisluste.files.wordpress.com/2010/11/deterrence-theory.pdf> [2017, March 12].

⁶⁰ Being certainty, severity and celerity.

⁶¹ (Case no 14/1984) 1985 ZASCA 32, 1985 (2) ALL SA 335 (A)

In an extract from the judgment it was evident that the Respondent must still take the responsibility of his business affairs upon himself. The court was focused on whether the penalty imposed was justifiable against the circumstances of the case.⁶²

The court held that a lesser penalty was more fitting to the circumstances of the matter. The court said *“Such an amount, which cannot conceivably be regarded as trifling to the person of the taxpayer’s means, enjoying the life-style he does, will certainly bring home to him the lesson which the legislature sought to teach errant taxpayers by providing for a penalty in circumstances such as are present here. A lesser penalty would not serve the legislature’s purpose. On the other hand, one as heavy as that deemed proper by the ‘penalty fixing committee’ is out of all proportion to the wrong committed. The punishment must fit the crime, in tax matters no less than elsewhere.”* Own emphasis added.

Deterrence has also been acknowledged to find application in cases that involved negligence and carelessness.⁶³ The court observed in *Bredell* that in a case of gross negligence the deterrent purpose of punishment must be emphasized.

Where it is evident, in *Hartmann*, that the crime is not likely to be repeated the deterrence, theory must not be applied.⁶⁴ In this case the doctor administered euthanasia to his aged father who suffered from an incurable disease and was accordingly sentenced to one year’s imprisonment.

Accordingly, we draw inference from the above case law, that the South African courts acknowledge the role of retribution and deterrence as important objectives in determining the appropriate sentencing.

Accordingly, one should focus more on the deterrent and retributive penal measures imposed by the courts than rehabilitation and incapacitation. There is no doubt that the communication of the threat of punishment is significant to its effectiveness.

⁶² *Da Costa’s* case ibid at 14.

⁶³ *R v Bredell* 1960 (3) SA 558 (A) 560

⁶⁴ *S v Hartmann* 1975 (3) SA 532 (C)

2.2.3 Reformation/Rehabilitation

It is necessary that reformation be applied to the needs of the individual.

Reformation is to restore to a former good state, to be put into a new and improved condition.⁶⁵

Rehabilitation is specifically in respect of the offender and considers the offenders' social past. It is to restore someone to their former state, reputation, possession and status.

These factors/considerations are not present with the retribution and deterrence philosophies.

Supporters⁶⁶ of rehabilitation recommend that one considers the offender and not the offence itself.

It is believed that rehabilitation has a deterrent effect, in so far as an offender that is rehabilitated will be less likely to commit future offences.

The United States used the rehabilitative model only until the 1970's because it was considered that the model did not achieve the objective of controlling or preventing crime.⁶⁷

2.2.4 Incapacitation

An example of incapacitation is where an offender is confined and cannot commit additional wrongdoings, in other words incarceration as incapacitation.

Incapacitation has a deterrent element to it, in that a potential offender before committing any wrongdoing can fear incarceration and accordingly refrain from committing any wrongdoings – in other words fear of incarceration as a deterrent.

⁶⁵Definition of Reformation. Available: <https://dictionary.law.com/Default.aspx?selected=1766> [2018, February 15]

⁶⁶Priya, T. 2014. *Reformative Theory of Punishment*. Available: <https://www.lawctopus.com/academike/reformative-theory-of-punishment/> [2017, March 3].

⁶⁷Garland, D. 2002. *The Culture of Control: Crime and Social Order in Contemporary Society*. Chicago: University of Chicago Press. Available: <http://onlinelibrary.wiley.com/doi/10.1525/pol.2002.25.2.109/full> [2018, February 15]

Research has found that incarceration may exacerbate reoffending.⁶⁸ Data used inside and outside the U.S concluded that “...compared to non-custodial sanctions, incarceration has a null or madly criminogenic impact on future offender involvement. We caution that this assessment is not sufficiently firm to guide policy, with the exception that is calls into question wild claims that imprisonment has strong specific deterrent effects.”⁶⁹

2.3 Conclusion

As stated in 2.1 above punishment of offences is generally categorized into four justifications namely:

“1) Retribution;

2) Deterrence;

3) Rehabilitation;

4) Incapacitation (social protection)”⁷⁰

In short retribution is focused on passed offences whilst the other categories find their justification in the future. In respect of retribution, the courts require that the punishment must fit the offence committed by the offender.

Though the punishment inflicted upon the offender will to a certain extent prevent the offender from committing future wrongdoings, the courts found it not to be the most important factor in preventing future wrongdoings.

The definition of deterrence clearly states that it is the action of discouraging an action or event through instilling doubt or fear of the consequences. It was found to be the more modern approach to punishment.

⁶⁸ Nagin, D.S, Francis, T., Cullen & Johnson, C.L. 2009. *Imprisonment and Reoffending*, Crime and Justice: A review of Research. Vol 38: at 115-200 Available: <http://www.journals.uchicago.edu/doi/abs/10.1086/599202> [2018, February 15]

⁶⁹ Nagin, D.S, Francis, T., Cullen & Johnson, C.L. *ibid* at 115 and following.

⁷⁰ Marson, J. *ibid* at 19 and following, *Swanepoel's case ibid, Whitehead's case ibid* at 436E-F and *Rabie's case ibid*.

Deterrence contains a preventative function and is used as a means of protecting the society. Deterrence is a way of preventing future wrongdoings. It was found that if the punishment is not severe enough it would not act as a deterrent.

It was evident from case law that the South African courts acknowledged the role of deterrence as a very important objective in the determination of the appropriate sentencing.

Reformation is applied specifically in relation to the needs of the individual. It is focused on restoring the former good state and to improve it and does not have much effect on preventing the wrongdoing from reoccurring.

Having considered these categories, it becomes clear that the dominant element for consideration, is deterrence. Ultimately, a penal system should be of such nature that individuals are wary of performing any wrongful activities.

CHAPTER 3: History of tax penalty provisions

In Chapter 2 above I examined the history of punishment and established what the objects of punishment are. I examined the different categories of punishment namely: retribution, deterrence, rehabilitation and incapacitation.

The identified categories all play a role in ensuring that the right 'outcome' is achieved. Punishment is therefore focused on the past and the future. Whilst retribution is focused on the past, deterrence, rehabilitation and incapacitation is focused on the future.

This is to ensure that wrongdoers are held accountable for what they did wrong and to prevent them from committing future wrongdoings. It was evident In Chapter 2 that the courts of South Africa favoured and focused on the role of *deterrence*.

In a tax context, it is important that a penal system should act as a deterrent to prevent any wrongful activities and accordingly for a penalty levying system to truly operate as an effective penal system there must be a suitable framework and it must align with the doctrine of punishment.

In a tax context punishment usually takes the form of a penalty that is imposed, however depending on the default in question it could be as drastic as imprisonment.

It has been explained by the courts⁷¹ that penalties are collected by SARS, however it is ultimately the penal statutory provisions that carry a penalty.

As pointed out in Chapter 2, it is necessary to obtain the correct equilibrium for punishment.

It also cannot be said that the imposition of high penalties would automatically reduce noncompliance, as such high penalties may result in taxpayers not being able to afford such penalties and could lead to a general feeling of unfairness.

This chapter provides an overview of the historic penal provisions and the new penalty regime currently operative in the Admin Act. In the next chapter the new penalty regime will be examined to determine whether the current penal provisions truly achieve its objectives and whether it accords with the objects of punishment.

⁷¹*Israelsohn v Commissioner of Inland Revenue* 1952 (3) SA 529 (A), *ITC 1295* *ibid*, *ITC 1351* 1981 44 SATC 58

In *ITC 1576*,⁷² it was held that the penalty should not be too harsh and effect the taxpayer to such an extent that it cannot continue to be an effective member of society.

The term 'tax' is defined in the Tax Administration Act, No 28 of 2011 'Admin Act' as:

"for purposes of administration under this Act, includes a tax, duty, levy, royalty, fee, contribution, penalty, interest and any other moneys imposed under a tax Act;" own emphasis added.

It is therefore clear from the TAA that the definition of tax includes a penalty.

3.1 Purpose of tax penalties

It appears that there are different motivations for the imposition of tax penalties and that different countries impose penalties for different purposes.⁷³ These purposes include: punitive, as deterrence and a compensation purpose.⁷⁴

It was evident in some countries that one of the purposes of penalties can very well be of a compensatory nature.⁷⁵

In another country⁷⁶ the tax authorities are empowered with the discretion to impose penalties at their discretion without any specific guidance. This was said to be an effective system for the imposition of the penalties as the burden to prove the opposite rests with the taxpayer and it is difficult to convince the tax authorities otherwise.⁷⁷ It can however be said that the effectiveness of the penal system depends on the effectiveness of the tax system and the tax administration.

⁷² 56 SATC 225 at 232

⁷³ Wilms, L. and Seer, R. Eds. 2016. *Surcharges and Penalties in Tax Law*. Vol 14. Netherlands: European Association of Tax Law Professors and authors. At 35

⁷⁴ Austria and Greece do not impose penalties with the consideration of punishment as purpose, they focus on the deterrence purpose; Wilms, L. and Seer, R. *ibid* at page 35 and following.

⁷⁵ It was previously perceived that Greece (prior to 2014) imposed penalties with the motive of collecting revenue especially in instances where the revenue authorities incorrectly imposed such penalties: Wilms, L. and Seer, R. *ibid* at page 35 and following.

⁷⁶ Switzerland, Wilms, L. and Seer, R. *ibid* at page 35 and following.

⁷⁷ Wilms, L. and Seer, R. *ibid* at page 42

When observing different countries, it is evident that the purpose of the imposition of penalties differs from country to country⁷⁸. The effectiveness of a penal system also very much depends on the economic situation of a specific country.

Another purpose of the imposition of penalties was to re-establish any economic imbalance that existed prior to the relevant violations.⁷⁹

Therefore, the purpose of penalties can be either that of a preventative nature or that of a punitive nature. Per the objectives of the penalty regime in South Africa it is evident that the main purpose should not be that of raising revenue but instead to promote effective tax compliance.⁸⁰

The Tax Court⁸¹ explained previously that the purpose of the penalty provisions of the ITA and the application of the imposition of a penalty is intended to act as a deterrent to taxpayers and potential wrongdoers. The focus of the penalty regime was to ensure that taxpayers submit their income tax returns in an accurate and honest manner in other words to deter from default. This would ultimately improve the revenue compliance and collection.

Accordingly, imposing penalties is necessary to promote and improve tax compliance. While penalties may be an effective manner to increase tax compliance it most certainly should not take “a one size fits all” approach. The incorrect application of the penalty regime could lead to an imbalance and possibly have Constitutional consequences. These will however not be discussed in this dissertation.

Judge Nicolas J A⁸² is of the opinion that the most important and universally admitted object of punishment is deterrence.

In *ITC 1430*⁸³ the court held that in the process of deciding the extent of the penalty that needs to be imposed there are ultimately three main factors to consider; punishment of the taxpayer; the deterrent effect on the taxpayer himself; and the deterrent effect on others.

⁷⁸ Wilms, L. and Seer, R. *ibid* at page 32 and following

⁷⁹ This was evident in Italy: Wilms, L. and Seer, R. *ibid* at page 32 and following

⁸⁰ *Memorandum on the Objects of the Tax Administration Bill. 2011*

⁸¹ *CIR v Ciccio* 1985 (3) SA 989 (T), *ITC 1351* 1981 44 SATC 58

⁸² *Khumalo's case* *ibid* at 330D-E

⁸³ 50 SATC 51 at 54

The court considered what effect the imposition of a penalty can have on a taxpayer.⁸⁴ In this case the taxpayer was illiterate and worked long hours without taking any breaks. The court's view on this was that a penalty should not be automatically imposed by SARS. The facts and circumstances of each case should be considered to determine whether extenuating circumstances exist that warrant the levying of a lesser penalty. The court stated that the imposition of an excessive penalty could negatively impact the taxpayer's labours and efforts. Ultimately considering all the facts, the court found that a 50% penalty was justified instead of the 100% originally imposed. It was also held that the purpose of the imposition of a penalty, was to make up for the *'loss of interest, which would have been paid if there had been a proper and timeous assessment, by virtue of the delayed payment of tax'*.⁸⁵

To determine the purpose of tax penalties in South Africa and the effectiveness thereof it is necessary to review the application of the penalty regime historically.

This chapter provides an overview of the penalty regime both prior to the enactment of the Admin Act and the regime currently operative. This chapter also provides an overview of concerns around the imposition and the remission of penalties.

3.2 Section 75B of the ITA

Previously, by failing to submit income tax returns, a taxpayer contravened section 75(1)(a) of the ITA and accordingly was guilty of an offence and liable on conviction to a fine or to imprisonment for a period not exceeding 24 months.

In terms of section 76 the Commissioner was entitled to levy additional tax in the event of default or omission as relates to the completion or submission of a person's annual income tax return.

Taxpayers were charged a fine for admission of guilt and the imposition of additional tax for the non-submission of the annual income tax returns. This caused much discontent as taxpayers believed it was not constitutional to pay a fine and be charged with additional tax for the same offence.⁸⁶

⁸⁴ *ITC 1331* 1980 43 SATC 76

⁸⁵ *ITC 1331* case ibid at 87

⁸⁶ *ITC 11641* ZATC (2006)

In *S v Odendaal*⁸⁷ clarity was provided that administrative penalties do not constitute criminal penalties. It was further evident that the main purpose of an administrative penalty was not to punish the wrongdoer, instead it was to maintain the effectiveness of the tax system.

It was questionable whether penalties for non-compliance were inconsistently imposed for different taxpayers and that the different SARS branch offices dealt with similar taxpayers in a different manner and seemingly arbitrarily.⁸⁸

In 2.2.2 above it was pointed out that the certainty of punishment is the real deterrent and not necessarily the extent of the punishment itself, however it was also pointed out that there are two different types of deterrence namely general deterrence and specific deterrence.

If the Commissioner is to conduct its matters in a fair and equitable manner, it would appear that specific deterrence rather than general deterrence be applied in a tax context.

The provisions were subsequently repealed and replaced with Section 75B of the ITA which took effect from 1 January 2009.⁸⁹ In terms of section 75B the Commissioner could impose administrative penalties in respect of non-compliance as prescribed. The Commissioner had to ensure that the administrative penalties for non-compliance were imposed impartially, consistently and proportionately to the seriousness of the non-compliance.

Section 75B only dealt with the administrative penalties imposed under the ITA and did not change or affect the penalties imposed for value-added tax, securities transfer tax, transfer duty, skills development and other taxes administered by the Commissioner.

Section 75B(3) empowered the Minister to make regulations prescribing the administrative penalties that the Commissioner may have imposed and the procedures that needed to be followed by the Commissioner when imposing such administrative penalties. Furthermore, it set out what procedures a taxpayer had to follow when an administrative penalty was imposed in order to obtain any relief thereof. Also, identifying in which circumstances the

⁸⁷ 1995 (2) SACR 449 (T)

⁸⁸ Edward Nathan Sonnenbergs. 2009. *Administrative Penalties*. Integritax SAICA Newsletter 1739 Issue 118. Available: www.saica.co.za/integritax/2009/1739_Aministrative_penalties.htm [2017, January 4].

⁸⁹ Edward Nathan Sonnenbergs. 2009. *Administrative Penalties*. Integritax SAICA Newsletter 1739 Issue 118. Available: www.saica.co.za/integritax/2009/1739_Aministrative_penalties.htm [2017, January 4].

Commissioner could remit any administrative penalty imposed. The Commissioner had an obligation to remit the administrative penalties in certain circumstances.⁹⁰

In practice there were many discussions relating to the imposition of penalties under section 75B(3) that has made it clear that the main object of these penalties was not to punish or deter the wrongdoer, instead it was rather to ensure the maintaining of the effectiveness of the tax system.

3.3 Section 76 of the ITA

In terms of section 76 of the ITA if a taxpayer in respect of any year of assessment defaulted in rendering a return and omitted from its return any amount which ought to have been included therein or made an incorrect statement therein which resulted in the assessment of normal tax at an amount which was less than the tax properly chargeable, then the taxpayer was required to pay in addition to the tax chargeable an amount equal to twice the difference between the tax amount calculated in respect of the taxable income returned by the taxpayer, and the tax properly chargeable in respect of the taxpayer's taxable income as determined after the inclusion of the omitted amount. The taxpayer could be liable for additional tax up to 200% in certain instances.

In *ITC 1489*⁹¹ it is evident that the reasoning behind the imposition of additional tax was not only to ensure the accuracy on income tax returns, but also to avoid loss to the *fiscus*.

The Commissioner must, if a penalty was imposed, give a notice of the assessment in the desired format to the relevant person and it must include:

- The non-compliance in respect of which the penalty is assessed and its duration;
- The amount of the penalty assessed;
- The due date for paying the penalty;
- The automatic increase of the penalty; and

⁹⁰National Gazette 31764, 31 December 2008. Vol 522: para 11. Available: https://www.greengazette.co.za/pages/national-gazette-31764-of-31-dec-2008-vol-522_20081231-GGN-31764-015.pdf [2017 August 16]

⁹¹ 1990 53 SATC 99

- A summary of procedures for requesting remittance of, or objecting to, the penalty.

A penalty was due upon assessment and had to be paid on or before the due date stated in the notice of the penalty assessment.

Upon receipt of the penalty assessment the taxpayer could, on or before the due date for payment, in the relevant prescribed format request that the Commissioner, remit the penalty in accordance with the various provisions of the regulations. In certain instances, the Commissioner could have extended the period. The prescribed remittance request had to contain the relevant circumstances which prevented the taxpayer from complying with the relevant obligations under the Act in respect of which the penalty had been imposed and had to contain any relevant supporting documentation and information as required by the Commissioner.

The Commissioner could remit a penalty or a portion thereof if it was satisfied that one or more specified circumstances existed. If extenuating circumstances were present, the Commissioner could, on a discretionary basis, have remitted or reduced the penalty. There was no exhaustive list in terms of what constituted extenuating circumstances.

In instances where the Commissioner was satisfied that the penalty was incorrectly assessed it could, within a limitation of three years of the penalty assessment, have issued an altered assessment to the taxpayer. The decision not to remit the penalty in part or in whole was subject to an objection and appeal.

It must however be borne in mind that in terms of section 82 of the ITA, the onus of proof rested on the taxpayer: once SARS alleges that an amount is so owing, the taxpayer must prove otherwise. Section 82 of the ITA has however been replaced with section 102 of the Admin Act.

Where the taxpayer has requested to be provided with reasons for the imposition of the penalty, the reasons provided by the Commissioner must be sufficient to place the taxpayer in a position to determine whether it is fitting to proceed with an objection and an appeal against the imposition of the additional tax.

The main concern with legislation was the fact that no guidelines existed that defined the Commissioner's powers or any indication of possible factors that could influence his decision-making.

The wording of section 76 of the ITA empowered the Commissioner to impose a 200 per cent penalty in cases of an 'understatement'⁹². Since there was no guidance or rules to regulate the imposition of additional taxes, the Commissioner in some cases provided inadequate or even no reasons at all when penalties were levied⁹³.

Considering that section 76 imposed a 200% penalty it was argued that the aim of the penalty was to punish the taxpayer rather than merely just ensuring that the taxpayer complies with the provisions of the ITA. In 2.2.1 above it was pointed out that the courts acknowledged retribution as requiring that the punishment bears some relation to the seriousness of the offence and that the wrongdoer should receive what it deserved – no more or no less. The punishment must be humane.

In *ITC 1295*⁹⁴ the Court was of the opinion that the Commissioner was in a far better position to determine the appropriate penalty to be imposed and that the court would only intervene in circumstances where the Commissioner has acted unreasonably. Typically, this would have been in instances where there was a significant difference between the penalty imposed by the Commissioner and that which the Court deemed appropriate to be imposed.

It is therefore evident that the application of the penalty provision imposing the highest penalty percentage were in some instances not aligned with the doctrine of punishment.

3.4 Remittance of the penalties

Section 76(2)(a) of the ITA previously provided the Commissioner with the power to remit additional tax or any part thereof as he may have considered appropriate.

In instances where there was intent on the part of the taxpayer to avoid tax and no extenuating circumstances were present for the tax position taken by the taxpayer, the

⁹² As defined in the Admin Act

⁹³ *Qwa-Qwa Cash and Carry (Pty) Ltd v CSARS* 2005 ZAGPHC 121

⁹⁴ 1983 42 SATC 19 at 30-31

Commissioner was not allowed to remit the additional tax levied by him.⁹⁵ This provision was aligned with the objectives of punishment as it provided certainty and the wrongdoer was punished for the wrong done.

In considering whether to remit the additional tax levied the intent of the taxpayer was to be tested.⁹⁶ This test was a subjective test and the test was that one needed to establish what the intention of the taxpayer was at that specific point in time. For the Commissioner to have concluded that intent on the part of the taxpayer was present, the Commissioner had to have concluded that certain circumstances were present at the time of the alleged wrongdoing. Where a taxpayer was knowingly aware and expected the consequent damages that followed, the criteria for intent would have been met.⁹⁷

For the Commissioner to have arrived at a fair and equitable penalty to be levied, he needed to have considered the circumstances of the specific case at hand. It was questionable whether the Commissioner could objectively and fairly interpret a penalty in the absence of any set of rules or some judicial guidance.

In a landmark case⁹⁸ SARS insisted on the imposition of a 200 per cent penalty as the Commissioner believed no extenuating circumstances were present that warranted a different penalty payable. Ultimately, upon appeal to the Supreme Court of Appeal the Court reduced the penalty from 200 per cent to a 100 per cent as they found that the percentage was too severe and out of proportion relating to the wrong that was committed by the taxpayer.

Accordingly, it was questionable whether certain factors such as personal circumstances, age, first time offender, number of dependents or ignorance of the law could be considered to justify the imposition of a lessor amount of penalty.

The Commissioner had to decide what was fair and equitable in each case without guidance from any provision on the factors to be considered or the circumstances of each taxpayer. The court provided some guidance in *ITC 1758*⁹⁹ in respect of the factors that a court would

⁹⁵ *S v Sigwahla* 1967 (4) SA 566 (A)

⁹⁶ *Sigwahla's* case *ibid.*

⁹⁷ *Sigwahla's* case *ibid.*

⁹⁸ *CSARS v NWK* 2011 (2) SA 67 (SCA)

⁹⁹ 2013 65 SATC 396

consider in respect of the penalty imposed. In this case the taxpayer initially denied that the amount received was not taxable. A settlement was reached between the Commissioner and the taxpayer on this point, however no settlement was reached in respect of the discretion exercised by SARS to impose a 100% penalty. The taxpayer, aggrieved by the imposition of a 100% penalty, proceeded with an objection against the penalty on the basis that his personal circumstances (his circumstances being: 65 years of age and having fled to SA from Angola during the war) justified a lesser penalty. The Commissioner contended that the main purpose of imposing penalties was to deter taxpayers from evading tax. Having considered all the facts and circumstances the Court imposed a 50% penalty.

In *ITC 1508*¹⁰⁰ the court held that the lack of knowledge on the part of a taxpayer resulted in a *bona fide* failure to submit certain amounts and it was found to be a sufficient defence against the imposition of a penalty.

Due to the lack of guidance in the ITA, taxpayers had to rely on court cases to support their contentions to have penalties remitted or reduced. This lack of guidance caused much uncertainty.

It is therefore clear that the Commissioner could not claim to have exercised its decision on a fair and equitable basis if it has no set of rules or at least some judicial guidelines against which to apply the imposition of penalties. It is therefore questionable whether certain rules and guidelines should exist for a decision of the Commissioner to be reasonable.

In *ITC 1576*¹⁰¹ it was questioned whether legislation should not provide a taxpayer with the right to represent itself before the imposition of a penalty. This is referred to as the *audi alterem partem* rule. This could very well eliminate unnecessary lengthy litigation processes, given the fact that some taxpayers cannot afford litigation and because of this must merely accept what has been imposed. If this rule had to be applied it would establish a more fair and effective process. The Commissioner might defend such position and state that the workload of SARS would increase tremendously. However, the counter argument is that if the facts and circumstances of the taxpayer's case is thoroughly examined before the

¹⁰⁰ 1991 53 SATC 442

¹⁰¹ 1992 56 SATC 225 at 235

imposition of a penalty and the penalty truly reflects the offence committed, then it will only be necessary to litigate on penalties in exceptional circumstances.

It is evident that a more guided penalty regime in respect of the imposition of penalties was needed for the outcome to be more fair and equitable to both the Commissioner and taxpayers.

3.5 Penalty regime contained in the Admin Act

The Admin Act became operative on 1 October 2012 and although the administrative penalty provisions are very similar to the penalty provisions that were previously introduced into the ITA in 2009, they are now overridden.

Sections 208 to Sections 220 of the Admin Act deal with administrative non-compliance penalties. These will be discussed in Chapter 4.

The provisions dealing with penalties for different types of non-compliance are grouped into three main categories and are dependent upon different circumstances and ultimately the degree of severity of the transgressions.

In terms of the Admin Act the Commissioner can impose two types of penalties, namely, the "fixed amount penalty" and the "percentage-based penalty".

A fixed amount penalty is imposed in terms of section 211 of the Admin Act and is in respect of failure to comply with an obligation that is imposed by or under a tax Act and is listed in a public notice.¹⁰²

A percentage-based penalty is imposed in terms of section 213 of the Admin Act and is imposed in respect of an amount of tax that was not paid as and when required to under a tax Act.

The ultimate significance of the Public Notice governing the imposition of administrative noncompliance penalties was to ensure that taxpayers are treated in the same manner for the same nature of offences, ultimately ensuring a fair, equitable and comparative platform for all.

¹⁰² Section 210(2)(a) – (c) of the Admin Act

It is still a difficult task, as the details and circumstances of each matter is not publicised, it is difficult to ensure that all taxpayers that have similar facts and circumstances are dealt with in the same manner.

It was pointed out in 2.1 above that the four categories of punishment form the basic factors of which the punishment doctrine is made up of and that the correct application of a “mixture” of those will ensure that punishment in each individual case will be effective and attain the ultimate objective of punishment. Punishment requires certainty as it contains a deterrence element.

Taxpayers have nevertheless welcomed the new penalty regime as it appears to be a solution to a great part of the controversy.¹⁰³

3.6 The Memorandum on the Objects of the Tax Administration Bill, 2011

Per the Explanatory Memorandum¹⁰⁴ the purpose of the Tax Administration Bill was to align and modernize the outdated framework in the ITA with the current modern business world today.¹⁰⁵ One of the most significant objectives is largely to reduce the cost and the burden of tax administration for taxpayers in general. Furthermore, it strives to achieve a balance between the powers and duties of the Commissioner and the rights and obligations of taxpayers. It further seeks to establish a transparent relationship between the Commissioner and taxpayers. For administrative justice to be attained, it is necessary to ensure consistent treatment among taxpayers in comparable circumstances.

The Admin Act endeavours to effect protection of administrative fairness and taxpayers’ rights through affording taxpayers more effective remedies and specific procedural rights.

When the Admin Act was drafted, the following principles of international best practices in tax administration were focused on¹⁰⁶:

¹⁰³ Cliffe Dekker Hofmeyr. 2011. *Understatement penalty*. Integritax SAICA Newsletter 2013 Issue 147. Available: https://www.saica.co.za/integritax/2011/2013_Understatement_penalty.htm [2017, August 14]

¹⁰⁴ *Memorandum on the Objects of the Tax Administration Bill. 2011*

¹⁰⁵ *Memorandum on the Objects of the Tax Administration Bill. 2011* para 2

¹⁰⁶ *Memorandum on the Objects of the Tax Administration Bill. 2011*

- (a) Equity and fairness to ensure that the tax system is fair and perceived to be fair, which should in turn enhance compliance.
- (b) Certainty and simplicity so that tax administration is not seen as arbitrary but transparent, clear and as simple as the complexity of the system allows.
- (c) Efficiency, where compliance and administration costs are kept to a minimum and payment of tax is as easy as possible.
- (d) Effectiveness, so that the right amount of tax is collected, active or passive non-compliance is kept to a minimum, and the system remains flexible and dynamic to keep pace with technological and commercial development.

In 2.1 above it was evident that punishment is applied to assist and maintain a balance in society and accordingly it should benefit the society. Furthermore, the state has a responsibility to prevent repeated unlawful manifestations from occurring and accordingly they must make it known that they would not tolerate such actions, in other words it should act as deterrent.

It was also pointed out that the punishment should fit the wrongdoer as well as the wrongdoing, it must be fair to the state and to the wrongdoer. Therefore, the four elements (retribution, deterrence, reformation/rehabilitation and incapacitation) that forms the basis of the punishment doctrine plays an important role and should be correctly applied to achieve the right equilibrium and result.

If no clear legislative framework exists, there will be uncertainty and inconsistency. Accordingly, it was evident that proper guidance and rules in legislation plays a vital role in the measuring and achieving of the objects of the purpose of punishment.

The proposed penal provisions indicated that it was focused on equity, fairness, certainty, simplicity, efficiency and effectiveness which aligns with the objectives of punishment.

3.7 Conclusion

There was, prior to the enactment of the Admin Act, no specific guidance in respect of the imposition of penalties and it could therefore be said that the implementation of the behaviour table in the Admin Act was a step in the right direction.

In terms of the Draft Explanatory Memorandum on the Draft Tax Administration Bill¹⁰⁷ it was indicated that the open-ended discretion to impose additional taxes up to 200% in terms of section 76 was inappropriate as it conferred a too wide discretion of SARS officials. This wide discretion could lead to unconstitutionality as it could cause an imbalance of the right to equality and the right to administrative justice of taxpayers.

It is not clear to what extent requests for remittance of penalties are considered and what factors and circumstances are considered to quantify the decision to remit a penalty.

The absence of proper guidance in the Admin Act therefore creates certain reservations as to whether the penalty regime and relevant discretion of the Commissioner to remit or not to remit penalties truly operates in the pursuance of the doctrine of punishment.

In Chapter 4 I address the specific areas of concern in respect of the amended penalty regime.

A penalty regime can only be proficient and act as a respectable deterrent if there is certainty, as it would be clear what the exact consequences of certain actions are. Where there are any grey areas it leaves room for wrongdoers to take chances and arrange their tax affairs accordingly.

¹⁰⁷ *National Treasury*, 2019:17 Available:
<http://www.treasury.gov.za/publications/annual%20reports/national%20treasury/nt%20annual%20report%202009-10.pdf> [2018, February 15]

CHAPTER 4: Different types of penalties and remission request

4.1 Administrative non-compliance penalties (Chapter 15)

4.1.1 Introduction

The administrative non-compliance penalties are imposed in terms of Section 210 of the Admin Act when a taxpayer fails to comply with the administrative requirements of the tax Acts and are referred to as administrative non-compliance penalties.

Section 210 states:

“(1) If SARS is satisfied that non-compliance by a person referred to in subsection (2) exists, SARS must impose the appropriate ‘penalty’ in accordance with the Table in section 211.

(2) Non-compliance is failure to comply with an obligation that is imposed by or under a tax Act and is listed in a public notice issued by the Commissioner, other than-

(a) the failure to pay tax subject to a percentage-based penalty under Part C;

(b) non-compliance in respect of which an understatement penalty under Chapter 16 has been imposed; or

(c) the failure to disclose information subject to a reportable arrangement penalty under section 212.”

4.1.2 Fixed amount administrative non-compliance penalties

Section 211(1) of the Admin Act contains a table with the fixed amounts that are to be imposed when a taxpayer commits any of the non-compliances listed by the Commissioner in a public notice. The reason for this is only to target serious non-compliance. It was decided that the new penalty provisions would be phased in gradually, accordingly only a public notice was issued,¹⁰⁸ in terms of which natural persons are only penalised if they have two or more outstanding income tax returns on or after 1 March 2006.

¹⁰⁸ National Gazette 35733. 1 October 2012. Vol. 568. Available: <http://www.sars.gov.za/AllDocs/LegalDoclib/SecLegis/LAPD-LSec-TAdm-PN-2012-01%20-%20Notice%20787%20GG%2035733%201%20October%202012.pdf> [2018, February 15]

The penalty to be imposed ranges from R250 to R16 000 per month. It is imposed based on the tax liability of the preceding year of assessment. Where the previous year of assessment had an assessed loss or a taxable income that does not exceed R250 000, the penalty imposed is R250. The penalty increases to a maximum of R16 000 where the preceding year of assessment's taxable income exceeds R50 million.

The penalty is levied monthly until the non-compliance is remedied, in other words the overdue return(s) are submitted. The imposition of the penalties does however not run limitless, a limit of 35 months has been attached to the imposition of this penalty.

A further deterrent has been included being that if SARS is not in possession of the wrongdoers address the period of the penalty imposed can be extended to a maximum of 47 months. This accords well with the endeavour to achieve good tax administration and is a way that assists to ensure that taxpayers keep SARS informed of their whereabouts.

However, on the other hand it could also be argued that taxpayers should be punished for not keeping their information up to date irrespective of whether their returns are rendered up to date.

Furthermore, the Commissioner is entitled to levy interest on the outstanding penalty monthly.

Also, taxpayers may face a double penalty in instances where they have failed to submit their tax returns and have an income tax liability in respect of those years of assessment. This is where the percentage-based penalties come into play. If a taxpayer is a provisional taxpayer and the amount due is paid late, the taxpayer will be charged an additional penalty in respect of the late payment.

4.1.3 Minimum penalties

Minimum penalties are available to taxpayers in certain instances such as:

- Companies listed on a recognized stock exchange;
- Companies whose gross receipts and accruals for the preceding year of assessment exceeded R500 million;

- Members of any group of companies that includes a company in either of the above two categories; and
- A person or an entity that are exempt from income tax (but is liable to tax under another tax act) with receipts and accruals that exceed R30 million.¹⁰⁹

4.1.4 Reportable Arrangement Penalty

Reportable arrangements are defined in the Admin Act¹¹⁰. In short there are two types of reportable arrangements (RA's) namely:

- Arrangements in which specific identified requirements are present¹¹¹; and
- The second category is reportable arrangements which are identified by the Minister by notice in the Gazette. These arrangements are identified based on certain characteristics which have the effect of avoiding or postponing liability for or reducing the amount of taxes on income.¹¹²

A fixed amount penalty is imposed on a participant to a reportable arrangement who neglects to provide information in respect of the reportable arrangement.

Depending on the amount of the anticipated tax benefit, the penalty for the 'participant' is R50 000 and in the case of the 'promotor' it is R100 000, imposed monthly for up to 12 months.

The penalty can be doubled if the projected tax benefit for the participant exceeds R5million and can be as much as three times the initial penalty amount if the tax benefit exceeds R10 million.

Where a reportable arrangement penalty has been imposed by SARS and the taxpayer is aggrieved by the penalty imposed the taxpayer may request for remittance of the penalty in terms of section 217 of the Admin Act.

Section 217 allows for the remittance of a penalty as related to the 'first incidence' of non-compliance. This is potentially a grey area for taxpayers as the wording of section 217 is too

¹⁰⁹ Section 211(3)(d) of the Admin Act

¹¹⁰ Section 35(1) of the Admin Act

¹¹¹ Section 35(1)(a) to (e) of the Admin Act

¹¹² Section 35(2) of the Admin Act

vague in respect of RA's. There is uncertainty in respect of whether the 'first incidence' refers to the first ever failure on the part of the taxpayer to disclose any reportable arrangement or if it refers to the first month of failure by a relevant participant to disclose the particular reportable arrangement.

A taxpayer who is aggrieved by the penalty may alternatively, if exceptional circumstances as listed in section 218(2) exist request for remittance. The taxpayer may request for remission irrespective of whether the non-compliance is a 'first incidence' of non-compliance or not.

There is uncertainty as to the extent of SARS' powers in respect of remission of a penalty for non-compliance under section 218. The main uncertainty is whether SARS may remit the whole amount of the penalty imposed if the relevant criteria as set out has been met or are satisfied.

Only if the whole amount is remitted can it be said that the result is fair and equitable to taxpayers. It can also only then truly reflect that the purpose of punishment is to only punish deliberate wrongdoers and not the taxpayer who goes about their tax affairs in a true, honest fashion.

4.1.5 Percentage based penalties

Section 213(1) of the Admin Act states-

"If SARS is satisfied that an amount of tax was not paid as and when required under a tax Act, SARS must, in addition to any other 'penalty' or interest for which a person may be liable, impose a 'penalty' equal to the percentage of the amount of unpaid tax as prescribed in the tax Act."

Accordingly, Section 213 provides for a penalty to be imposed under the Admin Act if SARS is satisfied that an amount of tax was not paid as and when it was required to be paid under a tax Act.

The Admin Act does not specify the actual percentages that are to be imposed. The penalty to be imposed is equal to a percentage of the amount of tax which is unpaid, as prescribed under the relevant tax Acts.

The circumstances which warrant the imposition of the percentage-based penalty are regulated by the relevant tax Acts. The Admin Act deals specifically with the procedures of imposition and the requests for remittance of such penalties.

4.1.6 Percentage based penalties applied: provisional tax, PAYE, VAT

Provisional tax:

Penalties relating to provisional tax are determined by the Fourth Schedule to the ITA. They are as follows:

- In terms of paragraph 27(1) a 10% late payment or non-payment of provisional tax may be imposed,
- In terms of paragraph 20A a penalty of 20% must be imposed for failure to submit a provisional tax estimate,¹¹³ and
- In terms of paragraph 20(1) a penalty of 20% must be imposed for the understatement of a provisional tax estimate if the taxpayer incorrectly estimates the taxable income by a certain percentage.

PAYE:

In terms of section 213 of the Admin Act read with paragraph 6(1) of the Fourth Schedule to the ITA, SARS may impose a penalty if an employer fails to pay any number of employees' tax for which the taxpayer is liable within the specified period for an amount equal to ten per cent of such unpaid amount.

Furthermore, a penalty may be imposed in terms of section 213 read with paragraph 14(6) of the Fourth Schedule to the ITA for failure to submit a complete, accurate and reconciled EMP501 to SARS by the relevant due date.

The penalty¹¹⁴ is levied for each month that the employer fails to submit a complete return which in total may not exceed 10 per cent of the total number of employees' tax deducted or

¹¹³ This penalty was deleted with effect from 1 March 2015

¹¹⁴ Paragraph 14(6)

withheld or which should have been deducted or withheld by the employer from the remuneration of the employees for the relevant period as described.

In instances where the EMP501 is outstanding, penalties are calculated as a percentage ranging from 1% up to a maximum of 10% of the total PAYE payable per month in respect of a specific period outstanding.¹¹⁵ The penalty imposed may be proportionally remitted depending on the circumstances of each case and dependent on the degree of the relevant compliance.¹¹⁶

Penalties are systematically levied and the penalty will recur if the taxpayer does not remedy the non-compliance that gave rise to the administrative non-compliance penalty by the same amount every month that the non-compliance is not remedied.

VAT:

SARS imposes a fixed amount penalty¹¹⁷ when it is satisfied that an amount of tax was not paid as and when it is required under the ITA. As relates to VAT, SARS may impose a penalty equal to the percentage¹¹⁸ of the amount of the unpaid tax.

A penalty equal to 10% is imposed by SARS when a vendor fails to pay VAT within the period allowed for payment. The applicable penalty percentage, currently 10%, is regulated by the VAT Act.¹¹⁹ The imposition of the penalty is regulated by the Admin Act.¹²⁰

Furthermore, an understatement penalty¹²¹ may be imposed by SARS if the *fiscus* is prejudiced by the vendor's conduct in reporting. The understatement penalty is imposed if there is a shortfall, which is the difference between the correct amount of tax that should have been disclosed and the amount that was disclosed by the vendor in respect of a tax period.

Accordingly, the *fiscus* will be prejudiced because a vendor¹²² -

¹¹⁵ Paragraph 14(6) of the ITA read together with section 213(1) of the Admin Act

¹¹⁶ section 217 and section 218 of the Admin Act

¹¹⁷ Section 217 and section 218 of the Admin Act

¹¹⁸ As prescribed in the VAT Act

¹¹⁹ Section 39 of the VAT Act

¹²⁰ Section 213 of the Admin Act

¹²¹ Section 222(1) of the Admin Act

¹²² Section 222(1) of the Admin Act

- Defaulted in rendering a return;
- Filed a return but omitted something from that return;
- Filed a return in which an incorrect statement was made.

A vendor can however request for the remittance of the percentage-based administrative penalty. SARS will grant the remittance if it is satisfied that the-

- Amount involved is either less than R2 000, or the non-payment is a *'first incidence'*;
- The vendor has reasonable grounds for the non-compliance; and
- The incidence of non-payment has been remedied.¹²³

The percentage-based penalty may also be remitted if exceptional circumstances¹²⁴ exist for the non-compliance.

If SARS decided to disallow the request for remittance, the vendor may object to this decision.¹²⁵

4.1.7 Request for remittance

A request for remittance is a method available to the taxpayer to request for the penalty levied in respect of any incidence of non-compliance to be waived and to dispute the imposition of the penalty.

A taxpayer who is aggrieved by the imposition of the penalty, can apply for the remittance of the penalty to SARS on or before the date on which the payment of the penalty is due and in the relevant prescribed form and manner.

If SARS does not allow the request, the taxpayer may object to the decision not to remit the penalty.¹²⁶

Section 215(1) states,

¹²³ Section 217(3) of the Admin Act

¹²⁴ *'Exceptional circumstances'* defined in section 218 of the Admin Act

¹²⁵ Section 224 of the Admin Act

¹²⁶ Section 215 of the Admin Act

“A person who is aggrieved by a ‘penalty assessment’ notice may, or before the date for payment in the ‘penalty assessment’, in the prescribed form and manner, request SARS to remit the ‘penalty’ in accordance with Part E.

(2) The ‘remittance request’ must include-

(a) a description of the circumstances which prevented the person from complying with the relevant obligation under a tax Act in respect of which the ‘penalty’ has been imposed; and

(b) the supporting documents and information as may be required by SARS in the prescribed form.

4.1.8 Remittance of a penalty in respect of nominal or ‘first incidence’ of non-compliance

Section 217 of the Admin Act provides for remittance of a non-compliance penalty where the non-compliance is in respect of a nominal or ‘first incidence’ of non-compliance.

Section 217(1) states,

“If a ‘penalty’ has been imposed in respect of-

(a) A ‘first incidence’ of non-compliance; or

(b) An incidence of non-compliance described in section 210 if the duration of the non-compliance is less than five business days,

SARS may, in respect of a ‘penalty’ imposed under section 210 or 212, remit the ‘penalty’, or a portion thereof if appropriate, up to an amount of R2 000 if SARS is satisfied that-

(i) Reasonable grounds for the non-compliance exist; and

(ii) The non-compliance in issue has been remedied.

(3) If a ‘penalty’ has been imposed under section 213, SARS may remit the ‘penalty’ or a portion thereof if SARS is satisfied that-

(a) the ‘penalty’ has been imposed in respect of a ‘first incidence’ of non-compliance, or involved an amount of less than R2000;

- (b) reasonable grounds for the non-compliance exist; and*
- (c) the non-compliance in issue has been remedied.”*

Furthermore, section 208 defines a ‘first incidence’ as *“an incidence of non-compliance by a person if no ‘penalty assessment’ under this Chapter was issued during the preceding 36 months”*.

It is questionable what would happen if the taxpayer registered for income tax and the taxpayer’s income tax returns are outstanding for the current and previous years of assessment. Both income tax returns are accordingly overdue and both had an amount to be paid which was not paid timeously. In this case the percentage-based penalty was imposed in respect of both years of assessment. The wording of section 217 is not clear and it could be interpreted that a taxpayer would only be able to request remittance in respect of the penalty imposed as relates to the first income tax return that was outstanding as that would fall within the request for remittance in respect of ‘first incidence’. As the request for remittance in respect of ‘first incidence’, if applied strictly, can only be applicable to the failure to submit the first income tax return, would SARS allow for the request for remittance to be collectively considered as ‘first incidence’ as relates to the failure to submit the second income tax return timeously.

Evidently, SARS’ powers in respect of remission under section 217 could be said to be limited to the ‘first incident’ of non-compliance.

Further, uncertainty exists regarding whether the ‘first incidence’ of non-compliance refers to the first failure of submission of an income tax return or the first month of the failure of submission on the part of the taxpayer.

So, although ‘first incidence’ is defined in the Admin Act it is still not clear how SARS will interpret scenarios as mentioned above where a taxpayer upon new income tax registration has two or more income tax returns outstanding. It is necessary to provide further guidance in this respect for taxpayers to know how they are to approach the request for remittance in such instances. It is therefore recommended that SARS clarify this by way of publishing further guidance.

4.1.9 Conclusion

In respect of the objects of punishment it was evident in Chapter 2 that it is necessary for wrongdoers to be punished for their wrongdoings and that punishment is necessary as a preventative and punitive measure. The incorrect application of punishment could lead to an imbalance and cause more harm than good.

It was also evident that a clear legislative framework is important to ensure clarity and certainty.

It is evident that the fixed amount and the percentage-based penalties provisions provide a clear legislative framework to taxpayers as there is no uncertainty or inconsistency in respect of the imposition of the penal provisions.

There is a consistent combination of both elements (preventative and punitive) that is necessary to achieve the purpose of punishment and the purpose of the penal provisions which ultimately should align with each other to achieve the right outcome.

The remittance of penalties imposed forms an integral part of the penalty regime as it provides for wrongdoers to obtain relief in certain circumstances. This is ultimately a mechanism to ensure that the penalty regime operates within its true purpose, as pointed out in 3.6 above, and with the doctrine of punishment.

In 2.1 it was evident that punishment is applied with the purpose of punishing the wrongdoer, however a very other important aspect of punishment is the determination of the extent of the punishment to be applied. It was pointed out that humans are not all alike and that punishment should not only be determined by the nature of the wrongdoing but also by the nature of the wrongdoer.

I briefly examined the courts powers in respect of sentencing and it was found that though there is no general legislation prescribing the courts on how to sentence and how much the offender should be sentenced, there are still limitations providing for a minimum and a maximum sentence. There are however limitations in respect of sentencing, a minimum and a maximum. The wide discretion of the courts can be problematic as the same set of facts

could be presented to two different judges and two completely different outcomes could be achieved.

The courts referred to a triad, which requires that the punishment should fit the wrongdoer as well as the wrongdoing, be fair to the state and to the wrongdoer blended with a measure of mercy.

In the current provisions providing remittance in respect of penalties imposed there are some deficiencies. There is no set of guidelines and the Commissioner has a very wide discretion. Taxpayers have no certainty as to what factors and circumstances would be considered or transparency in respect of the outcomes of other cases which have similar facts and circumstances.

It is therefore evident that the provisions in respect of the remission of the penalties does not align with the doctrine of punishment.

4.2 Understatement penalty (Chapter 16)

4.2.1 Introduction

The understatement penalty percentage provisions in Section 221 to 223 of the Admin Act predominantly targets serious noncompliance offences. It specifically lists certain behaviour and conducts on the part of the taxpayer. Such conduct includes elements of tax evasion.

The Hong Kong penalty table¹²⁷ provided South Africa with a base for the levying of penalties on the nature of the omission or the understatement of income or profit and included mitigating and aggravating factors that need to be considered when evaluating the specific cases at hand.

The main purpose of the understatement penalty regime was the deterrence of non-compliant reporting.¹²⁸

¹²⁷ Inland Revenue Department of the Government of the Hong Kong Special Administrative Region. 2003. Section 82A of the Penalty policies

¹²⁸ Draft guide to understatement penalties (2017)

Though the understatement penalty percentage table was an improvement it is nevertheless necessary to examine and determine whether it is effective and whether it operates in the pursuance of the objects of punishment as identified in Chapter 2 above.

In terms of Chapter 16 of the Admin Act a taxpayer may be liable for an understatement penalty because of certain behaviour demonstrated on the part of the taxpayer. The extent of the understatement penalty depends on the type of the behaviour demonstrated.

There are six types of behaviours and it is listed in the understatement penalty percentage table¹²⁹ as follows:

1 Item	2 Behaviour	3 Standard case	4 If obstructive, or if it is a 'repeat case'	5 Voluntary disclosure after notification of audit	6 Voluntary disclosure before notification of audit
(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)	Impermissible avoidance arrangement	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

The table above is the amended version of that what was originally announced and applied.¹³⁰

The purpose for this was to align the penalty percentages with similar penalty regimes of

¹²⁹ Section 223(1) of the Admin Act

¹³⁰ 1 October 2012

comparative tax jurisdictions. This is but one of SARS' initiatives to encourage compliance and to attain revenue targets.¹³¹

The amendments were introduced by the Tax Administration Laws Amendment Bill¹³² and enacted as the Tax Administration Laws Amendment Act.¹³³

The amendment has provided for a reduction in the understatement penalty rates in respect of behaviour as relates to a "substantial understatement", "reasonable care not taken in completing a return" or where the taxpayer has "no reasonable grounds for the tax position taken". The penalty rates relating to the other behaviours has remained the same.

The amendment provides that an understatement penalty shall not be levied in circumstances where the understatement arose because of a *bona fide* inadvertent error.¹³⁴

Taxpayers may request for the understatement penalty to be remitted in the prescribed format and manner.¹³⁵

4.2.2 Imposition of understatement penalties

SARS has the discretion to impose an understatement penalty of up to 200% depending upon the behaviour of the taxpayer and the objective criteria listed in the specific table (refer to 4.2.1 above).

It is said to be aimed at ensuring consistent treatment of taxpayers in comparable circumstances.¹³⁶

An 'understatement' as defined in Chapter 16 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;

¹³¹ Memorandum on the objects of the Tax Administration Bill, 2011

¹³² No 40 of 2013 ('the TALAB') 24 October 2013

¹³³ No 39 of 2013 ('the TALAA') 16 January 2014

¹³⁴ See discussions in 4.2.3 below.

¹³⁵ Section 224(1) of the Admin Act

¹³⁶ Memorandum on the objects of the Tax Administration Bill. 2011

- (d) if no return is required, the failure to pay the correct amount of 'tax'; or
(e) an "impermissible avoidance arrangement'."

An understatement penalty is calculated by applying the highest applicable understatement penalty percentage in the listed percentage table to the difference between the amount of tax properly chargeable for the relevant tax period and the amount of tax that would have been chargeable if the understatement were to be accepted.

When the understatement penalty regime was ratified, SARS envisioned that the regime would be a method to punish delinquent taxpayers whose actions fall within any of the six misdemeanours of the definition of an understatement.¹³⁷

Depending on the taxpayer's behaviour, the understatement penalty percentage ranges from a minimum of 5%, to a high of 200% in occurrences where the taxpayer has a recurrence of intentional tax evasion.

The amendment also provides for events where more than one behavioural category may be present. It is necessary to determine the behavioural category in respect of each understatement separately and not simply applying the highest penalty percentage to the total understatement.

Prejudice to SARS or the fiscus:

The definition of an 'understatement' contains the words '*prejudice to SARS or the fiscus*', this creates uncertainty as the term '*prejudice*' is not defined in the Admin Act. One is then obliged to look at the ordinary dictionary meaning, which in itself creates uncertainty as to whether SARS is warranted to levy an understatement penalty.

I can demonstrate by way of example that there is uncertainty and that clarification is necessary.

Example:

A taxpayer submits an income tax return and claims a deduction in respect of a travel allowance which results in a refund of R30 000 due to the taxpayer. A few days later the

¹³⁷ Section 223 of the Admin Act

taxpayer realizes that it erroneously overstated its kilometres which resulted in a greater deduction and informs SARS accordingly. The refund should have been R15 000 and this was also the amount that was refunded to the taxpayer.

Evidently, there are concerns that arise, such as whether SARS is justified in levying an understatement penalty even if it only paid out the actual refund due to the taxpayer.

It is questionable whether SARS has been prejudiced in this instance, does the administrative action by SARS falls within the domain of '*prejudice*'?

The meaning of '*prejudice*' is to cause harm to someone.¹³⁸ This could only be the case if SARS was at any given time at a disadvantage to the extent of the incorrect amount, in other words the difference between the correct amount refundable to the taxpayer and the amount that was ultimately refunded. In this example, the correct amount was refunded to the taxpayer, therefore it is evident to say that there was no prejudice to SARS or the *fiscus*.

Due to the absence of the direct definition of the word '*prejudice*', it is questionable whether SARS should levy an understatement penalty when there is clearly no monetary prejudice to them. Therefore, it would be welcomed if SARS could clarify its interpretation by way of an Interpretation Note, or if Government could possibly make changes to current legislation.¹³⁹

The current view is that the understatement penalty regime was designed to safeguard SARS against any prejudice which would emanate from any one of the six actions which enforce an understatement and that results in an actual monetary prejudice and not an administrative prejudice.

Burden of proof:

In terms of the previous penalty regime,¹⁴⁰ SARS invited the taxpayer to make suggestions as to the extent that the penalty should or should not be imposed.

¹³⁸ Definition of *prejudice* means damage, detriment, disadvantage, harm, hurt, impairment, injustice, irreversible damage, loss, unfairness, wrong. Available: <https://legal-dictionary.thefreedictionary.com/prejudice> [2018, February 16]

¹³⁹ ENSafrica.2015. *Understatement penalties*. Integritax SAICA Newsletter 2418 Issue 189. Available: https://www.saica.co.za/integritax/2015/2418. Understatement_penalties.htm [2018, February 16]

¹⁴⁰ Section 76 of the Income Tax Act 58 of 1962

The regime previously lacked a purpose and objective differentiation and was mostly applied universally in all instances. The highest percentage was levied irrespective of the behaviour on the part of the taxpayer.

Another concern was that the Commissioner had the power to act as he deemed fit. The taxpayer then faces an unregulated and very unpredictable process to motivate its reasons for remission of the penalty.

Accordingly, it is evident that any such approach by SARS would be in direct contrast with the policy of the Admin Act.

Section 102(2) of the Admin Act states-

“Burden of proof – “(1)

(2) The burden of proving whether an estimate under section 95 is reasonable or the facts on which SARS based the imposition of an understatement penalty under Chapter 16, is upon SARS.” Own emphasis added.

After the amendment, section 102(2) now places the burden upon SARS to state the facts on which it has based the imposition of the understatement penalty.

The appropriate manner is for SARS to inform the taxpayer that it relies on certain facts, adequate proof and accordingly intends to impose a certain rate of understatement penalties, allowing the taxpayer to make commentaries thereon.¹⁴¹

In a published article¹⁴² it was pointed out that the issue is that SARS lacks an understanding of the structure and policy behind the understatement penalty regime and how it should correctly be construed and imposed.

It is evident that there are still uncertainties regarding the practical application of the Admin Act and accordingly necessitates that SARS provide further clarification.

¹⁴¹ Van Manen, L. 2014. *Understatement Penalties in hindsight*. Available: <http://www.thesait.org.za/news/180728/Understatement-Penalties-in-hindsight.htm> [2018, February 16]

¹⁴² Mazansky, E. *Business Tax and Company Law Quarterly*. Vol. 7. Issue 3 at 1-4. South Africa: Siber Ink. Available: <https://journals.co.za/content/btclg/7/3/EJC194781> [2018, February 16]

4.3 Investigating a ‘Bona fide’ inadvertent error

It was announced by the Minister of Finance that the understatement penalty provisions would be amended to provide relief for incidences that arose because of *bona fide* errors.¹⁴³

After the amendment, an understatement penalty shall not be imposed in the event where an ‘understatement’ as defined results from a *bona fide* inadvertent error.¹⁴⁴

In 2.1 above I identified the four elements (retribution, deterrence, rehabilitation and incapacitation) that the punishment doctrine is made up of.

Specifically, in respect of deterrence, it was found that its primary focus is on the prevention of future wrongdoings. Specifically, in respect of a tax context the courts found that the punishment must fit the offence.

It is therefore clear that if a penalty had to be imposed in respect of a *bona fide* inadvertent error that the penalty regime would not align with the doctrine of punishment.

Therefore, the amendment is aligned with the objects of punishment as a *bona fide* error does not require any deterrence.

Certain specified circumstances were identified in the draft memorandum on the objects of the TALAB¹⁴⁵ that would be considered when determining if a ‘*bona fide*’ inadvertent error has been made.

The way in which *bona fide* inadvertent errors would be assessed:¹⁴⁶

“In determining if the ‘understatement’ results from a ‘bona fide’ inadvertent error, a SARS official will generally have regard to the circumstances in which the errors were made as well as other factors, for example:

- *In the context of factual errors-*
- *If the standard of care taken by the taxpayer in completing the return is commensurate with the taxpayer’s knowledge, education, experience and skill and the care a reasonable person in the same circumstances would have exercised;*

¹⁴³ The Tax Administration Laws Amendment Act, 2013

¹⁴⁴ Section 222(1) of the Admin Act

¹⁴⁵ The Tax Administration Laws Amendment Act, 2013

¹⁴⁶ Clause 2.62 of the Draft Memorandum on the Objects of the Draft Tax Administration Laws Amendment Bill 2013

- *The size or quantum, nature and frequency of the error;*
- *Whether a similar error was made in a return submitted during the preceding years; or*
- *In the case of an arithmetical error, whether the taxpayer had procedures in place to detect arithmetical errors.*
- *In the case of a legal interpretive error, whether-*
- *The relevant provision of a tax Act is generally regarded as complex;*
- *The taxpayer took steps to understand it including following available explanatory material or making reasonable enquiries; or*
- *The taxpayer relied on information that, although incorrect or misleading, came from reputable sources and a reasonable person in the same circumstances would be likely to find the relevant information complex.”*

In the final version of the explanatory memorandum, the criteria previously mentioned in the draft was removed.

Clause 2.75 of the final Memorandum on the Objects of the Tax Administration Laws Amendment Bill 2013 reads as follows:

“The proposed amendment will apply with effect from 1 October 2012, but will also apply to understatement made in a return before 1 October 2012. Due to the broad range of possible errors, the proposal to define the term “bona fide inadvertent error” has the potential to inadvertently exclude deserving cases and include undeserving cases. SARS will, however, develop guidance in this regard for the use of taxpayers and SARS officials.” Own emphasis added.

One would think that the ‘guidance’ would take the form of the issuing of an interpretation note, however after a few years SARS has still has not provided any ‘guidance’.

In practice¹⁴⁷ it appears that because the SARS officials lack the means in which to apply the *bona fide* inadvertent error exclusion, they are simply just ignoring it altogether. This ignorance does not mirror the elements of the true purpose of the penalty regime as it does not ensure fairness, transparency and effectiveness.¹⁴⁸

¹⁴⁷ Bowmans. 2017. *Penalties: the application of “bona fide inadvertent error”*. Integritax SAICA Newsletter 2588 Issue 210. Available: https://www.saica.co.za/Integritax/2017/2588_Penalties_the_application_of_%E2%80%9Cbona_fide_inadvertent_error%E2%80%9D.htm [2018, February 16]

¹⁴⁸ *Memorandum on the objects of the Tax Administration Bill. 2011* para 2 at 179

The *bona fide* inadvertent error exclusion from understatement penalties has been specifically sanctioned to ensure fairness and to illuminate the unjustified and undeserved imposition of understatement penalties. Taxpayers have the right to the proper application of the law.

The meaning of *bona fide* inadvertent error is not defined in the Admin Act. The courts¹⁴⁹ therefore turn to the dictionary meaning of the words which concludes that '*bona fide* inadvertent error has to be an innocent misstatement by a taxpayer on his or her return, resulting in an understatement, while acting in good faith and without the intention to deceive'.

Bona fide inadvertent error essentially applies to instances that occurred because of an act or omission which has not been intended. In this instance, the understatement is a result of an unintended mistake and accordingly the Commissioner will not be sanctioned to levy an understatement penalty.

SARS would have to discredit the taxpayer's version of the facts and convince a court, on a balance of probabilities, that the facts provided by the taxpayer in defence is not reliable.¹⁵⁰

In *ITC 1377*¹⁵¹ the taxpayer believed that an amount received constituted a capital amount and therefore did not include it in his tax return as gross income. The Court held that the taxpayer *omitted* the amount under the *bona fide* belief that it was not taxable and accordingly the Tax Court ordered the remittance of the total amount of the penalty that was imposed.

The above discussion highlights the necessity for SARS to further clarify and provide the necessary guidance in respect of the application of the law.

4.4 Investigating the percentage table and certain specific behaviours

As referred to in 4.2.1 above, section 223 of the Admin Act contains the understatement penalty percentage table that determines what percentage, based on certain behaviour on

¹⁴⁹ *ABC Holdings (Pty) Ltd v CSARS* Case number ITI 13772 Available: <http://www.sars.gov.za/AllDocs/LegalDoclib/Judgments/LAPD-DRJ-TC-2016-10%20-%20TCIT%2013772%20WC%204%20November%202016.pdf> [2018, February 16]

¹⁵⁰ Section 102(2) of the Admin Act

¹⁵¹ 45 SATC 221 at 229

the part of the taxpayer, will be imposed in the event of an understatement as defined. I have limited the investigation of the behaviours of the understatement penalty percentage table to that of '*gross negligence*' and '*reasonable grounds*' as these can be very widely interpreted and are more commonly present in practice.

4.4.1 Gross negligence

I have examined a *bona fide* inadvertent error separately at point 4.3 above as it does not form part of the understatement percentage table.

The '*gross negligence*' behaviour on the part of taxpayer's forms part of the understatement percentage table and will be discussed accordingly.

The term '*gross negligence*' is not defined in the Admin Act, yet we can find some guidance on its meaning in law other than tax law.¹⁵²

It should be noted that there is a difference between gross negligence and ordinary negligence. It was held that it is non-consciousness of risk-taking that distinguishes gross negligence from ordinary negligence.¹⁵³ It was further held that a person's conduct in relation to risk that a person is conscious of can depart drastically from the standard of the reasonable person that it can amount to gross negligence.¹⁵⁴

In considering gross negligence in relation to a person that intentionally takes a risk, the conduct in question must involve a departure from a standard of the reasonable person to such an extent that it may be categorized as extreme complete ignorance of mind and must be demonstrated.¹⁵⁵

One can interpret the meaning of '*gross negligence*' as a mindful and intended disregard of the need to use reasonable care, which is expected to cause injury or damage to persons,

¹⁵² Van der Zwan, P. 2003. *A taxpayer's right to manage its exposure*. Cape Town: South African Institute of Tax Practitioners. Available: <http://www.thesait.org.za/news/115961/A-taxpayers-right-to-manage-its-exposure.htm> [2017, November 14] and *South Africa (Department of Industries) v Fibre Spinners and Weaves (Pty) Ltd* (1977) (2) SA 324 (D)

¹⁵³ *S v Van Zyl* 1969 (1) SA 553 (A)

¹⁵⁴ *CSAR v Adlington & Co* 1906 TS 964 at 973 (1906)

¹⁵⁵ *Transnet Ltd t/a Portnet v MV 'Stella Tingas' and Another* (378/01) [2002] ZASCA 145

property or both. If compared to ordinary negligence, it is behaviour that is extreme and not just a case of failure to take reasonable care.

Therefore, it can be said that ordinary negligence differs from gross negligence in relation to the degree of the inattentiveness of the taxpayer. Accordingly, both differ from wilful conduct, as wilful is reasonably considered to cause harm. It is important that we make this distinction, as contributory negligence is an absence of care combined with certain conduct causing harm.

The actions of the taxpayer therefore play a vital role in categorizing whether a certain act falls within the conduct of gross negligence. In short one can define gross negligence as an indifference to, and a blatant violation of, a legal duty with respect to the rights of others.

As no specific guidance, has been provided as to what would define a case of gross negligence in a tax context, the interpretation by the Commissioner of what constitutes gross negligence is left open.

It is difficult to ensure that when a specific behaviour is present that it would be interpreted in the manner it ought to. If no guidance is provided it would be difficult to ensure that the stated objects in the Objects of the Memorandum would be attained.

4.4.2 Reasonable grounds

The term 'reasonable grounds' is not defined in the Admin Act and it does not determine what grounds presented by the taxpayer will be considered to be reasonable.

There are no parameters laid down in law that provides us with an absolute standard to determine what actually constitutes 'reasonableness'. Every matter is to be considered independently and will be decided upon the particular circumstances of each matter.

The taxpayer is to prove that reasonable grounds for the non-compliance exist and that the taxpayer did not act unreasonably.

Taxpayers have been provided with the test in respect of whether a reasonable ground for the 'tax position' was taken by the taxpayer.¹⁵⁶ In terms of this test it is not necessary that the position taken by the taxpayer must be a 'better view' than that of the Commissioner, it should just as likely be correct as it can be incorrect.

It was found¹⁵⁷ in an Australia matter that the actual intention of the person said to be at fault was not relevant as the test for establishing whether reasonable grounds is present is an objective one. It is not in question whether the taxpayer has tried to act with reasonable care it is however relevant that, on an objective examination, reasonable care has been shown. Accordingly, it can be said that the test does not depend on the actual intentions of the taxpayer.

An understatement penalty percentage should be imposed where the taxpayer's position could not be reasonably argued. Therefore, taxpayers must not only take reasonable care; it must also attain a reasonably arguable tax position to conclude that the circumstances at hand would less likely be correct than incorrect.¹⁵⁸

In terms of the SARS short guide¹⁵⁹ certain factors should be considered to evaluate the tax position taken by the taxpayer; such as whether an amount, transaction, event or item is taxable; whether an amount or item is deductible or may be set off; a lower rate of tax than the maximum applicable to that class of taxpayer, transaction, event or item applies; or if an amount qualifies as a reduction of tax payable. Where any shortfall arises due to a substantive disagreement concerning the interpretation and application of a provision, the understatement penalty percentage will be imposed if the position of the taxpayer is not based on reasonable grounds or facts.

¹⁵⁶ *A New Tax System (Tax Administration) Bill (No. 2) 2000* Available: <https://www.legislation.gov.au/Details/C2004B00704/Revised%20Explanatory%20Memorandum/Text> [2017, October 21]

¹⁵⁷ Australian tax Office. 2008. Miscellaneous Taxation Ruling MT2008/1 information paper. Available: <http://law.ato.gov.au/atolaw/view.htm?DocID=MXR/MT20081/NAT/ATO/00001> [2017, August 7].

¹⁵⁸ *A New Tax System (Tax Administration) Bill (No. 2) 2000* Available: <https://www.legislation.gov.au/Details/C2004B00704/Revised%20Explanatory%20Memorandum/Text> [2017, October 21]

¹⁵⁹ SARS. *SARS Short Guide to the Tax Administration Act 2011*. 2013. SARS Version 2. Available: <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-TAdm-G01%20-%20Short%20Guide%20to%20the%20Tax%20Administration%20Act%202011%20-%20External%20Guide.pdf> [2017, November 14]

It is clear that the purpose is not to levy a penalty when the Commissioner disagrees with a position taken by the taxpayer and interprets it differently to the taxpayer. It is to attach a penalty in specific instances where a taxpayer unreasonably undertakes its position.

In 2.2.2 reference was made to two different types of deterrence, specific and general deterrence. In a tax context, specific deterrence is required to ensure that taxpayers are appropriately punished for their wrongdoings and to prevent the wrongdoing from reoccurring. I have also previously established that the punishment must fit the wrongdoing.

Yet again it is crucial that the penal provisions align with the objective of punishment as any deficit could lead to injustice.

4.5 Remittance procedure

In the event of the imposition of an understatement penalty in respect of a 'substantial understatement' SARS must remit an understatement penalty in certain circumstances: SARS must remit the understatement penalty if it is satisfied that the taxpayer made full disclosure of the arrangement that gave rise thereto by no later than the date of the return,¹⁶⁰ and if it is satisfied that the taxpayer was in possession of an opinion issued from a registered independent tax practitioner, by no later than the date the return was due and that it was based upon full disclosure of the complete facts and circumstances pertaining to the arrangement.¹⁶¹ The opinion also needs to confirm that based upon the facts the position of the taxpayer will more likely than not be upheld if the matter had to proceed to court.

The subsequent amendment permits for taxpayers who submitted their returns prior to the commencement of the Admin Act to rely on an opinion that was obtained after the submission of the return.

In a published article,¹⁶² it was pointed out that the court¹⁶³ has previously held that where a taxpayer had received professional advice there were '*reasonable grounds*' for tax position

¹⁶⁰ Section 223(3)(a) of the Admin Act

¹⁶¹ Section 223(3)(b) of the Admin Act

¹⁶² Cliffe Dekker Hofmeyr. 2015. *Mitigation of penalties and interest*. Integritax SAICA Newsletter 2398 Issue 186. Available: https://www.saica.co.za/integritax/2015/2398_Mitigation_of_penalties_and_interest.htm [2018, February 16]

¹⁶³ *United States of America case of Estate of Spruill v Commissioner* 88 TC 1197 (1987)

taken and accordingly it cannot be said that *'reasonable care was not taken in completing the return'*.

4.5.1 Discretion to remit penalties

As is evident from the Admin Act, the discretion to remit penalties rests with the Commissioner. How are taxpayers assured that this discretion is exercised within the ambit of the doctrine of punishment?

It can be extremely costly for a taxpayer to object to a penalty or the decision not to remit the penalty. This is contradictive to the purpose of the Admin Act when it initiated the new sections, as the aim was to reduce the costs of tax administration in the medium to longer term.

Taxpayers are not assured that the Commissioner exercises its discretion in such a manner that it considers the true purpose of penalties, as deterrent, and not for example as a mechanism for collecting additional revenue.

SARS does not disclose to taxpayers what portion of the raised revenue consists of additional tax and non-compliance penalties.

The Admin Act seeks to achieve a balance between the powers and duties of SARS and the rights and obligations of taxpayers as this balance would contribute to the equity and fairness of tax administration in general. Furthermore, it also seeks to ensure administrative fairness and more effective remedies.

Currently there is no assurance to taxpayers that the administrative fairness and effectiveness of the remedies are achieved within the current penalty regime and SARS' discretion to remit penalties.

Section 222 places an obligation upon the taxpayer to pay an understatement penalty as determined. In this regard SARS is obligated to impose the penalty if the relevant requirements have been met. This is somewhat in contrast with the repealed section 76 as SARS previously had the discretion to impose a penalty up to 200%.

4.5.2 Decision by a Tax Court

Section 129(3) of the Admin Act states-

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

In terms of section 129(3) the Tax Court evaluates SARS’ application of the table. The Tax Court may increase or decrease the understatement penalty as it deems suitable. Based on the evidence available, the court may also decide which behavioural category is more appropriate.

It appears that the courts’ abilities are more exhaustive than that of the Commissioner and apply more effort in considering whether the understatement penalty should be remitted or not. This should be the default way the remittance should be considered as this aligns perfectly with the policy of the penalty regime and ultimately the purpose of punishment.

Therefore, it would be recommended that to achieve optimal administrative fairness and to coincide with the purpose of the penalty regime, the Commissioner should have less discretion and even in some instances no discretion at all.

We can therefore conclude that where wrongdoers can determine a trend or a fashion in which the Commissioner normally exercises its discretion, it could possibly leave the door open for a certain degree of manipulation.

It appears from the discussions above that when a matter proceeds to court and is to be decided by the courts, only then does a proper investigation of the facts and circumstances take place.

The reason for this seems to be that the courts consider the specific elements necessary to deliver a fair and equitable outcome in a matter, in other words considering the elements necessary for a fair trial and determining the sufficient punishment to prevent future wrongdoing, rather than simply applying a general approach and standard outcome.

Though there should be a more detailed criterion for the imposition of a penalty, it would be recommended that it be considered that the discretion to remit penalties be delegated to an

independent third party. This party can thoroughly without *'prejudice'* evaluate the circumstances of each case and decide whether to remit the penalty or not.

Only in this fashion can one be assured that there are no tainted elements that arbitrarily influence any decision to remit or not to remit a penalty.

In the alternative, a more exhaustive procedure which covers widespread scenarios of non-compliance, such as was present in the draft Memorandum on the Objects of the Tax Administration Bill, 2011 should be published.

4.6 VDP

The Admin Act provides a permanent framework for taxpayers to obtain relief by voluntarily disclosing instances of administrative non-compliance and understatements.¹⁶⁴ The relief contained in this provision is however limited to 100% relief in respect of an administrative non-compliance penalty that was or may be imposed under Chapter 15 (excluding a penalty for late submission of a return). The relief is in respect of any understatement penalty referred to in column 5 or 6 of the understatement percentage table, SARS will also not proceed with a criminal prosecution.

Consideration is given to circumstances where the Commissioner discovers any omission or non-disclosure during an investigation. This was evident in *ITC 1351*¹⁶⁵ where it was said,

"If this investigation had never been made then presumably the understatement of income would never have come to light, and the appellant would have evaded tax. Mr. Marais is, in our view correct when he says that a high standard of diligence is required of the taxpayer in the rendering of his returns, because the Commissioner is entirely dependent upon that information for the purpose of making the assessment."

The burden of proof rests upon the taxpayer to disclose accurate information on a tax return. The VDP regime has been created for taxpayers who voluntarily approach the Commissioner to request to rectify any default.

¹⁶⁴ Section 225 of the Admin Act

¹⁶⁵ 44 SATC 58 at 63

A sense of fairness is achieved with this regime as it is ensured that the punishment fits the offence. The degree of punishment only extends here to the instances where the Commissioner discovers the non-disclosure and even then, the Commissioner gives the benefit of the doubt and imposes appropriate penalties. The taxpayer is still provided with an opportunity of stating the facts and circumstances that gave rise to the omission or non-disclosure.

The VDP regime clearly aligns with the doctrine of punishment as it contains all the important factors. There is certainty and the processes are applied to ensure that the punishment fits the wrongdoing.

4.7 Conclusion

To clarify and resolve the concerns with the current penalty regime it is necessary for National Treasury to provide specific definitions for the relevant behaviours stated in the understatement penalty percentage table.

Once the above process has been simplified and made accessible to taxpayers it will leave less room for alternative interpretation and/or any manipulation.

In conclusion, taxpayers should take the necessary steps to avoid exposure to understatement penalties as far as possible. One way in which they can opt to do this is to make voluntary disclosure of understatements prior to receiving a notice of audit from SARS.

Taxpayers can also acquire an opinion from registered tax practitioners in aid of avoiding a substantial understatement penalty.

This unfortunately has a cost attached to it, which is in contrast with the aim of the Admin Act which endeavours to lighten the burden of administration and cost to the taxpayer.

In respect of the remission of penalties, the wide discretion afforded to the Commissioner does not align with the doctrine of punishment as it neglects to adhere to the various elements that make up the objects of punishment.

It does not provide certainty and does not currently ensure fairness. There is no assurance to taxpayers that the punishment fits the wrongdoing.

CHAPTER 5: Conclusion

5.1 Summary

The main purpose of this research was to determine the true nature and purpose of the penal system. Furthermore, to determine whether the penal system operates and coincides with the philosophy of punishment, in other words acts as a deterrent for wrongdoers.

To achieve the research objective of this study it was necessary to do a review of the history of the purpose of punishment¹⁶⁶, to do a brief overview of the history of the penal system and a review of the penal system that is currently operative.

I further established what the different categories of punishment are, namely:

- Retribution
- Deterrence
- Rehabilitation
- Incapacitation

Retribution was found to be focused on passed offences which supports the courts practice: the punishment must fit the crime. The other categories, deterrence; rehabilitation and incapacitation were found to be focused on the future, in other words focused on preventing future wrongdoings.

It was evident from case law that the South African courts specifically acknowledged the role of *deterrence* as a very important objective in the determination of the appropriate sentencing for wrongdoers.

In a tax context, it is important that a penal system should act as a specific deterrent rather than a general deterrent to prevent any future wrongful activities. For a penalty levying system to truly operate as an effective penal system there must be a suitable framework and the punishment must fit the wrongdoing committed, effectively it must align with the doctrine of punishment.

¹⁶⁶ Chapter 2

In Chapter 3, I reviewed the history of the penal provisions and it was evident that the current penal provisions in the Admin Act has been a step in the right direction. The understatement penalty percentage provisions in the Admin Act introduced significant changes in respect of the way in which penalties are to be levied as the previous penal provisions contained no set guidelines that regulated the imposition of additional taxes and penalties.

The Admin Act was enacted to consolidate all tax administrative provisions into a single piece of legislation and has provided taxpayers with some much-needed guidance in the tax administration process. The penal provisions have undergone a great transformation since it was initially initiated in the ITA versus the current penal provisions in the Admin Act. There have been many amendments to the penal provisions to ensure that fairness, effectiveness and equality are improved and maintained in respect of both the taxpayers and the revenue authorities.

In Chapter 4 I examined the penalty provisions under sections 221 to 223 of the Admin Act, also referred to as the understatement penalty percentages provisions and it became apparent that the purpose of the penalty regime is not in the pursuance of the doctrine of punishment and accordingly in some instances ineffective, or merely incorrectly labelled.

In respect of the remittance of penalties, SARS has the authority to remit penalties but this is only in certain circumstances and it has become evident that there are deficiencies in this regard which should be addressed as there is a responsibility on SARS to conduct its business in a fair and just manner.

To determine whether the research objective has been addressed, one has to determine whether the individual research objectives have been met, namely:

- (i) The review of prior legislative provisions prior to the enactment of the Tax Admin Act,
- (ii) The evaluation of the effectiveness of the current penal system of the Tax Admin Act and to identify any possible deficiencies with the application and interpretation of the provisions by the Commissioner. The review conducted in Chapter 4 reveals and highlights that certain behaviours referred to in the understatement percentage tables contained in the Tax Admin Act, are not

defined and causes much uncertainty. Likewise, there are uncertainties in respect of the request for remission of the penalties levied, as relates to the extent to which a 'first incidence' could be applied and to what extent the discretion to remit penalties should rest with the Commissioner. The result of the application of the provisions by SARS causes much confusion. Factually, the Commissioner, the courts and the taxpayers will not interpret certain behaviour and provisions of the Admin Act in the same manner. By examination and review of these behaviours it was evident that most of the behaviours that are not defined could to an extent be defined by the application of case law and publications on the interpretations of these behaviours. The review also revealed that when an understatement penalty is levied certain additional factors need to be considered, which are referred to as 'behaviours' and unfortunately these are also not defined in the Admin Act. SARS has attempted to provide guidance in respect of the relevant behaviours meanings with the publication of the SARS Short guide to the Tax Admin Act, however it still does not satisfy the deficiencies. The review in Chapter 4 makes it evident that future amendments are undoubtedly still required. Having said that it is apparent that the enactment and the application of the understatement penalty percentage provisions in the Admin Act do contain some of the elements required to act as a deterrent for wrongdoers and is an improvement, however guidance for both taxpayers and SARS officials are still very much needed.

- (iii) The literature review in Chapter 2 identified the four elements of the main purpose of punishment namely retribution; deterrence, rehabilitation and incapacitation. The main element that is relevant to a tax penal system is deterrence. In respect of Chapter 3 and Chapter 4 it became evident that the main purpose of the penalty regime appears to be that of deterrence, to prevent and deter taxpayers and to provide certainty, so that they know what penalties are imposed and in respect of what circumstances it is to be imposed. In Chapter 4 it become evident that there are certain misalignments as relates to the doctrine of punishment and the purpose of the penal system. The Commissioner with its discretion to impose or remit penalties needs to consider the elements as the disregarding of the

essentials could result in the disproportion of the purpose of punishment and ultimately result in arbitration.

5.2 Recommendation

The findings of this research study have revealed that:

- The enactment of the penal provisions in the Admin Act only partially achieves the philosophy of the doctrine of punishment and,
- In instances where the penal provisions do achieve the objects of punishment, it appears that the application thereof is not consistently applied in practice.

The penal levying system in the Admin Act has been an improvement on the past penalty provisions as is evident in Chapter 3. However, despite the more favourable and fair outcome achieved by the penal provisions in the Admin Act, the research concludes that more specific guidance and measures in respect of the application of the penal provisions are necessary. The behaviours listed in the understatement penalty percentage table are not defined and creates the need for further improvement. Though changes have been made since the implementation thereof it still requires further revisions.

I submit that the application of the penal provisions is not consistently applied in practice and it is recommended that the administrators of the legislation be better equipped in respect of the application of the penal provisions or that the processes should be changed to address the misalignment of the application of the penal provisions.

Having identified the essential issues in section 221 to 223 of the Admin Act the following recommendations are made:

- (i) Proper definitions of the behaviours in these sections should be provided by National Treasury. The definitions could be clarified by way of publications, case law and amendment to the Admin Act.
- (ii) Currently the discretion to remit the penalties rests with the Commissioner. It is recommended that the administrators of the legislation be provided with more guidance or alternatively that the decision be outsourced or reviewed by an independent source to ensure that each case be considered upon its own facts and

circumstances. Taxpayers can then be assured that the application of the penal system operates within its true purpose in other words to act as deterrent and not used as a mechanism to obtain tax revenue.

It is clear from the above that further research is necessary to achieve the ultimate balance of fairness and effectiveness in the understatement penalty provisions under the Admin Act and to ensure that the penal provisions align with the doctrine of punishment.

5.3 Conclusion

The following important factors was evident in Chapter 2:

- Penalties should be governed by clear legal rules
- Purpose of punishment is to punish the wrongdoer
- Punishment must be appropriately applied to prevent future wrongdoings in other words act as deterrent
- The extent of punishment to be applied is important as the incorrect application of punishment can lead to an imbalance and unfairness

The fact that most of the behaviours and conducts in the understatement penalty percentage table are not defined, creates ambiguity. The behaviours of the taxpayers play a vital role in determining an understatement penalty and SARS has not provided any form of guidance or communication of the way they will determine the taxpayers' behaviour. It is therefore difficult to align the penal provision with the objects of punishment.

There are instances where the penal provisions do align with the objects of punishment however, it appears that in practice there is a misalignment with the application of the provisions.

The misalignment in practice could be due to ignorance on the part of the administrators of legislation or could in some instances be ascribed to be part of a revenue raising mechanism. To eliminate such contentions, it is advised that more specific guidance be provided.

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