

Sars and penalties for understatement

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In addition to the tax payable, the South African Revenue Service (Sars) can impose penalties on a taxpayer for an understatement. In a standard case, and depending on the taxpayer's behaviour, penalties can range from 10% for a substantial understatement to 150% for intentional tax evasion.



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In *Purlish Holdings (Pty) Ltd v CSARS*, the Supreme Court of Appeal (SCA) had to decide whether the imposition of penalties by Sars was justified.

The taxpayer had submitted nil returns for 2012 to 2014 financial years, reflecting its status as dormant in circumstances where it had already paid provisional tax of R13.7m. The submission of nil returns, if properly assessed, would result in a refund due to the taxpayer. An audit was initiated due to the magnitude of the refund sought by the taxpayer during which it was discovered that the taxpayer had concluded consultancy agreements for the period 2011 to 2014 where it had earned substantial income. Despite this, it filed nil returns. Furthermore, no VAT returns had been filed.

Following the audit, assessments for corporate income tax (CIT) and VAT were raised together with understatement penalties. Initially Sars levied 100% understatement penalties as it regarded the taxpayer's conduct as gross negligence. The taxpayer objected, and after considering the objections, Sars reduced the penalties to 25% for CIT and 50% for VAT. The taxpayer appealed to the Tax Court, and when dismissing the appeal, the Tax Court increased the understatement penalties back to 100% for both CIT and VAT.

Prejudice to the fiscus

On appeal to the SCA it was held that the burden of proof was on Sars to show that there had been an understatement and that it had caused the fiscus to suffer prejudice. It was common cause that the taxpayer did not render VAT returns. This clearly fell within the definition of an understatement, which includes "a default in rendering a return". Further, the submission of nil CIT returns was also an understatement as defined, as it constituted an "omission from a return" or an "incorrect statement in a return". The SCA was also satisfied that prejudice to the fiscus is not only determined in financial terms, and the use of additional Sars resources in time and human capital auditing the taxpayer constituted prejudice.

On the question of whether the Tax Court was entitled to increase the penalties to 100%, the SCA held that because the issue of increasing the reduced penalties was never raised by Sars, it was incompetent of the Tax Court to increase them. The penalties were therefore reduced to 25% for CIT and 50% for VAT.

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