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Exposure to penalties while in an assessed loss position

Taxpayers who find themselves in a loss-making position often intuitively assume that as long as they are not liable to pay tax, they would not be exposed to understatement penalties. The Tax Court recently held that there was prejudice to SARS where a taxpayer who remained in an assessed loss position, even after adjustments by SARS. Taxpayers in assessed loss positions must exercise the same care as any other taxpayer in preparing their tax returns and ensuring that they take reasonable tax positions.

Introduction

Taxpayers who find themselves in a loss-making position often intuitively assume that as long as they are not liable to pay tax due to the fact that they have an assessed loss, they would not be exposed to understatement penalties ('USPs').

This is not the case if one considers the detail of the provisions of the Tax Administration Act ('the TAA') that deal with USPs. These provisions were recently the subject of a tax court case heard in the Gauteng Tax Court (Case No 24674). This article briefly considers the relevant provisions of the TAA that underpin USPs. This is followed by an analysis of the views expressed in the Tax Court in the context of the imposition of USP where a taxpayer is in an assessed loss position.

The law

SARS must impose an USP in the event of an understatement by a taxpayer, except if it results from a *bona fide* inadvertent error. An understatement is defined as any prejudice to SARS or the *fiscus* as a result of, amongst others, failure to submit a return, an omission from or incorrect statement in a return.

The USP is calculated as the highest percentage from the penalty rate table in section 223(1) of the TAA multiplied by the shortfall. In the case of a taxpayer who finds itself in an assessed loss position, the shortfall is calculated as the difference between the amount of an assessed loss properly carried forward from the tax period to a succeeding tax period and the amount that would have been carried forward if the understatement were accepted, multiplied by the maximum tax rate that would have applied ignoring the assessed loss.

Case 24674

Background to the dispute

The taxpayer claimed less wear-and-tear ('W&T') allowances than it was entitled to in years of assessment prior to 2016. When it became aware of this fact, it claimed the W&T allowances that it

failed to deduct in prior years as "catch-up" W&T allowances in the 2016 year of assessment. SARS disallowed this deduction on the basis that tax is an annual event and the taxpayer accepted it. The taxpayer disputed the USP that SARS imposed at a rate of 50%.

Judgment and analysis

The judgment deals with a number of arguments raised by the taxpayer that I do not deal with in this article. The argument raised that is relevant to the focus of this article is that no USP can be levied unless there is prejudice to SARS or *fiscus*. There would be harm to SARS if it were out of pocket. It appears from paragraphs 16 and 17 of the judgment as if it was contended that since taxpayer was in an assessed loss position, and remained so after the adjustment by SARS, that SARS was not out of pocket and that there was no loss of the *fiscus*.

Counsel for SARS argued that prejudice does not only refer to actual prejudice, but also includes prospective or potential prejudice. It based this on *Wavelengths Construction CC v The Commissioner for the South African Revenue Service* (Case No. 24622) where the court stated that "[a]ny prejudice is, in our view, wide enough to include the existence of a realisable that the mistake will hamper the ability of the Respondent to effectively and efficiently administer the provisions of the tax legislation and to perform in terms thereof by assessing and collecting taxes which are due". Mabuse J agreed that the prejudice requirement was met in this case.

A peculiar aspect of this case is that, unlike a taxpayer who deducted an amount that should never have been deducted, the taxpayer did not deduct more W&T allowances than it is entitled to on a cumulative basis (although on a year by year basis, it claimed the W&T allowances in the incorrect periods). There could possibly have been an argument that the since the balance of the assessed loss carried forward reflected the correct cumulative amount of W&T allowances SARS suffered no prejudice. It is not clear whether counsel for the taxpayer pursued this argument.

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