

**CHAPTER 1****INTRODUCTION AND IDENTIFICATION OF AREA OF RESEARCH, OBJECTIVE OF RESEARCH, RESEARCH METHOD, IMPORTANCE OF THE RESEARCH AND MATTERS GENERALLY CONSIDERED TO BE BEYOND THE SCOPE OF THIS DISSERTATION**

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**1.1 PREVIEW**

“*Exactor*” is the Latin word for a tax collector and the English word "exaction" is derived from it. "Exaction" is defined in the Concise Oxford Dictionary<sup>1</sup> as including, *inter alia*, an "illegal or exorbitant demand, extortion", and gives us the basic meaning behind the word "taxation". It is therefore understandable that there has been the analogy between the tax collector and a robber. This reputation is enhanced by the threats and intimidation that are inherent in the operations of the tax authorities, even today.

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<sup>1</sup> Concise Oxford Dictionary, Oxford University Press, Oxford, (7<sup>th</sup> Edition), 1982.

The tax man, however, is more like a bureaucratic Robin Hood, taking wealth where he can find it, and, like Robin Hood, he often does much good with the money he takes. Without revenue, governments would collapse, society as we know it would disappear, and chaos would follow.

It is of interest to note that the imposition of income tax is inherently the expropriation of a taxpayer's assets, which is contrary to the South African Constitution ("Constitution")<sup>2</sup>. Section 25(1) states that no-one,

*"may be deprived of property except in terms of law of general application and no law may permit arbitrary deprivation of property"*<sup>3</sup>.

Ostensibly then, the imposition of income tax is unconstitutional. However, section 36 of the Constitution provides for the limitation of an individual's rights in the appropriate circumstances. These individual rights are limited in favour of the government. Section 36(1) provides that,

*"the rights in the Bill of Rights may be limited only in terms of law of general application to the extent that the limitation is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom . . ."*

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<sup>2</sup> Constitution of the Republic of South Africa Act, No. 108 of 1996. This Act replaced the Constitution of the Republic of South Africa Act, No. 200 of 1993, commonly referred to as the "Interim Constitution".

<sup>3</sup> This section must be read in conjunction with the right of all citizens to administrative justice - see section 33 of the Constitution.

In view of this limitation clause, the Income Tax Act<sup>4</sup> (the “Act”) is, *prima facie*, constitutional since the imposition of taxes is considered reasonable and justifiable in an open and democratic society<sup>5</sup>. However, this does not mean that every section of the Act is constitutional. Each section must be individually tested against the provisions of the Constitution to establish its constitutionality. Those sections which do not meet the requirements of the Constitution, must be struck down.

People will generally pay taxes if they are reasonable. They realise that the revenue raised is the basis of their sovereignty. However, they will instinctively rebel if the taxes become oppressive: the first warning is tax evasion on a large scale or, at the very least, avoidance; secondly, tax boycotts; thirdly, riots and violence.

Going back in time, Rome fell, not to the Huns, but to tax evasion, as wealthy landowners devised one clever scheme after another to escape taxation, leaving the state without resources to defend itself. A fascinating story<sup>6</sup> is told of “Virgil’s

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<sup>4</sup> No. 58 of 1962.

<sup>5</sup> See also sections 43, 44 and 213 of the Constitution.

<sup>6</sup> Whether this story it is true or not is open to some debate (the author has not been able to verify this story).

Vigil". Virgil, one of the greatest of the Roman poets, was said to have brought his enormous intellect to bear on a means of avoiding what he considered to be, an unfair property tax. In 43 BC, the year after Julius Caesar was murdered, the Roman Emperor ordered that landowners should surrender their property in favour of returning war veterans or pay a heavy tax. Virgil was a substantial landowner. Exempted from the new tax were cemeteries and mausoleums. Legend has it that it was the winter solstice, almost exactly when we now celebrate Christmas, when Virgil invited senators and friends to a solemn ceremony. The senators gave mournful grave side eulogies whilst Virgil spoke tearfully of his sad loss as a coffin was lowered into the grave on his land. He was burying his pet housefly. The subsequent wake cost him a great deal of money, but the ritual funeral turned his land into a cemetery and exempted him from the new tax in perpetuity<sup>7</sup>.

"Taxation without representation"<sup>8</sup> was the central issue when in 1773, the colonial residents of Boston, Massachusetts, destroyed 340 tea chests by dumping them into the harbour to protest against the imposition of a tax on tea. The defiance by the colonialists is generally known as the "Boston Tea Party".

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<sup>7</sup> Penelope Webb, "Virgil's Tax Saving Vigil", Accountancy South Africa, February 2001, page 41.

<sup>8</sup> The cynical view of "taxation without representation" has been expressed since then as, "if you think that taxation without representation is bad, you should see how bad it is with representation". Anonymous.

Prior to the French Revolution, France employed the services of “tax farmers”, or tax collectors, who used brutal methods to collect taxes. Such was the hatred by the general populace of these tax collectors, who had existed since ancient Roman times, that many of them were executed during the French Revolution when the system of tax farming was abolished. The infamous “salt tax”, unfairly imposed on the peasantry, has been attributed by historians as being one of the causes of the French Revolution<sup>9</sup>.

It has been mooted that the development of the cockney slang is closely linked to the introduction of income tax by the British government. Apparently, the barrow sellers introduced the rhyming slang so that the tax authorities would not know what they were selling and therefore would be unable to tax them<sup>10</sup>.

Today our rebelliousness is surprisingly, and relative to our ancestors, embarrassingly but fortunately, mild. Various local newspapers in South Africa in 1995 reported that truck drivers blockaded roads demanding that Pay-As-You-Earn (“PAYE”) not be deducted from their overtime. In 1996 the local newspapers reported that nursing staff went on a general strike to demand that all PAYE

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<sup>9</sup> Charles Adams, “For Good and Evil”, Madison Books, Maryland, (2nd Edition), 1999; James Coffield, “A Popular History of Taxation”, Longman, 1970; “The New Encyclopaedia Britannica”, Chicago, (15th Edition), 1986, Volume 28, pages 408 - 432.

<sup>10</sup> See “Taxation: Myths and Realities”, B E Sabine, Trinity Press, London, 1966.

previously deducted from their salaries be returned to them. Of course, they did not succeed in their endeavours but their actions did put seriously ill patients at risk.

Perhaps South Africa is hovering on the brink of a non-violent tax rebellion. The Government, especially the Minister of Finance, Mr Trevor Manuel, continuously refers to the large “tax gap”<sup>11</sup> arising from tax evasion and tax avoidance. With the new residence basis of taxation<sup>12</sup>, and the introduction of Capital Gains Tax<sup>13</sup>, the burden of taxation is increasing for all South Africans. Along with the high rates of tax for income in excess of R240 000<sup>14</sup> and the fact that the government is not seen to be providing the services that other highly taxed countries provide<sup>15</sup>, it is

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<sup>11</sup> Refer to the “Interim Report of the Commission of Enquiry into Certain Aspects of the Tax Structure in South Africa”, Pretoria, South Africa, Government Gazette, 1994 (generally known as the “Katz Report”) at page 62. The tax gap or leakage was estimated in 1994 at some R3 billion per annum for Value-Added Tax (“VAT”) alone (14,6% of potential VAT revenue). The gap, as far as income tax is concerned, was not quantified in the Katz Report but was estimated to be as high as 30% of potential revenue from that source. Extrapolating these figures, the amounts involved are probably double in today’s Rand equivalent.

<sup>12</sup> Effective in practice from 1 January 2000.

<sup>13</sup> Effective from 1 October 2001.

<sup>14</sup> Marginal tax rate presently stands at 40% (for the 2003 fiscal year).

<sup>15</sup> For example, the Scandinavian countries, Britain, The Netherlands, etc., which, although heavily taxed, provide social security and national health services which South Africans can only envy.

not surprising that many South African taxpayers regard the tax man as fair game and if given the opportunity, will not disclose their full income if they feel that they will not be caught. This is in spite of the fact that the procedural provisions of the Act provide for Draconian methods to be employed by the revenue authorities to investigate and punish tax defaulters<sup>16</sup>.

The universal distaste for paying taxes has been cynically expressed by W Feather as “the reward for energy, enterprise, and thrift - is taxes”<sup>17</sup>. Arthur Godfrey humorously expressed his sentiments as, “I am proud to be paying taxes in the United States. The only thing is - I could be just as proud for half the money”<sup>18</sup>. But perhaps the most appropriate adage, coined by Ralph Waldo Emerson at some date between 1830 and 1840, which is as pertinent today as it was then, is: “Of all debts men are least willing to pay [are] the taxes”<sup>19</sup>.

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<sup>16</sup> In terms of section 76(1) of the Act, the Commissioner may impose additional tax of up to 200% of the undisclosed tax liability. It is for this reason that section 76(1) is commonly referred to as the “triple tax” provision. As will be briefly discussed later on in this dissertation, the methods used by the revenue authorities to investigate taxpayers, is not always considered constitutional.

<sup>17</sup> Extracted from “Quotes Galore”, Desco Electronic Software, c 1985.

<sup>18</sup> Extracted from “Quotes Galore”. See footnote 17 above.

<sup>19</sup> R W Emerson, “History, Essays”, 1830 -1840.

**1.2 IDENTIFICATION OF AREA OF RESEARCH, OBJECTIVE OF RESEARCH, RESEARCH METHOD, IMPORTANCE OF THE RESEARCH AND MATTERS GENERALLY CONSIDERED TO BE BEYOND THE SCOPE OF THIS DISSERTATION**

**1.2.1 Identification of area of research and objective of research**

Virtually every taxpayer will commit a tax offence in terms of the Act at some time during his taxpaying days, be it merely, on the one hand, the late submission of an income tax return or a careless omission in filling in his tax return or, on the other hand, blatant tax fraud on the *fiscus*. Potentially, all tax offences, even minor offences, are punishable and the Act even provides for a period of imprisonment for certain offences.

Recognising the inevitability of tax offences, be they minor or major transgressions and the potentially heavy penalties that revenue authorities may impose, the primary objective of this dissertation is to analyse the defences or pleas or factors which a taxpayer can advance to mitigate or extenuate the extent of any punishment imposed. In effect, this dissertation seeks to establish the

considerations that have influenced the decision of a court<sup>20</sup> in fixing the punishment they have determined under section 76 of the Act. However, the considerations for fixing the level of punishment under other sections of the Act and even other statutes<sup>21</sup> and the common law, will be referred to, as and when appropriate.

### **1.2.2 Research method**

The research method adopted comprises a literature review and analysis of the relevant provisions of the Act, the reported decisions of the Special Court for Hearing Income Tax Appeals (“Special Court”), the High Court (formerly known as the “Supreme Court”) and the relevant reference books and journal articles on the subject. Foreign reported decisions, especially those from Zimbabwe (formerly Rhodesia), Britain, the United States of America and Canada, are referred to where appropriate.

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<sup>20</sup> Be it the Special Court for Hearing Income Tax Appeals or the High Court or even courts of foreign jurisdiction.

<sup>21</sup> For example, the now repealed Sales Tax Act, No. 103 of 1978 and other relevant Acts, both in South Africa and other countries.

As far as the local court decisions and those of Zimbabwe are concerned, a comprehensive search was done on the Butterworths Intranet<sup>22</sup> and the appropriate cases relating to the objective, were selected. The main keywords used in the search were:

- Section 76 of the Income Tax Act.
- Additional tax.
- Penalties.
- Extenuating circumstances.
- Mitigating circumstances.
- Versagende omstandighede.

Such an examination, by the very nature of the inquiry, is beset with considerable limitations. Nevertheless, it will be possible to make some generalisations based on the decisions analysed.

### **1.2.3 Importance of the research**

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<sup>22</sup> “Butterworths Intranet Resource for Students and Lecturers, Commercial Resources, Complete Tax Library and South African Tax Cases Reports”, (<http://livepublish@butterworths.co.za>).

Both the Special Court and the High Court have made the effort to explain the reasons or factors for choosing a particular punishment for an errant individual or corporate taxpayer. Thus, to the extent that the decisions are treated as authoritative, the courts have the means to shape the normal range or extent of the punishment, depending on the type of tax offence committed and the defences or pleas advanced by errant taxpayers, to mitigate the potentially harsh penalties which may be imposed.

By examining the defences and pleas which a taxpayer may advance and the weight given by the courts to such defences or pleas, it is possible for a taxpayer who has committed a tax offence, either in terms of the Act or under the common law, to predict the type of sanction or punishment he can expect in a court of law. Similarly, it is beneficial for the revenue authorities to understand how the judiciary will treat a plea or defence by an errant taxpayer and apply the same or a similar sanction in the same or similar circumstances. This will avoid unnecessary litigation and also prevent the revenue authorities from being seen as abusing a taxpayer in contravention of the Constitution<sup>23</sup> by imposing, for example, additional tax or a penalty of 200% in terms of section 76 of the Act in a situation where it is clear that if the matter went to court, the court would only impose additional tax or a penalty of 50%.

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<sup>23</sup> See section 33 of the Constitution.

The discretion given to the Commissioner (or one of his appointed subordinates on his behalf) to impose, and in the appropriate circumstances, to remit additional tax (referred to hereinafter as a “penalty”<sup>24</sup>) and the reasons given for his decision to impose penalties in terms of section 76 of the Act, will not be discussed in any great detail because the Special Court has the power to substitute its own discretion for that of the Commissioner<sup>25</sup>. Nevertheless, the use or sometimes even the abuse of the Commissioner’s discretion in the imposition of penalties, will be referred to and be commented on where appropriate. The conclusion to this dissertation, however, will comment on how the Commissioner (and the judiciary, for that matter) should, when applying penalties, be guided by previous judicial decisions.

#### **1.2.4 Matters generally considered to be beyond the scope of this dissertation**

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<sup>24</sup> “Additional tax” which may be imposed in terms of section 76 is not referred to as a penalty in that section. However, Schreiner JA in CIR v McNeil, 22 SATC 374 at 382, refers to “additional tax” as “in essence a penalty”. He followed Centlivres CJ who had also used the word “penalty” in Israelsohn v CIR, 18 SATC 247, to describe “additional tax” imposed in terms of the equivalent of section 76(1) of the Act. Most cases which have come before our courts subsequently have used the word “penalty” to describe the “additional tax” payable in terms of section 76. See also CIR v Da Costa, 47 SATC 87.

<sup>25</sup> See Chapter 4, paragraph 4.2 for a full discussion on the role of the Special Court and High Court in this regard.

Considered to be beyond the scope of this dissertation is any detailed discussion of the investigative methods used by the revenue authorities to investigate a potential tax offender and whether these methods used are in accordance with the Constitution, except where it may impact upon the actual level of punishment imposed on the offender.

Other than what has been referred to briefly in paragraph 1.1 above, the fundamental reasons generally advanced for tax evasion will also not be discussed other than when pleaded by a taxpayer as a reason for a remission of penalties imposed.

**CHAPTER 2****TAX PLANNING, TAX AVOIDANCE AND TAX EVASION**

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**2.1 THE DISTINCTION BETWEEN TAX PLANNING, TAX AVOIDANCE AND TAX EVASION**

Before discussing the statutory and common law sanctions which may be imposed on an errant taxpayer, it is considered appropriate to examine the distinction between tax planning, tax avoidance and tax evasion. Substantially different sanctions can be imposed depending on the category into which the actions of the taxpayer fall.

In South Africa, there is no legal distinction between tax planning and tax avoidance. Both are legal but both can fall foul of section 103(1)<sup>26</sup> of the Act where elements of abnormality and lack of a *bona fide* commercial purpose are present<sup>27</sup>. However, even if a taxpayer falls foul of section 103(1), there is virtually

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<sup>26</sup> This is the general anti-tax avoidance provision in the Income Tax Act.

<sup>27</sup> See Henry Vorster "The Parameters of Tax Planning" (Witwatersrand University -1984), Chapter 2, pages 8 - 20, (Master of Laws dissertation).

no risk to him - the taxpayer is taxed as if the transaction had not taken place. He is not subject to the Draconian penalties which may be imposed by the Commissioner for offences committed in terms of section 76(1) of the Act - the so-called "triple tax" provision<sup>28</sup>. The only sanction which may be imposed, if it may be called a sanction, is that of interest provided for in terms of section 89*quat*(3) or (3A) read together with section 103(6) of the Act<sup>29</sup>.

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<sup>28</sup> Already referred to in footnote 16 above.

<sup>29</sup> Where section 103(1) is successfully imposed by the Commissioner, he has no discretion to remit any portion of the interest provided for in terms of section 89*quat*(3) or (3A).

Although it is legal to practise tax avoidance techniques<sup>30</sup>, the revenue authorities are passionate in their dislike of tax avoiders. Lord Houghton

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<sup>30</sup> See CIR v Estate Kohler, 18 SATC 354 at page 361, where Centlivres CJ accepted that it was a long established principle of South African law that a person may so order his affairs so as to escape taxation. See also CIR v George Forest Timber Company Ltd, 1 SATC 20, and more recently, Hicklin v CIR, 41 SATC 179 at page 195. These cases in effect, acknowledged the *dictum* of Lord President Clyde in Ayrshire Pullman Motor Services and Ritchie v I. R. Commrs., (1929) 14 TC 754 at page 763, where he said:

*“No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow - and quite rightly - to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer’s pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.”*

aptly summed up the feelings of the revenue authorities regarding taxpayers who adopt aggressive tax planning schemes as follows<sup>31</sup>:

*“Tax-gatherers dislike people who get the better of them. They see themselves as the custodians of the fiscal morals of the nation. Tax avoiders, they say, are bad citizens who dodge the column and put part of their burden on to others. While the small fry get up to minor tricks, the big boys employ specialists to launch tax-avoidance rackets on a scale which make bank robbers envious. The picture is one of the hapless tax gatherer constantly following his astute quarry through a revolving door and never coming out in front. The tax avoider keeps one move ahead and all the complicated anti-avoidance legislation fails to stop him.”*

The distinction between tax evasion and tax avoidance is, on the other hand, well recognised, not only in South Africa but also in the United States of America, Canada, the United Kingdom, Denmark, Switzerland, Australia and virtually all other countries which impose a system of income tax. Perhaps the best distinction between the two concepts is given in the United States Internal Revenue Manual which offers the following explanation<sup>32</sup>:

*“Avoidance of taxes is not a criminal offence. Any attempt to reduce, avoid, minimise or alleviate taxes by legitimate means is permissible. The distinction between avoidance and evasion is fine yet definite. One who avoids tax does not conceal or misrepresent. He shapes events to reduce or eliminate tax liability and, upon the happening of the events, makes a complete*

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<sup>31</sup> Writing in “Taxes”, The Journal of the Inland Revenue Staff Federation, England, January, 1978.

<sup>32</sup> Internal Revenue Manual 9781, paragraph 412.

*disclosure. Evasion on the other hand involves deceit, subterfuge, camouflage, concealment, some attempt to colour or obscure events, or make things seem other than they are.”*

Tax evasion in the South African context has also been described by Vorster as involving<sup>33</sup>:

*“. . . fraud, deceit, misrepresentation and non-disclosure. The expression itself is not afforded legislative recognition but the distinction between tax avoidance and tax evasion is entrenched.”*

The description of evasion in the Internal Revenue Manual appears to be wider than the description given by Vorster. For example, the Internal Revenue manual mentions “some attempt to colour . . . events”. This, in effect, is the same old problem of substance versus form. If a South African court were to find that the substance of an agreement is different to the form of the agreement, would this be regarded as evasion and therefore be subject to the harsh penalties provided for in terms of section 76 of the Act?

Sir Raymond Evershed MR in Henley v Murray (Inspector of Taxes) discussed the matter as follows<sup>34</sup>:

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<sup>33</sup> See Vorster, page 18, footnote 27 above.

<sup>34</sup> [1951] All E.R. 908 at page 910.

*“I quite agree that language which the parties may use, such as “compensation for loss of office”, is not the determining factor when one has to decide what in truth was the bargain, and that the duty of the court is to see what in substance, and in truth the bargain was and not to be blinded by some formula which the parties may have used. That proposition is not peculiar to tax cases, though there is perhaps a tendency for the subject to try to disguise the real nature of a transaction by forms of words if he thinks the result would be profitable.”*

The South African courts do not lightly disregard what the parties say<sup>35</sup>. The traditional approach is that only where the court is satisfied that the agreement is a sham or is a dishonest transaction, will the words in the agreement be disregarded. Watermeyer JA in Commissioner of Customs and Excise v Randles, Bros and Hudson Ltd<sup>36</sup>, expressed the traditional approach as follows:

*“. . . dishonest, inasmuch as the parties to it do not really intend it to have, inter parties, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties.”*

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<sup>35</sup> See Zandberg v Van Zyl, 1910 AD 302. At page 309 it was said:

*“The court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For, if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstance that the same object might have been obtained in another way will not necessarily make the arrangement other than it purports to be. The enquiry therefore is in each case one of fact, for the right solution of which no general rule can be laid down.”*

<sup>36</sup> 1941 AD 369.

In order to determine whether it is dishonest in that sense, the court looks at factors such as the object of the contract, the surrounding circumstances and unusual provisions in the contract.

In Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR<sup>37</sup>, the Appellate Division stripped the transactions of their disguise and exposed their true nature or substance. However, the court had to reconcile two legal principles before being able to do so. The first principle is the one adopted in South Africa by Centlivres CJ in his minority judgment in CIR v Estate Kohler and Others<sup>38</sup>, and affirmed in subsequent judgments of the Appellate Division, that a person may so order his affairs so as to escape taxation, or in other words, it permits parties to arrange their affairs so as to remain outside the provisions of a particular statute. The other principle is to the effect that<sup>39</sup>:

*“Courts of law will not be deceived by the form of a transaction: it will rend aside the veil in which the transaction is wrapped and examine its true nature and substance.”*

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<sup>37</sup> 58 SATC 229.

<sup>38</sup> 18 SATC 354.

<sup>39</sup> Per Wessels ACJ in Kilburn v Estate Kilburn, 1931 AD 501 at page 507.

After discussing the principles involved, Hefer JA, in the Ladysmith case, went on to say<sup>40</sup>:

*“Provided that each of them is confined to its recognised bounds there is no reason why both principles cannot be applied in the same case. I have indicated that the court only becomes concerned with the substance rather than the form of a transaction when it has to decide whether the party concerned has succeeded in avoiding the application of a statute by an effective arrangement of his affairs. Thus applied, the two principles do not conflict.”<sup>41</sup>*

It is submitted that should a taxpayer attempt to “colour” an agreement into something which it is not in order to obtain a more favourable tax treatment, such “colouring” could be regarded as a sham and, therefore, as tax evasion or an offence falling within the ambit of section 76(1)(b). If it is so classified, the taxpayer faces the possibility of heavy and severe penalties.

Additionally, it would be very difficult for the taxpayer to argue “extenuating circumstances” for the purposes of remission of penalties in terms of section 76(2)(a) of the Act for the very reason that the taxpayer set out in a deliberate and systematic manner to “colour” the events with the intention to evade rather than avoid taxes. A deliberate and systematic path leading to tax evasion usually

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<sup>40</sup> At page 239.

<sup>41</sup> The reasoning in the Ladysmith case was subsequently followed in the recent Appellate Division decision of Relier (Pty) Ltd v CIR, 60 SATC 1.

results in harsher penalties being imposed than a “spur of the moment” decision to evade taxes<sup>42</sup>.

The fine line between tax avoidance and tax evasion means that it may be very difficult to distinguish aggressive tax planning from tax evasion. Cleverness is often difficult to distinguish from dishonesty. However, one crosses the line at one’s peril. Mr Justice Holmes in Bullen v Wisconsin<sup>43</sup> commented:

*“We do not speak of evasion, because, when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits. When an act is condemned as an evasion what is meant is that it is on the wrong side of the line indicated by the policy if not by the mere letter of the law.”*

## 2.2 **CONCLUSION**

The punishment for a tax offender is severe, particularly for those offenders who embrace a deliberate policy of tax evasion. A story is told of Al Capone, the notorious American gangster of the 1930's, while waiting to be charged for tax offences in the United States District Court building in Chicago, heard the clerk

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<sup>42</sup> See Chapter 7 of this dissertation for a fuller discussion on this aspect.

<sup>43</sup> 240 US 625 at page 630.

of the court call his case, “United States of America versus Alphonse Capone”. He turned to his attorneys and said, “What kinda odds are those?”<sup>44</sup>

Almost every tax offender in South Africa (even if only negligent in not submitting his return timeously) probably has the same feeling when confronted by the power which the Commissioner for Inland Revenue theoretically has at his disposal. The word theoretically is used because our Constitution has *prima facie* outlawed, or at least cast doubt on, certain practices which previously were available to the Commissioner to investigate and accordingly punish the tax offender. This aspect will be discussed, as and when appropriate, during the course of this dissertation.

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<sup>44</sup> Comisky, Feld and Harris, “Tax Fraud and Evasion”, published by Warren, Gorham & Lamont, Boston, (6th Edition), 1995, Volume 1, page 1 -1.

**CHAPTER 3****LEGISLATIVE AND COMMON LAW OFFENCES**

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**3.1 INTRODUCTION**

*“China has executed six men and jailed 21 for dealing illegally in thousands of dollars worth of tax invoices, Xinhua news agency said. Gao Changali, vice president of the Supreme Court, explaining the severity of the sentences, said value added tax invoices were an important part of China’s tax system reform.”<sup>45</sup>*

Fortunately, and rightly so, capital punishment is outlawed in most democratic countries of the so-called Western World and even if imposed, is normally only imposed for acts of terrorism and murder. Rather, those found guilty of income tax offences are either sentenced to a period of imprisonment or a pecuniary fine or to both such fine and imprisonment.

**3.2 PUNISHMENT IN GENERAL**

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<sup>45</sup> Report in “The Cape Argus” newspaper, Argus Newspapers, Cape Town, June 16, 1995, page 2.

In early societies, punishment for a crime was left to the person wronged or to his or her kin or tribe. The punishments inflicted were characteristically cruel and, by modern standards, out of proportion to the offence committed. The cruel punishments evolved largely from old beliefs in vengeance.

The right to punish was, in later society, taken away from the offended party and vested in the state. Deterrence and separation from society, rather than revenge, became the principal purpose of punishment, with the degree of penalty adjusted to reflect the nature of the crime. Emphasis began to be placed on rehabilitation for the good of society and the individual, rather than on punishment for its own sake.

Nicholas JA in S v Khumalo, had the following to say about the objectives of punishment<sup>46</sup>:

*“In the assessment of an appropriate sentence, regard must be had, inter alia, to the main purposes of punishment mentioned by Davis AJA in R v Swanepoel, 1945 AD 444 at 455, namely deterrent, preventative, reformatory and retributive (see S v Whitehead, 1970(4) SA 424(A) at 436E-F; S v Rabie, 1975(4) SA 855(A) at 862). Deterrence has been described as the ‘essential’, ‘all important’, ‘paramount’ and ‘universally admitted’ object of punishment. See R v Swanepoel (supra at 455). The other objectives are accessory”.*

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<sup>46</sup> 1984(4) SA 327(A) at page 330.

Income tax evasion is generally regarded as a “white-collar crime”, together with crimes such as fraud, embezzlement, price fixing, misuse of public funds and abuse of political and legal powers. Although the term has no legal significance in South Africa, it is normally associated with and committed by persons of relatively high social status, and is intimately connected with the socially approved occupation of the perpetrator.

Historically, the chief sanctions against white-collar criminals have been loss of position and public trust, being debarred from practising a profession or loss of a professional licence, and the levying of fines. Even where jail sentences have been imposed, the sentences have been relatively light and rarely have the full sentences been served. This leniency stems partly from the perception that a high-status individual implicated in a criminal activity was sufficiently punished by the presumed loss of social esteem or occupational prospects, or both<sup>47</sup>; and partly from the fact that most white-collar crimes are so-called victimless offences.

Nevertheless, the South African legislature, in common with the United States of America, the United Kingdom, Australia and Canada, through the Act, have

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<sup>47</sup> See M A Rabie and S A Strauss, “Punishment; An Introduction to Principles”, Johannesburg, Lex Patria, 1981 (3rd edition) at page 26.

*“In fact, merely being convicted of a crime is already for many persons a sufficient punishment to deter them from future criminal behaviour.”*

provided for strong measures to be taken against those who have committed income tax offences. The offences range from merely submitting a return for income tax after its due date to blatant fraud and evasion or even assistance in the evasion of income tax. The punishment for such offences usually takes the form of a pecuniary fine as is the case when the Commissioner imposes a penalty in terms of section 76 of the Act.

However, there are two other sections in the Act, namely, sections 75 and 104, which provide for incarceration or a term of imprisonment on conviction of a taxpayer for a stipulated tax offence. The maximum period of imprisonment provided for was, until recently, a period of two years where section 104 applied. This period was increased to five years with effect from 13 December 2002<sup>48</sup>. Nevertheless, these sections provide for an alternative to imprisonment, namely a fine, and it is submitted that the South African judiciary are reluctant to imprison a tax offender and would rather impose a fine<sup>49</sup>. This is unlike, for example, the position in the United Kingdom, where the judiciary appear not to be adverse to

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<sup>48</sup> See also section 75 where the maximum penalty provided for is a now a period of imprisonment of twenty four months for the same or similar offences. This difference in imprisonment periods is due to the fact that for section 104 to apply, there must be an intent to evade or to assist any other person to evade assessment or taxation, whereas section 75 does not require any intention to evade tax. The effective date of the increases of the maximum period of imprisonment for these sections was 13 December 2002 (section 51 of the Revenue Laws Amendment Act, No. 74 of 2002).

<sup>49</sup> See Van der Walt v S, 52 SATC 186.

sentencing a tax offender who has been proved guilty of tax fraud, to a term of imprisonment under the “clang of the prison gates” principle<sup>50</sup>. The same principle of imprisonment applies in the United States of America for those convicted of tax fraud<sup>51</sup>.

In cases other than the statutory income tax offences in terms of section 76 of the Act, the onus of proof is usually on the State to prove beyond a reasonable doubt that fraud or some other criminal offence has been committed. In terms of section 82 of the Act, however, there is no onus on the State to prove that a taxpayer has committed an offence in terms of section 76<sup>52</sup> of the Act. The State merely needs to allege that a taxpayer has committed an offence and then it is up to the taxpayer to discharge the onus of proof, on a balance of probabilities, that no offence has been committed.

The reverse onus of proof in cases where a heavy pecuniary penalty can be imposed, its fairness and the possible ramifications under the Constitution will not

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<sup>50</sup> See R v Hayes, (1981) 3 Cr. App. R.(S) 205 at page 208, where it was said:

*“This man has heard the clang of prison gates, and is likely to hear the reverberations of that noise for a very long time.”*

<sup>51</sup> See the United States Internal Revenue Code, title 18.

<sup>52</sup> As mentioned in footnote 16, this section is commonly referred to as the “triple tax” provision. It provides for a 200% penalty to be imposed if an offence, as listed in that section, is contravened.

be discussed in detail as it is considered to be beyond the scope of this dissertation. Nevertheless, it is submitted that it will only be a matter of time before the reverse onus in these matters will be challenged on a constitutional basis by an adversely affected taxpayer. Support for this view has been given in a fairly recent decision by the Constitutional Court in S v Prinsloo: S v Mbatha<sup>53</sup> when Constitutional Court judge Pius Langa handed down the unanimous decision of eleven Constitutional Court judges reversing the statutory presumption that, if it were proved that arms or ammunition were on any premises, then any person on the premises was presumed to be in possession of the arms or ammunition. The presumption was rebuttable by the accused on a balance of probabilities. This reverse onus was an almost identical provision to the reverse onus provision in section 82 of the Act. The eleven judges concurred that the presumption infringed on the right of the accused to a presumption of innocence in terms of section 25(3)(c) of the Interim Constitution because it could result in the conviction of an accused person despite the existence of a reasonable doubt as to his or her guilt.

It is important that when an administrative official, such as a tax officer, has it in his power to find that a taxpayer has committed or is “guilty” of an offence<sup>54</sup> and has the discretion to impose and remit penalties, that it is done on a fair, consistent

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<sup>53</sup> 1996(1) SACR 371(CC).

<sup>54</sup> The word “guilty” is not used in the Act - rather the offences are detailed.

and appropriate basis and in line with the procedural and fundamental rights granted to the taxpayer by the Constitution and the common law<sup>55</sup>. The theories of punishment as laid down by the judiciary and our Constitution must also be complied with strictly. The “watchdog” for this process is the judiciary - it protects the individual from the over zealous administrative official. It is the final point of the triad constituting the legislative, administrative and judicial functions.

The purpose of this chapter is to examine the statutory offences provided for in the Act by the legislature as well as offences relating to taxation under the common law and the maximum penalties which may be imposed in each case. A comparison between the approach of the South African legislature and the legislatures of the United States of America, the United Kingdom and Canada regarding the possible punishments which may be imposed on a tax offender, will also be briefly examined.

### **3.3 LEGISLATIVE PROVISIONS**

Lord Greene in Lord Howard de Walden v I.R. Commissioners<sup>56</sup>, stated:

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<sup>55</sup> The “procedural and fundamental rights” of a taxpayer are not discussed in detail since they are considered to be beyond the scope of this dissertation. However, these rights will be discussed during the course of this dissertation, as and when appropriate.

<sup>56</sup> 1942 1 All.ER 287 at page 289.

*“It would not shock us in the least to find that the legislature has determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.”*

A similar sentiment was expressed by Holmes J in R v Mbele<sup>57</sup>:

*“In general, such persons, and others potentially like them, have to be convinced, by the heaviness of the fine, that financially the game is not worth the candle.”*

The South African legislature and the judiciary are on record as stating that tax evasion is an evil. The judge in COT v Ferera<sup>58</sup>, however, went even further and included tax avoidance in the category of an evil.

The sentiments of tax evasion being an evil, are unequivocally expressed in the penal provisions of the Act which have been drawn up to deter and punish tax offenders and potential tax offenders. The provisions are potentially (if the maximum penalties are imposed) the most penal provisions of any statute in South Africa.

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<sup>57</sup> 1955(4) SA 203(N) at page 207A.

<sup>58</sup> 38 SATC 66 (a Rhodesian Appellate Division decision). It is submitted that it is highly improbable that a South African court would ever endorse these sentiments.

As has already been mentioned, there are three main penal provisions in the Act (excluding offences in connection with PAYE and provisional tax) which can be instituted against tax offenders, the most important being section 76. Section 76(1) provides for a taxpayer to pay in addition to the tax chargeable in respect of his taxable income:

- “(a) if he makes default in rendering a return in respect of any year of assessment, an amount equal to twice the tax chargeable in respect of his taxable income for that year of assessment; or*
- (b) if he omits from his return any amount which ought to have been included therein, an amount equal to twice the difference between the tax as calculated in respect of the taxable income returned by him and the tax properly chargeable in respect of his taxable income as determined after including the amount omitted;*
- (c) if he makes an incorrect statement in any return rendered by him which results or would if accepted result in the assessment of the normal tax at an amount which is less than the tax properly chargeable, an amount equal to twice the difference between the tax as assessed in accordance with the return made by him and the tax which would have been properly chargeable.”*

Subsections 5, 6 and 7 of section 76 set out the circumstances in which a taxpayer is deemed to omit an amount from his return for the purposes of section 76(1)(b). The subsections provide as follows:

- “(5) Any taxpayer who in determining his taxable income as disclosed by his return, deducts or sets-off any amount the deduction or set-off whereof is not permissible under the provisions of this Act, or shows as an expenditure or loss any amount which he has not in fact expended or lost, shall be deemed for the purposes of this section to have omitted such amount from his return.*
- (6) Any taxpayer who wilfully fails to disclose in any return made by him any facts which should be disclosed and the disclosure of which would result in the taxation of the taxpayer’s income on an amount which is higher than the amount upon which such income would be taxable on such return, shall for the purposes of this section be deemed to have omitted from his return the amount by which the former amount exceeds the latter.*
- (7) If in any year of assessment in which the determination of the taxable income of the taxpayer does not result in an assessed loss, he is entitled to the set-off of a balance of assessed loss from the previous year of assessment and such balance is less than it would have been had it been calculated on the basis of the returns rendered by him, he shall for the purposes of this section be deemed to have omitted from his return for the first mentioned year of assessment an amount equal to the difference between the amount at which such balance is finally determined and the amount at which it would have been determined on the said basis.”*

This section is generally known as the “triple tax” provision, that is, it provides for the proper tax chargeable on the undisclosed income (or false claim of expenditure, as the case may be) which should have been subject to tax plus a possible maximum penalty of 200%. However, section 76(2)(a) gives the

Commissioner the discretion to remit the penalty *in toto*, or any part thereof, as he may think fit, if there was no intention by the taxpayer to evade taxation. Where there was an intention to evade taxation, the Commissioner may not remit the penalty unless he is of the opinion that there were “extenuating circumstances”.

The penalty as imposed by the Commissioner is subject to objection and appeal to the Special Court<sup>59</sup>. The Special Court may substitute its own punishment for that of the Commissioner’s. The Special Court, in deciding on the quantum of penalties, is called upon to exercise its own, original discretion and may take into account factors or evidence which were not available to the Commissioner<sup>60</sup>.

The revenue authorities are certainly not afraid to impose the maximum 200% penalty in cases of blatant tax evasion and the judiciary support such heavy sanction in appropriate cases. This is especially so where the errant taxpayer does not plead “extenuating circumstances” for the remission of penalties either to the revenue authorities in the first instance or to the Special Court on appeal. In fact, it is submitted that if “extenuating circumstances” are not pleaded by the taxpayer in cases of blatant tax evasion, neither the revenue authorities nor the Special Court has the discretion to remit any portion of the prescribed penalty.

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<sup>59</sup> Section 76(2)(b).

<sup>60</sup> See CIR v Da Costa, 47 SATC 87 at page 95, and paragraph 4.2 of Chapter 4 below for a more detailed discussion on this aspect.

In ITC 1658<sup>61</sup>, the sole shareholder and director of the taxpayer (a company), claimed overseas travelling expenses allegedly incurred by him whilst on company business. Since he was the sole shareholder in the company, the court regarded him, for all practical purposes, as the taxpayer. The travels were described as “export marketing trips”. The trips were undertaken during the traditional holiday period of December to January. They were extended affairs (in more ways than one), ranging in duration from approximately one month to some six weeks, leaving him, as the court remarked, lots of time for non-business activities. On one occasion he was accompanied by his son and on another occasion by a female companion, who later became his wife.

His annual trips followed a similar pattern and his travel itinerary included many places where, historically, the appellant had done no business whatsoever - year after year his attempts proved fruitless. In fact, his total export sales over a fifteen-year period only amounted to some R260 000 of which approximately R200 000 came from Germany. His final port-of-call on his annual “around the world” trips before returning to South Africa, was always Mauritius, a country to which he never exported any goods. In this regard, the judge remarked that “no reasonable businessman would ever have sent one of its executives to Mauritius, year in year

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<sup>61</sup> 61 SATC 231.

out, without him ever doing business with anyone on the island if it had not been for the holiday attractions which were also on offer<sup>62</sup>.

The court held that the travelling expenses were clearly claimed as a deduction by the appellant with the intent to evade taxation. Accordingly, the 200% penalty imposed by the revenue authorities could not be remitted since the appellant had not shown any “extenuating circumstances” to be present as required by section 76(2)(a) of the Act.

The only defence put forward by the appellant was that the revenue authorities had allowed the cost of similar overseas trips in the past, as a deduction. The judge dealt with this defence as follows: “. . . the mere fact that similar expenditure had been allowed in the past is not justification for the appellant to falsely claim it as a deduction once more. After all, two wrongs do not make a right<sup>63</sup>.”

The two other penal sections relating to taxpayers, which have already been mentioned, are sections 75 and 104. Only a court of law, usually a Magistrate’s Court, may impose a penalty (imprisonment or a fine or both imprisonment and a fine) for the specific offences committed in terms of those two sections. Appendix I of this dissertation details the offences in terms of sections 75 and

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<sup>62</sup> At page 237.

<sup>63</sup> At page 239.

104. Generally, however, the offences include the same offences as detailed in section 76 as well as offences such as not furnishing information or books or papers on demand to the Commissioner or officer, or assisting a taxpayer to evade taxation<sup>64</sup>.

### 3.4 **COMMON LAW OFFENCES**

#### 3.4.1 **Preview**

Until 1987, it was not the policy of the South African revenue authorities to impose penalties in terms of section 76 of the Act and to recommend to the Attorney-General that a tax offender be prosecuted for common law fraud for the same offence. However, in 1987<sup>65</sup>, the revenue authorities decided to do just that.

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<sup>64</sup> But these demands for information from a taxpayer may, *prima facie*, be considered unconstitutional unless the “conduct” of the Commissioner is reasonable in relation to the information demanded. “Concrete evidence” must be available to the revenue authorities before an investigation into a taxpayer’s affairs is launched and a demand for information is instituted. A general “fishing expedition”, not based on solid evidence or flimsy evidence is considered to be unlawful and unreasonable “conduct” on the part of the Commissioner and contravenes the Constitution. See Park-Ross and Another v Director: Office for Serious Economic Offences, 1996(2) SA 148(C). However, it is only if the taxpayer is aware of his constitutional rights that the revenue authorities can be challenged on this aspect. Further discussion on this aspect is not deemed necessary as it is considered to be beyond the scope of this dissertation.

<sup>65</sup> Note that the Van Der Walt case was decided some six years prior to the acceptance of our Interim Constitution in 1993, Act No. 200 of 1993.

### 3.4.2 The Case of Van der Walt v S

In Van Der Walt v S<sup>66</sup>, the Commissioner imposed the full 200% penalty in terms of section 76(1) read together with section 76(2)(a) of the Act on a taxpayer who had prepared false books of account and records, submitted false income tax returns and thereby evaded income tax and in the circumstances, defrauded the Treasury. The Commissioner imposed the maximum 200% penalty because, in his opinion, he could not find any “extenuating circumstances” in the taxpayer’s favour which would enable him to reduce or remit the penalty. Section 76(2) only allows the Commissioner to remit the 200% penalty or part thereof in cases in which the taxpayer had the intention to evade taxes, if he is satisfied that “extenuating circumstances” exist<sup>67</sup>. The penalty amounted to some R423 000. The taxpayer did not object to the imposition of the full 200% penalty.

The Commissioner, thereafter, decided to take the matter further and the taxpayer was charged with fraud under the common law. The taxpayer pleaded guilty in the Magistrate’s Court. He was convicted and sentenced to pay a fine of R50 000 or serve a term of imprisonment of twelve-and-a-half years. In addition, he was given a suspended prison sentence of an effective twelve-and-a-half-years. He

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<sup>66</sup> 52 SATC 186.

<sup>67</sup> See Chapter 5 below which deals with the general meaning and extent of “extenuating circumstances”.

appealed to the Witwatersrand Local Division of the Supreme Court against this fine and suspended sentence.

In the course of the judgement, Schwartzman AJ remarked that he had not been referred to nor could he personally find, any similar case in which a taxpayer had been punished in terms of section 76 of the Act and thereafter charged with, and found guilty on the same facts, of common law fraud. Nevertheless, the taxpayer having pleaded guilty to the fraud charge, the judge was of the opinion that it was his duty to decide on an appropriate sentence in the circumstances.

He detailed both the “extenuating” and “aggravating” factors which were found by the magistrate in the court *a quo* to be present and which influenced the punishment imposed on the taxpayer in that court. Regarding the conduct of the taxpayer, the magistrate in the court *a quo* had found<sup>68</sup>:

*“That when the investigations into his affairs started in 1982, he confessed to the police, and thereafter assisted the Department in its investigations. When he came to court, he pleaded guilty and has shown remorse for his crimes. As a result of the publicity which followed upon his being charged, he suffered a punishment in that he lost the position of eminence and respectability in the community which he had earned over the years.*

*“The magistrate then went on to have regard to the seriousness of the offence, the fact that it had been planned and executed over*

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<sup>68</sup> At page 189.

*a number of years and for the sole purpose of benefiting the appellant at the expense of the fiscus, and that it was in the circumstances a crime that affected the economic interests of the State and thereby the interests of the community.”*

The judge confirmed that he agreed with the magistrate’s finding as regards the factors present (both “extenuating” and “aggravating”) which would influence the punishment. The judge continued as follows<sup>69</sup>:

*“By reason of the provisions of section 76 of the Income Tax Act, the State has not only recovered the whole of its loss, but will also, at the expense of the appellant, receive payment of a further amount of R423 466 by way of the penalty imposed. This latter payment to the State, exceeds in my judgment any fine which a court would impose for a fraud involving an amount of R211 733.*

*“Apart from his dishonest conduct towards the fiscus, there is no suggestion that over the years in question he was guilty of any dishonesty towards his clients for whom he had acted as a bookkeeper and internal auditor. In fact, and from the references and letters included in his written statement in mitigation of sentence, some of his clients and those with whom he was associated in public life, regard him as a respected and honourable member of society.”*

The sentence of the magistrate was set aside and was substituted by a five-year sentence suspended for five years.

### **3.4.3 Conclusion**

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<sup>69</sup> At page 192.

The practical effect of the Van der Walt judgement is that a taxpayer can be found guilty of the common law offence of fraud in addition to being punished in terms of the penal sections of the Act. However, it must be questioned whether the Constitution allows a person to be “tried” twice for the same offence.

Section 35(3)(m) of the Constitution provides for a person,

*“not to be tried for an offence in respect of an act or omission for which that person has previously been either acquitted or convicted.”*

Having penalties imposed in terms of section 76 of the Act is neither a conviction nor an acquittal. It is an administrative action initiated by the revenue authorities but regulated by the judiciary. On a strict reading, therefore, there can be no violation of the Constitution in this regard. The Canadian Constitution or “Charter”, has a similar provision to the South African Constitution which guarantees that a person is not punished twice for the same offence. In the Canadian case of Re Vespoli and R<sup>70</sup>, the issue was whether civil and criminal fines could be imposed on a taxpayer for the same tax offence. The British Columbia Supreme Court held that the dual system of civil and criminal penalties did not offend the Charter.

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<sup>70</sup> (1985) 32 A.C.W.S.(2nd) 423(B.C.S.Ct.).

The approach of the judge in the Van Der Walt case was, it is submitted, a practical way to deal with the matter. Although the case was decided some time before the introduction of the Constitution, the judge did, in effect, apply the principle that a person should not be punished twice for the same offence.

He made the valid point that any financial penalty imposed in terms of the common law would go into the same financial coffers as a penalty imposed in terms of section 76 of the Act. It differs from the situation where a person commits fraud against a third party. The offender can validly be charged under the common law (criminal sanctions) as well as be sued by the person he has defrauded (civil sanctions). These actions do not offend the Constitution.

Predictably, since the Vander Walt case, the Commissioner has not, as far as the author has been able to establish, attempted to prosecute a tax offender under the common law crime of fraud after having imposed penalties under section 76, although from various local newspaper reports, he frequently threatens to do so. This is probably because no further effective sanctions were imposed on the taxpayer in the Van der Walt case by the Supreme Court.

However, it is still theoretically possible for the Commissioner to pursue this route. It is submitted that where the Commissioner considers that it is time to warn taxpayers of the harsh penalties awaiting them for tax evasion, he could attempt

to obtain the most effective publicity for his cause by prosecuting a high profile tax offender under the common law instead of under the Act, especially where there is a case to be made for a jail sentence to be imposed<sup>71</sup>.

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<sup>71</sup> Although much has recently been written in the local South African newspapers of the possible prosecution of businessman Dave King and soccer boss Irvin Khoza for alleged tax fraud, it is submitted that it is highly unlikely that the Commissioner will ultimately pursue this route. This is because, firstly, the Commissioner has already obtained the requisite publicity. Secondly, it is most probable that the Commissioner will agree with the taxpayer and his legal advisors on any penalty to be imposed (if, indeed, there has been a contravention of section 76(1) of the Act). Such agreement will probably be done in terms of the new section 107B of the Act - the so-called alternative dispute resolution procedures ("ADR"). The circumstances under which the Commissioner may settle a dispute between himself and a taxpayer are reproduced in Appendix II of this dissertation. Thirdly, and most importantly, it is submitted that any case brought before the High Court would probably be thrown out on the basis that one of the taxpayer's fundamental rights in terms of section 35 of the Constitution had been violated, namely, the right to remain silent and not make incriminatory remarks which could subsequently be used against him at trial. The investigation by the Commissioner, demanding access to information in terms of the Act, can be construed as obtaining information under duress and therefore becomes tainted evidence which may not be used against the accused in a criminal trial. Tebbett J in Park-Ross and Another v Director: Office for Economic Offences, 1995(2) SA 148 (C), stated:

*" . . . our law favours the approach eloquently expressed by Warren CJ in Miranda v Arizona, 384 US 436 (1966) at 460 that: 'our accusatory system of criminal justice demands that the government seeking to punish an individual, produce the evidence against him by its own independent labours rather than by the cruel, simple expedient of compelling it from his own mouth.'"*

Further discussion on this aspect is considered to be beyond the scope of this dissertation.

It is furthermore submitted that the general approach of the magistrate (although he misguidedly imposed a heavy fine) and the judge regarding what constitutes “extenuating” and “aggravating” factors for the purposes of punishing tax offenders, was and remains the correct approach<sup>72</sup>.

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<sup>72</sup> It is submitted that had the taxpayer appealed against the imposition by the Commissioner of the 200% penalty in terms of section 76(1) to the Special Court, the Special Court probably would have taken into account the “extenuating” and “aggravating” factors found by the magistrate and confirmed by the judge in the Witwatersrand Local Division of the Supreme Court to be present in the case and would have reduced the 200% penalty. It has been said that:

*“A sentence should not be excessive. A maximum punishment is intended for the worst offences of the class for which the punishment is provided. A court, in sentencing for an offence, should consider whether it may not be likely that far worse instances of the same class may in future come before it, and should keep some penalty in reserve in order to be able more severely to punish the greater offender.”*

See F G Gardiner and C W H Lansdown, “South African Criminal Law and Procedure”, Volume 1, Juta & Co, Cape Town and Johannesburg, (4th edition), 1939, at page 498.

### 3.5 **A BRIEF COMPARISON OF FOREIGN LEGISLATIVE APPROACHES**

#### 3.5.1 **The United States of America**

The Congress of the United States of America has created a comprehensive statutory system of criminal and civil sanctions to deter and punish tax fraud. In addition to being convicted of criminal tax fraud and being severely sentenced, a taxpayer will almost certainly face civil penalties for the same offence. Even if found not guilty of the criminal offence, the unfortunate taxpayer may still be found guilty of civil tax fraud<sup>73</sup>.

In addition to the underlying taxes evaded, plus interest, a conviction for criminal tax fraud can lead to a period of imprisonment for up to five years as well as a fine of up to \$250 000 in the case of an individual and \$500 000 in the case of an

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<sup>73</sup> The burden of proof in a criminal tax matter is on the United States Internal Revenue Service to prove beyond a reasonable doubt that the taxpayer has committed the offence with which he is charged. Civil tax fraud, on the other hand, only requires that the Internal Revenue Service prove on clear and convincing evidence that the offence has been committed, a still heavy but lesser burden of proof. The South African common law does not distinguish between criminal fraud and civil fraud. If a person is found guilty of common law fraud in South Africa, it is a criminal conviction and the onus of proof would have been on the State to prove that the defendant was guilty "beyond a reasonable doubt". Statutory fraud in relation to section 76 of the Act, places the onus on the taxpayer to prove on a balance of probabilities that he did not intend to evade taxes. The constitutionality of this reverse onus has been questioned in paragraph 3.2 above.

“organisation” which would include a company. A civil tax penalty of 75% of the tax deficiency resulting from the fraud is also automatically imposed. Furthermore, the taxpayer is liable for a 20% understatement penalty (administratively imposed) and is liable for the costs of the prosecution<sup>74</sup>.

Although the American system may appear harsh, it is important to note that the administrative portion of the “penalty” is limited to 20% of the understated tax liability plus interest. The remainder of the penalties can only be imposed by a court of law on conviction of a taxpayer for tax evasion (fraud) with the burden of proof being on the revenue authorities.

### **3.5.2 The United Kingdom**

The United Kingdom also provides for criminal sanctions to be applied against tax offenders in addition to administrative penalties. Prior to 1989, section 85 of the Tax Management Act, 1970, provided for an administrative penalty of 50 pounds plus a penalty up to an amount of double the tax underpaid, that is, a 200% maximum penalty, for any offence outlined in section 85 of that Act. The offences provided for are very similar to the offences provided for by section 76 of the

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<sup>74</sup> See Comisky, Feld, Harris at page 2-5.

South African Income Tax Act and include knowingly or negligently making incorrect statements.

From 1989 onwards, the maximum administrative penalty has been reduced to 100% of the tax underpaid<sup>75</sup>.

Nevertheless, it appears that Her Majesty's tax inspectors do not attempt to prosecute a taxpayer criminally for a tax offence unless it is one of blatant fraud. The Court of Appeal considers income tax fraud to be a serious offence and this has been shown by custodial sentences being imposed even if the amounts involved were relatively small and the offender was otherwise of good character<sup>76</sup>.

### 3.5.3 Canada

The Canadian legislature has provided for both administrative penalties and criminal prosecutions through their Income Tax Act. The maximum penalty which can be imposed by the administrative function is a fine of up to 50% of the tax

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<sup>75</sup> In terms of section 106 of the Finance Act, 1989.

<sup>76</sup> See article entitled "Clang of the Prison Gates - The Sentencing of Income Tax Offenders" by W Azlan Ahmed and M Hingun, published in the 1995 British Tax Review, pages 581-587 at page 581.

evaded<sup>77</sup>. In the case of tax evasion, the judiciary may impose a fine of not less than 50% but not more than 200% of the tax evaded plus imprisonment for a term not exceeding five years<sup>78</sup>. There is no “reverse onus” on the taxpayer in a penalty situation even if imposed by the administrative function<sup>79</sup>.

### 3.6 **CONCLUSION**

This chapter has concentrated on the legislative provisions which attempt to curtail and deter income tax evasion by taxpayers. In common with the legislatures of the United States of America, the United Kingdom and Canada, the South African legislature has provided for harsh penalties to be imposed on tax offenders who evade or attempt to evade income tax. However, neither the United States of America, the United Kingdom nor Canada allows their administrative function to impose the potentially harsh penalties which the South African administrative tax officials are permitted to impose.

Nevertheless, in cases where there has been blatant tax evasion, the United States of America, the United Kingdom and Canada provide for criminal

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<sup>77</sup> See sections 162 and 163 of the Canadian Income Tax Act, 1952, as amended.

<sup>78</sup> See section 239.

<sup>79</sup> See section 163(2).

sanctions to be imposed on the offender. Their courts are not averse to imposing a custodial sentence together with a fine on tax offenders in such circumstances. This is in addition to any administrative penalty imposed. On the other hand, it has been shown in the Van der Walt case that, because of the large penalties which may be imposed on a tax offender by the administrative function in South Africa and because there is no specific legislation to criminalize tax offences, it is most unlikely that a South African court will impose a criminal penalty in addition to that imposed in terms of section 76 of the Act.

It is submitted that the United States of America, the United Kingdom and Canada have the correct approach: set a low maximum penalty which can be imposed by an administrative official for the various tax offences and allow the judiciary to determine the rest of the punishment for blatant tax evasion cases according to the principles embodied in the Constitution.

This chapter has also questioned whether the reverse onus imposed on a taxpayer, especially where penalties are involved, is constitutional. Without much discussion on the matter, a *prima facie* conclusion based on the decision of S v Prinsloo: S v Mbatha<sup>80</sup> was reached that it is only a matter of time before the

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<sup>80</sup> 1996(1) SACR 371(CC).

constitutionality or otherwise of the reverse onus is challenged in the Constitutional Court.

**CHAPTER 4**                      **THE ROLE OF THE SPECIAL COURT IN HEARING**  
**APPEALS AND APPEALS TO THE HIGH COURT**

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**4.1**    **PREVIEW**

In Da Costa v CIR<sup>81</sup>, decided in 1985, the Appellate Division held that the Special Court, in deciding on the quantum of penalties to be imposed in terms of section 76 of the Act, is called upon, in the words of van Heerden JA, “to exercise its own, original discretion . . .”

Prior to that case, certain Special Court decisions were conflicting on that point.

Friedman J, in ITC 1351<sup>82</sup>, held:

*“The question which arises (and which is dealt with in ITC 1295) is what the approach of this court should be in those exceptional cases where an appeal is allowed against the exercise by the Commissioner of a discretionary power. In terms of the Income Tax Act, the discretion, in such cases, is primarily a discretion given to the Commissioner, and the mere fact that an appeal against the exercise by him of his discretion is permitted, does not*

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<sup>81</sup>     47 SATC 87 at page 95.

<sup>82</sup>     44 SATC 58 at pages 62-63.

*mean that the discretion which was previously that of the Commissioner is now a discretion of this court. It seems to me . . . that where one is concerned with a permitted appeal against the exercise by the Commissioner of a discretionary power, then the approach of this court should be similar to that adopted by appeal courts in general when considering appeals against decisions involving the exercise by the court a quo of a discretion.”*

In ITC 1295<sup>83</sup>, Friedman J had said:

*“It is true, and I accept, that this appeal is a rehearing; that this court must itself consider what an appropriate remission would be, but it does not follow that if this court comes to a decision which differs from that of the Secretary, that it will necessarily replace the Secretary’s decision with its own. As I have indicated, the power of remission is the power of remission given by the legislature to the Secretary. Indeed, that this is so is not surprising. The Secretary deals with a large number of cases of this kind. He has yardsticks by which to go and is in a far better position to decide upon appropriate remissions than this court. Where, of course, the Secretary exercises his discretion on an incorrect basis or by taking into account matters which he is not entitled to take into account, this court will disregard the Secretary’s decision and be at large to itself decide upon an appropriate remission. Where, however, the Secretary has properly exercised his discretion in a bona fide manner, then it seems to me that this court will interfere only where there has been an unreasonable exercise by the Secretary of his discretion.”*

Melamet J, however, in ITC 1331<sup>84</sup>, after being referred to ITC 1295 by the Commissioner’s representative regarding the limitation placed on the powers of

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<sup>83</sup> 42 SATC 19 at pages 30-31.

<sup>84</sup> 43 SATC 76 at page 87.

the Special Court to replace the Commissioner's decision with its own, clearly stated that he was not bound by that limitation. He made the following remarks;

*“ . . . we, in the exercise of our discretion, have arrived at an amount by which the prescribed additional tax should be remitted only slightly less than that allowed by the Commissioner for Inland Revenue. In the circumstances we are of the opinion that the decision of the Commissioner for Inland Revenue should not be disturbed.”*

Although Melamet J disagreed with Friedman J as regards the power of the Special Court to rehear matters on appeal, he came to the conclusion that the Special Court on a full rehearing of that specific matter did not come to a conclusion which was significantly different to the decision of the Commissioner. Therefore, he would not disturb the decision of the Commissioner.

## **4.2 THE ROLE OF THE COURTS AS INTERPRETED BY THE APPELLATE DIVISION**

### **4.2.1 The role of the Special Court**

Van Heerden JA in Da Costa's case<sup>85</sup>, rejected Friedman J's view and said that his reasoning,

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<sup>85</sup> At pages 94 - 95.

“cannot be reconciled with the approach of this court in Rand Ropes (Pty) Ltd v CIR, 1944 AD 142. With reference to the provisions of the Income Tax Act 40 of 1925 Centlivres JA said at 150:

*‘That the Legislature apparently thought that it was necessary to give a special right of appeal in cases where a matter is left to the discretion of the Commissioner appears from a number of instances where that special right is conferred . . . In all these cases it seems to me that the Legislature intended that there should be a re-hearing of the whole matter by the Special Court and that that court could substitute its own decision for that of the Commissioner. For as Curlewis JA pointed out in Bailey v CIR, 1933 AD at 220, the Special court is not a Court of Appeal in the ordinary sense: it is a court of revision.’*

*“It seems clear, therefore, that in cases involving the exercise of a discretion by the Commissioner, the Special Court on appeal, is called upon to exercise its own, original, discretion and that the views expressed by Friedman J are not well founded.”*

#### **4.2.2 The role of the Appeal Court**

Regarding the role of the Appeal Court, van Heerden JA had the following to say<sup>86</sup>:

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<sup>86</sup> At page 95.

*“It was also common cause that this court will interfere with the determination of the extent of the penalty (or the exercise of any discretion) by a Special Court only on the limited grounds on which a value judgement of a court of first instance may be set aside or varied on appeal. Prior to the enactment of section 86A of the Act in 1976 (by virtue of Act 103 of 1976) such a determination would have been final unless it was erroneous in law: Rand Ropes case at 150. Section 86A now provides for a full right of appeal against any decision of a Special Court on fact or law. As was pointed out by Trollip JA in Hicklin v SIR, 1980(1) SA 481(A) at 485, such an appeal:*

*‘Is therefore a re-hearing of the case in the ordinary well known way in which this court, while paying due regard to the findings of the Special Court on the facts and credibility of witnesses, is not necessarily bound by them.’*

*“Having pointed out that the section is silent about the powers of this court in such an appeal, Trollip JA went on to say that it was manifestly the intention of the legislature that this court was to have those general powers that are conferred upon it by section 22 of the Supreme Court Act 59 of 1959. In my view it is implicit in these dicta that in an appeal from a Special Court those powers should be exercised according to the principles and subject to the restrictions applicable to appeals in general. And, there is indeed no reason to differentiate between an appeal from a Special Court and an appeal from a local or provincial division. Unlike the position obtaining in a Special Court where a decision is given on facts which may not have been considered by the Commissioner, this court hears an appeal from a Special Court on the record of the proceedings in that court. It follows that if a decision of a Special Court is based on the exercise of a discretion, this court will interfere only if the Special Court did not bring an unbiased judgement to bear on the question, or did not act for substantial reasons, or exercised its discretion capriciously or upon a wrong principle: Ex Parte Neethling & Others, 1951(4) SA 331(A) at 335.”*

### 4.2.3 Commentary

It is surprising that Friedman J, a well respected judge in the Natal Provincial Division, came to such a obviously incorrect decision in spite of previous Appellate Division decisions which clearly set out the procedure for appeals against the Commissioner's discretion in terms of section 76 of the Income Tax Act and which he was obliged to follow in terms of the *stare decisis* doctrine.

It is also surprising that the Commissioner's representative in ITC 1331<sup>87</sup> persisted in requesting the court to follow the unsound reasoning of Friedman J.

It is this apparent unwillingness of revenue to accept that they might be wrong that led to the taxpayer in the Da Costa case once again having to proceed through the courts all the way to the Appellate Division merely for the Appellate Division to predictably restate the principle that the Special Court, when called upon to decide on the question of penalties, must, "... exercise its own, original discretion ...".

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<sup>87</sup> 43 SATC 76.

In KBI v Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk<sup>88</sup>, the taxpayer had depreciated his stock-in-trade by 5% - without the approval of the Commissioner in terms of section 22(1)(a) of the Income Tax Act. The Commissioner contended that since the taxpayer had not disclosed this information in his return, he had committed an offence in terms of section 76(1) (a) or (b) in that he “omitted” an amount from his return which ought to have been included therein or “made an incorrect statement” in his return which resulted in the assessment of normal tax at an amount which was less than the tax properly chargeable. It was common cause that the taxpayer’s failure to mention the depreciation in its returns was not an attempt to evade taxation and the issue before the court was whether penalties were payable as a result of this failure.

The Commissioner contended that the Special Court was not competent to consider his discretion exercised in terms of section 22(1) to determine the value of the taxpayer’s stock-in-trade, because a decision of the Commissioner in terms of section 22(1) was not subject to appeal. He also contended that the fact that he had only imposed a penalty of 50% of the additional tax payable indicated that he had properly exercised his discretion in terms of section 76 and that there was accordingly no grounds upon which the Special Court could interfere in spite of the fact that the Appellate Division in Da Costa’s case had decided otherwise.

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<sup>88</sup> 58 SATC 273.

The Appellate Division held that the Commissioner for Inland Revenue's argument confused two separate discretions – in terms of section 22(1)(a) the Commissioner could approve a reduction of the cost price of stock and his decision in this regard was not subject to appeal but if he did not approve the reduction and imposed additional tax, the exercise of a further discretion came into play, that is, he would have to decide whether to impose a penalty and, if so, what the extent thereof would be; and where the Commissioner decided to impose a penalty, such a decision would be subject to appeal in terms of section 76(2)(b) and a Special Court was entitled to replace his decision with its own impartial judgment.

The Special Court had held that the Commissioner had unreasonably exercised his discretion in not allowing the 5% depreciation of the stock value and in finding in favour of the taxpayer, remitted the penalty *in toto*. The Special Court had also held that it could not interfere with the Commissioner's unreasonable decision to impose normal tax on the amount of depreciation of the stock value not disclosed since there was no appeal against the Commissioner's discretion in terms of

section 22<sup>89</sup> and unreasonableness on its own did not constitute a ground for review of a non-appealable discretion of the Commissioner.

The Appellate Division held that the Special Court had not erred in finding that reasonableness or otherwise of depreciation of the stock value was obviously an important factor and, also, the reasonableness or otherwise of the Commissioner's decision not to approve the depreciation in terms of section 22 when the question of penalties arose and thus that the Special Court had not exercised its discretion improperly by emphasising the importance of the depreciation and remitting the penalty imposed *in toto*.

The grounds for review of an administrative action have now been extended, it is submitted, to include unreasonableness<sup>90</sup>.

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<sup>89</sup> Although there is no provision for objection and appeal against the Commissioner's discretion in terms of section 22, the discretion is subject to review by the courts. The courts in the past only interfered with an administrative discretion not subject to objection and appeal on specific grounds, namely, if the judgement was erroneous in law or fact, if the person vested with the discretion did not bring an unbiased judgement to bear on the question, did not act for substantial reasons or exercised his discretion capriciously (*mala fides*) or upon a wrong principle. See Da Costa v CIR, 47 SATC 87 at page 95. Unreasonableness, on its own, was not one of the grounds of review. See Ex Parte: Neethling & Others, 1951(4) SA 331(A). However, in terms of section 6 of the Promotion of Administrative Justice Act, No. 3 of 2000, unreasonableness, it is submitted, is now a ground for review on its own. Section 6 of that Act is reproduced in full in Appendix IV.

<sup>90</sup> See footnote 89 above.

#### 4.2.4 Findings

It is submitted that in the Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk case, the Commissioner took a wholly unreasonable attitude as to the right of the Special Court to substitute its own discretion for that of the Commissioner regarding penalties. By arguing the point, the Commissioner was flying directly in the face of a previous decision of the Appellate Division<sup>91</sup>. In spite of finding against the Commissioner, and referring to the Commissioner's unreasonable attitude, the Appellate Division could only award "costs" against the Commissioner. However, "costs" only include "party and party" costs and do not include other expenses associated with the action, such as time wasted by the taxpayer and his staff and other incidentals like travelling expenses.

It is probably for reasons similar to this that the "Katz Report"<sup>92</sup> recommended, under the principle of a taxpayer being "entitled to expect the law to be applied fairly, impartially and consistently"<sup>93</sup>, that enabling legislation be drawn up to provide for cost refunds where revenue has made a serious mistake in dealing

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<sup>91</sup> See CIR v Da Costa, 47 SATC 87.

<sup>92</sup> "Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa", Government Printer, Pretoria, 1995, paragraphs 12.2.12 to 12.2.15, pages 134 to 136.

<sup>93</sup> In accordance with section 33(1) of the Constitution.

with a taxpayer's affairs. It also recommends that a written undertaking be given by the revenue authorities, based on the United Kingdom "Code of Practice", that:

*"If we make a serious mistake in dealing with your tax affairs, we will pay any reasonable costs you incur as a direct result of our mistake. Examples might be professional fees, incidental personal expenses, wages, or fees which you would have earned and which you lost through having to sort things out. They could also include such items as postage and telephone charges."*

The 'Katz Report' also refers to the United Kingdom Code as to what might constitute a serious mistake:

*"We would consider a mistake serious if we had taken a wholly unreasonable view of the law - as opposed to a genuine difference of opinion between us about the law - or if we had started or pursued inquiries into matters which were obviously trivial on the basis of the facts available at the time."*

The principle recommended by the 'Katz Report' has, as its foundation, the Constitution. Section 33 provides that: "Everyone has the right to administrative action that is lawful, reasonable and procedurally fair."

Nothing has been done, so far, by the revenue authorities to implement these recommendations.

### 4.3 CONCLUSION

It is submitted that the Commissioner's representative has a duty not to perpetuate an obviously incorrect judgement to further (as he did in ITC1331) the Commissioner's interests. Correctly, the Commissioner's representative when arguing his case in front of the Appellate Division in Da Costa's case, conceded, without argument, that the approach as set out by Melamet J in ITC 1331, was the correct approach to follow. Why then, did he thereafter, try to undermine the Da Costa decision by arguing in the Special Court, later before the full bench of the Orange Free State Division of the Supreme Court (now referred to as the High Court) and finally before the Appellate Division in the Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk case, that the Special Court had no power to substitute its decision for his decision even if he had improperly exercised his discretion?

Whatever the reasons are for the arrogant attitude of the revenue authorities, it is submitted that it is time that their attitude changed. There is no room under the Constitution for an attitude which assumes that revenue officials are above the law and are always correct. In fact, even before the promulgation of the Interim Constitution in 1993, there was no room for such an attitude.

A “Code of Conduct”, as recommended by the “Katz Report”, is not necessary in theory. Our judiciary protects our constitutional rights. However, many taxpayers are unaware that their rights are protected by the Constitution. In practice, therefore, it is submitted that the “SARS Client Charter”<sup>94</sup> be expanded to incorporate a “Code of Conduct” as recommended by the Katz Report. It is submitted that such a “Code of Conduct” be included on every return as well as be sent or given to all taxpayers at the time of any investigation into their affairs. This would stop the revenue authorities from pursuing a course of conduct which is obviously incorrect and which they know or ought to know, is unconstitutional.

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<sup>94</sup> Reproduced in full in Appendix III and included in every taxpayer’s annual return of income (Form IT12).

**CHAPTER 5**                    **“EXTENUATING CIRCUMSTANCES” - THE GENERAL**  
**MEANING OF “EXTENUATING CIRCUMSTANCES”**  
**FOR THE PURPOSES OF SECTION 76(2)(a) OF THE**  
**INCOME TAX ACT**<sup>95</sup>

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**5.1**    **INTRODUCTION**

In the case of Lutterworth Rugby Football Club v Commissioner of Customs<sup>96</sup>, a football club successfully disputed the argument of the revenue authorities that the bar takings of the club were under-declared. The tax tribunal appointed to hear the appeal declined to impose tax or penalties on the club on the basis that the bar was not run as a commercial activity as it “was often staffed by volunteers not necessarily numerate or even sober. Confusion as to charges and change could easily occur”. Perhaps the confusion arose because the volunteer barmen had been supplied free drinks for staffing the bar.

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<sup>95</sup> This chapter is based on an article written by the author (G K Goldswain) entitled “The General Meaning of Extenuating Circumstances for the Purposes of Section 76(2)(a) of the Income Tax Act”, *Meditari - Accountancy Research*, Volume 9, Butterworths, 2001, pages 123 - 135.

<sup>96</sup> MAN/86/405 at page 406.

The Lutterworth decision, although handed down by a foreign court (but which carries persuasive authority in South Africa), illustrates the general principle that, if there are special circumstances in a case, the moral blameworthiness of a taxpayer for the under-declaration of income can be substantially reduced and may in some instances even be regarded as non-existent. Section 76(2)(a) of the Act recognises this general principle and makes special provision for the remission of the penalties that may be imposed on a defaulting taxpayer in terms of section 76(1).

## 5.2 **REMISSION OF PENALTIES IN TERMS OF SECTION 76**

As discussed previously in this dissertation<sup>97</sup>, a penalty imposed in terms of section 76(1) can be very harsh - as much as 200% of the amount of the tax defaulted. However, section 76(2)(a) provides for the following relief:

*“The Commissioner may remit the additional charge imposed under subsection (1) or any part thereof as he may think fit: Provided that, unless he is of the opinion that there were extenuating circumstances, he shall not so remit if he is satisfied that any act or omission of the taxpayer referred to in paragraph (a), (b) or (c) of subsection (1) was done with intent to evade taxation.”*

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<sup>97</sup> See paragraph 3.3 of chapter 3.

In addition, section 76(2)(c) provides that:

*“Notwithstanding the provisions of this subsection, the Commissioner may either before or after an assessment is issued agree with the taxpayer on the amount of the additional charge to be paid, and the amount so agreed upon shall not be subject to any objection and appeal.”*

Section 76(2)(a), read in conjunction with section 76(2)(c), can be analysed as follows:

- If the taxpayer had no intention to evade the payment of tax, the Commissioner has the discretion to remit the whole or part of the 200% penalty that has been imposed, but he is not obliged to remit the penalty even if there was no intent on the part of the taxpayer to evade tax<sup>98</sup>. It is, however, highly unlikely that where there was no intention to evade tax and

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<sup>98</sup> Nestadt J in CIR v Di Ciccio, 47 SATC 199, stated that the intention to evade is not *a sine qua non* for the operation of section 76(1). Carelessness or negligence or even inadvertence on the part of the taxpayer brings section 76(1) into play. He continued as follows at page 205:

*“In other words, then, no particular form of mens rea is required. The question is simply whether, objectively considered, there was an omission of an amount which ought to have been included or an incorrect statement.”*

the taxpayer has given a satisfactory explanation for the default, the Commissioner would not consider remitting the penalty, at least in part.

- If the Commissioner is satisfied that the taxpayer did intend to evade the payment of tax, he may not remit the 200% penalty imposed, unless he is of the opinion that there are “extenuating circumstances”. If the Commissioner should find that there are “extenuating circumstances”, he may remit the 200% penalty as he sees fit.
- The Commissioner is nevertheless competent to impose a penalty (of up to 200% of the amount of the default in tax, or even not to impose a penalty) by agreement with the taxpayer even where there was intent on the part of the taxpayer to evade tax.
- When the taxpayer and the Commissioner have agreed on the amount of the penalty to be imposed, the taxpayer may not thereafter appeal against the penalty agreed upon to the Special Court or to any penalty

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sioner's<sup>9</sup><sup>9</sup>.

The main problem areas that arise from the analysis of section 76(2)(a) are:

Firstly, if there is no intention to evade tax, but a taxpayer has committed a section 76(1) offence, what factors are taken into account or should be taken into account by the Commissioner or, on appeal by the courts, in deciding whether any penalty imposed should be remitted and do these factors bear the same meaning as “extenuating circumstances”?

Secondly, what constitutes “extenuating circumstances” for the purpose of remission of penalties in the case of a deliberate intent on the part of a taxpayer to evade the payment of tax?

It is beyond the scope of this dissertation to devote special attention to the level of penalties imposed once “extenuating circumstances” or other factors are found to be present. The reader will, nevertheless, be able to draw preliminary conclusions in this regard, because, in appropriate cases, the level of the penalty

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<sup>99</sup> See Chapter 4 and specifically CIR v Da Costa, 47 SATC 87 .

imposed will be mentioned in relation to the “extenuating circumstances” that were found to be present.

The controversial issue of permitting the Commissioner and the taxpayer to agree on the amount of the penalty (even when the taxpayer intended to evade the payment of tax) will also not be discussed in this dissertation<sup>100</sup>. Since any agreement reached between the Commissioner and the taxpayer is confidential and not open to objection and appeal, there is no public record from which the researcher can obtain such information and upon which commentary on the practice can be based<sup>101</sup>. In fact, in terms of section 4 of the Act, the Commissioner is obliged to preserve secrecy regarding all matters (not only tax matters) that come to his attention.

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<sup>100</sup> The circumstances under which the Alternative Dispute Resolution (“ADR”) process can be applied in terms of the recently promulgated (2001) section 107B, is also considered to be beyond the scope of this dissertation and is not discussed in any great detail. It is, nevertheless, mentioned in the final conclusion as having the potential to reduce friction between the revenue authorities and the taxpayer provided that the revenue authorities do not attempt to misuse the process for their own ends thereby contravening a taxpayer’s constitutional rights. The section and the regulations pertaining to the section, are reproduced in full in Appendix II.

<sup>101</sup> It is submitted that this route is followed by the revenue authorities in those circumstances where evidential difficulties are foreseen in relation to any offence committed by a taxpayer.

Section 75A can override the secrecy provisions of section 4, but only in very limited circumstances. It provides that the Commissioner may publish from time to time for general information, the name, particulars of the tax offence committed, amount of tax and additional tax involved and particulars of the fine or penalties imposed on a taxpayer who has been convicted of a tax offence in terms of sections 75 or 104 or paragraph 11A(7) or 30 of the Fourth Schedule or paragraph 19 of the Seventh Schedule of the Act or the common law. It is imperative to note that there must first be a conviction in a court of law. The Special Court cannot and does not convict a tax defaulter in terms of section 75 or in terms of the other provisions mentioned above. Rather, the Special Court imposes additional tax or penalties in terms of section 76 of the Act.

Therefore, for the Commissioner to be able to publish the details of a tax offender in terms of section 75A of the Act, he should prosecute him through the ordinary courts and obtain a conviction either in terms of section 75 or section 76 of the Act. This route can either be followed before or after the Special Court has confirmed or substituted a penalty that had been imposed by the Commissioner. Alternatively, the Commissioner may proceed directly through the criminal court system without applying penalties in terms of section 76 and charge the taxpayer with common law fraud.

The Commissioner may not publish a tax offender's name in a case in which the offender has agreed with the Commissioner on the amount of the penalty because the taxpayer would not have been convicted of a stipulated offence. This applies even if the Special Court imposes a penalty. Nevertheless, should the taxpayer appeal to the High Court (formerly known as the Supreme Court) against a Special Court decision, the name or identity of the taxpayer may be published.

Anyone who contravenes the secrecy provisions of the Act is guilty of an offence and is liable, upon conviction, to a fine or to imprisonment for a period not exceeding two years.

### **5.3 THE GENERAL MEANING OF “EXTENUATING CIRCUMSTANCES”**

#### **5.3.1 Introduction**

AA Landman<sup>102</sup>, in an article in which he examines aspects of penalties in tax matters, correctly remarks that there is no definition of “extenuating circumstances” in the Act. He is of the opinion that the generally accepted meaning of the phrase can be found in R v Biyana<sup>103</sup>, in which Landsdown JP said:

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<sup>102</sup> AA Landman, “Treble Tax: An Examination of Aspects of Additional Tax”, Volume 6, Modern Business Law, 1984, page 107 at page 108.

<sup>103</sup> 1938 ECD 310 at page 311.

*“In our view an extenuating circumstance . . . is in fact associated with the crime which serves in the mind of reasonable men to diminish, morally albeit not legally, the degree of the prisoner's guilt.”*

Landman further states<sup>104</sup>:

*“It is submitted that extenuating circumstances have a narrower meaning than mitigatory circumstances. The Afrikaans text used the words ‘versagtende omstandighede’ which in criminal law may mean extenuating circumstances or mitigatory circumstances. Broadly the distinction between extenuating circumstances and mitigatory circumstances is that the former relate to the circumstances present at the commission of the ‘crime’ whilst the latter would embrace all other circumstances including those which are present at the time punishment is considered.”*

He comes to the conclusion that the concept of “extenuating circumstances” as found in section 76(2)(a), “ . . . bears the same or similar meaning as in criminal law.”

He also submits<sup>105</sup>:

*“The emphasis on the past tense in section 72(2)(a) of the Act - ‘there were extenuating circumstances’- restricts the relevant*

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<sup>104</sup> Also at page 108 of his article.

<sup>105</sup> Also on page 108 of his article.

*circumstances to those which were present at the stage of the default.”*

### **5.3.2 Interpretation of “extenuating circumstances” by the courts in income tax matters**

Ogilvie Thompson JA in the Appellate Division case of SIR v Somers Vine<sup>106</sup>, held in his majority judgement that, in construing the meaning of words it is possible to refer to the unsigned version of the Act. He said<sup>107</sup>:

*“While the English text of the (Income Tax) Act is the signed version, it is, on the principle set out in Peter v Peter & Others, 1959(2) SA 347(A) at 350-1, and applied in CIR v Witwatersrand Association of Racing Clubs, 1960(3) SA 291(A) at 302, in my opinion permissible to refer to the Afrikaans text.”*

Van Heerden JA, in CIR v Da Costa<sup>108</sup>, went further when he stated “. . . regard may be had not only to the extenuating circumstances but to all relevant factors.”

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<sup>106</sup> 29 SATC 179.

<sup>107</sup> At page 187.

<sup>108</sup> 47 SATC 87 at page 97.

Regarding “relevant factors”, he found<sup>109</sup>, “. . . the means of the taxpayer clearly may be - and in the present case were - a relevant factor in determining the quantum of the reduced penalty.”

In addition, the judge in ITC 1612<sup>110</sup>, used the words “mitigating circumstances” rather than the phrase “extenuating circumstances” in relation to the remission of penalties in terms of section 76(2)(a).

Based on the views of Ogilvy Thompson JA in Somers Vine (that the meaning ascribed to the Afrikaans wording is permissible in interpreting the meaning to be ascribed to it in English, even if the legislation was signed in English and could bear a different meaning), van Heerden JA in Da Costa and Conradie J in ITC 1612, it is submitted that the distinction between the two phrases (“extenuating circumstances” and “mitigatory circumstances”) is merely an academic debate in income tax matters. In practice there is no distinction.

It is further submitted that the court is not restricted to the relevant circumstances existing at the time of the default but regard can be had to circumstances which

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<sup>109</sup> Also at page 97.

<sup>110</sup> 59 SATC 180 at page186.

arise subsequently. In ITC 1430<sup>111</sup>, Mullins J made the following comments in this regard:

*“Nor does it seem to me that the Special Court is restricted to evidence of facts existing as at the date of assessment or of imposition of the additional charges. This would be the situation in an ordinary civil or criminal appeal, where the court on appeal is confined solely to the record (author’s underlining). Even on questions of sentence, an appeal court will usually not concern itself with events subsequent to the date of original imposition of the sentence. R v Hobson 1953 (4) SA 464 (AD); R v Verster 1952 (2) SA 231 (AD).*

*“In the present case, however, we have to decide not whether the Commissioner’s decision was correct or not, but how we should exercise our discretion. There seems therefore to be no logical reason why we should not consider the facts existing as at the date of the appeal in exercising our powers on appeal, under s 83 (13) (b), whether to ‘reduce, confirm or increase the amount of the additional charge imposed.’ It would, for example, require us to sit with blinkers if we were obliged to close our minds to the fact of the supervening death of the taxpayer, (author’s underlining) as well as to certain other facts to which I shall refer.”*

Mullins J referred to the “other facts” that he felt obliged to consider<sup>112</sup>, namely, that the taxpayer was married and had four minor children, and that his estate was apparently insolvent to the extent of R19 613 (which amount included penalties of R66 195). If the penalties were to be remitted, the estate might just be solvent,

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<sup>111</sup> 50 SATC 51 at page 56.

<sup>112</sup> At page 58.

because the R19 613 insolvency amount did not include administration expenses, liquidation costs or possible claims for the maintenance of the taxpayer's four minor children. He went even further by stating that, if the penalties were not remitted, the concurrent creditors and the minor children would be prejudiced and it would be them, rather than the deceased taxpayer, who would be punished.

Regarding the principle of deterrence in punishing a person, he commented as follows<sup>113</sup>:

*"In so far as additional charges are intended to punish the taxpayer, therefore, such object falls away on the taxpayer's death. Similarly there can be no deterrent effect in so far as the taxpayer is concerned.*

*"The only possibly remaining object in not remitting additional charges at this stage, is the deterrent effect on other persons. In our view any remission of additional charges by this court is hardly likely to come to the notice of many other taxpayers."*

Previously, Mullins J had said<sup>114</sup>:

*"Presumably the phrase 'extenuating circumstances' in its broad sense, would mean, as it does in criminal law, facts 'which serve in the minds of reasonable men to diminish, morally albeit not*

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<sup>113</sup> Also at page 58.

<sup>114</sup> At page 55.

*legally, the degree of the (taxpayer's) guilt.' R v Biyana 1938 ECL 310; R v Fundakubi, 1948 (3) SA 810 (AD). However in regard to remission of additional charges, I am of the view that factors other than the moral guilt of the wrongdoer may be considered as extenuating circumstances."*

It is submitted that Mullins J, together with van Heerden JA, have succeeded in shaping the meaning of "extenuating circumstances" for the purposes of section 76(2)(a) to include factors not normally regarded as "extenuating circumstances" in criminal law cases. The fine line, although lip service is sometimes paid to it, between "extenuating circumstances" and other factors that are taken into account in deciding the level of the penalty to be imposed, has also been blurred. It is submitted that this is a fair and equitable way to approach the matter, as was illustrated in CIR v Da Costa<sup>115</sup>.

In the aforementioned case, the taxpayer was an immigrant of humble origin who had had little schooling. Through hard work he ultimately established a thriving corner-café business. He entrusted the bookkeeping and the handling of his tax returns to a firm of accountants whom he regarded as possessing the necessary knowledge and skill regarding such matters. After an investigation by the Commissioner's office, the taxpayer's income was found to be understated and tax of approximately R15 500 owing. A penalty of 100% (or in terms of a legalistic

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<sup>115</sup> 47 SATC 87.

perspective, a 50% remission) was imposed on the taxpayer in spite of the fact that the Commissioner's representative made it clear that no intention to deceive was being imputed against the taxpayer in his personal capacity. The basis for the penalty was that the taxpayer should be punished for the deceit of his agents.

The Special Court took the view that, because the taxpayer's agents had acted with intent to evade tax, the penalty could not be remitted unless "extenuating circumstances" were found to exist. The extract from the Special Court judgement, quoted with the approval of the Appellate Division<sup>116</sup> is enlightening as to what the Special Court (and the Appellate Division) regarded as "extenuating circumstances", namely:

*"The taxpayer, it appears, is a man of 59 years of age who, when he migrated to South Africa, was a farm labourer. He had no more than four to five years of schooling. He acquired his 'corner café' by paying off the purchase price in instalments, working seven days a week for 12 to 13 hours a day. He has five children, two of whom are still at school. He has paid the additional normal tax and the penalty of R15 590. He appeared to the court to be a man without guile and patently honest, who believed that by entrusting the bookkeeping of his business and the handling of his tax to people whom he regarded as professionals in the field of accounting and taxation matters, he was doing all that was required of him with regard to the payment of tax. Ignorance, naivete, semi-literacy, and a simple-minded (albeit misplaced) confidence in an apparently reputable firm of accountants,*

*together with a single-minded devotion to the task of making a living for his wife and children they were rearing all constitute strong, indeed very strong, extenuating circumstances.”*

However, van Heerden JA was not convinced that the Special Court had adopted the correct approach in imputing the intent to evade tax from the accountants to the taxpayer. He commented, as follows<sup>117</sup>:

*“The Special Court’s approach was clearly that, because in its view the respondent’s agents had acted with intent to evade taxation, the penalty could not be remitted unless extenuation existed. Assuming that such intent can be ascribed to the aforesaid firm, I am not satisfied that the court a quo adopted the correct approach. The key words of s 76(2)(a) are ‘any act or omission of the taxpayer . . . done with intent to evade taxation’, and it is certainly arguable that this phrase applies only to an actual – and not also an imputed – intention of the taxpayer. However, in view of the conclusion at which I have arrived, I find it unnecessary to decide this point. I shall therefore assume in favour of the appellant (the Commissioner) that the penalty could not be remitted unless extenuating circumstances were present.”*

This point was considered by the judge in ITC 1486<sup>118</sup> (in relation to the Sales Tax Act<sup>119</sup>, which had similar wording to the Income Tax Act in provisions relating to the imposition of penalties). He held that the intent of a few employees could not be

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<sup>117</sup> At page 97.

<sup>118</sup> 53 SATC 39.

<sup>119</sup> No. 103 of 1978.

imputed to the taxpayer, but that some blameworthiness attached to the taxpayer in that the taxpayer failed to exercise proper supervision over its employees. The court was of the opinion that<sup>120</sup>:

*“If the Legislature had wished to attribute the intent of the employee to the taxpayer it could easily have so provided and in the absence of such provision this is not to be presumed. Halsbury's Laws of England (4ed) vol 23 para 1588 (fn); Commissioner for Inland Revenue v Da Costa.”*

Van Heerden JA also dealt with the submission of the Commissioner's representative that the Special Court erred in taking into account the taxpayer's financial position as an “extenuating circumstance”. He dismissed the submission as follows<sup>121</sup>:

*“The short answer is that the court did not do so. Having found that there were extenuating circumstances, the court merely said that a penalty of R3 000 could not conceivably ‘be regarded as trifling to a person of the taxpayer's means, enjoying the life-style he does’. It appears to me that the submission in question tends to confuse two separate enquiries. If intent to evade taxation was present, the first enquiry in terms of s 76(2)(a) is whether there were extenuating circumstances. If the answer is in the affirmative, the second enquiry is whether the additional charge or any part thereof should be remitted. For the purposes of the second enquiry regard may be had not only to the extenuating circumstances but to all relevant factors. And the means of the taxpayer clearly may be - and in the present case were - a*

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<sup>120</sup> At page 48.

<sup>121</sup> At pages 97-98.

*relevant factor in determining the quantum of the reduced penalty.”*

These words imply that once “extenuating circumstances” have been found to be present, then, even in the most blatant cases of tax evasion, other factors can be taken into account in determining the level of the penalties to be imposed.

The courts have often said that there is no room for equity in taxation. If a person falls within the letter of a provision, he is taxable, no matter how inequitable it may seem. However, judges prefer to find an equitable solution, if at all possible. In CIR v Nemojim (Pty) Ltd<sup>122</sup>, Corbett JA, with some sense of satisfaction, commented as follows:

*“It has been said that ‘there is no equity about a tax’. While this may in many instances be a relevant guiding principle in the interpretation of fiscal legislation, there is nevertheless a measure of satisfaction to be gained from a result which seems equitable, both from the point of view of the taxpayer and from the point of view of the fiscus. And it may be fairly inferred that such a result is in conformity with the intention of the legislature.”*

Perhaps van Heerden JA and Mullins J were giving expression to these sentiments when defining, very liberally, the meaning of “extenuating circumstances” for the purposes of section 76(2)(a) of the Act. It is submitted that

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<sup>122</sup> 45 SATC 241 at page 267.

with the harsh penalties that are prescribed for tax evasion, and with the taxpayer at an unfair advantage regarding the reverse burden of proof, the judiciary have correctly endeavoured to lessen the burden of the taxpayer by including in the interpretation of “extenuating circumstances”, factors that are not normally taken into account for criminal law purposes.

Landman<sup>123</sup> also argues that section 76(1) emphasises the subjective state of mind of the taxpayer at the time of the act or omission referred to in that section. Accordingly, in deciding whether or not there are extenuating circumstances, he argues:

*“ . . . it would not be proper to take into account . . . objective factors such as the fact that the taxpayer has not previously defaulted, etc. It would also be irrelevant to consider the effect of the penalty on a taxpayer and his dependants at this stage.”*

It is submitted that the author’s reasoning is flawed in this respect. It is agreed that the subjective state of mind of the taxpayer is emphasised<sup>124</sup>, but the objective factors are not excluded and should be taken into account as “extenuating

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<sup>123</sup> At page 108 of his article.

<sup>124</sup> While this is entirely true, it is obvious that it is a very difficult task to read the mind of the taxpayer at the time of the act or omission. Justice Salmond, speaking in the Privy Council around 1860, is reputed to have said, “the thought of man is not triable for the Devil himself knoweth not the thought of man”.

circumstances”. After all, the state of mind of the taxpayer (subjective test), in many instances, can only be established by reference to objective factors. That this is so has been demonstrated in many cases, especially in those cases dealing with whether a receipt, for the purposes of the definition of “gross income” in section 1 of the Act, is of a capital nature or not.

In Malan v KBI<sup>125</sup>, the court held that a person’s *ipse dixit* is not conclusive and inferences may be drawn from the surrounding circumstances. Grosskopf J indicated that a taxpayer’s *ipse dixit* as to his intention may not be accepted by the court, not because his honesty is doubted, but because<sup>126</sup>:

*“Mense se bedoelings is dikwels wisselend, ongevorm en ongefomuleer, en hul ex post facto getuienis daaroor, hoewel eerlik, is dikwels onbetroubaar, of bestaan uit blote rekonstruksie.”*

Prior to this case, Miller J in ITC 1185<sup>127</sup>, had commented:

*“It is no difficult matter to say that an important factor is: what was the taxpayer’s intention . . . ? It is often very difficult, however, to discover what his true intention was . . . It is the function of the court to determine on an objective review of all the relevant facts*

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<sup>125</sup> 43 SATC 1.

<sup>126</sup> At page 7.

<sup>127</sup> 35 SATC 122 at pages 123 - 124.

*and circumstances what the motive, purpose and intention of the taxpayer were . . . This is not to say that the court will give little or no weight to what the taxpayer says his intention was, as is sometimes contended in argument on behalf of the Secretary in cases of this nature. The taxpayer's evidence under oath and that of his witnesses must necessarily be given full consideration and the credibility of the witnesses must be assessed as in any other case which comes before the court. But direct evidence of intent and purpose must be weighed and tested against the probabilities and the inferences normally to be drawn from the established facts."*

In CIR V Pick 'n Pay Employee Share Purchase Trust<sup>128</sup>, the Appellate Division held in its majority judgement delivered by Smalberger JA that:

*"As was pointed out in Secretary for Inland Revenue v The Trust Bank of Africa Ltd 1975 (2) SA 652 (A) at 669E-G*

*'In an enquiry as to the intention with which a transaction was entered into for the purpose of the law relating to income tax, a court of law is not concerned with that kind of subjective state of mind required for the purposes of the criminal law, but rather with the purpose for which the transaction was entered into.'*

*"Contemplation is not to be confused with intention in the above sense. In a tax case one is not concerned with what possibilities, apart from his actual purpose, the taxpayer foresaw and with which he reconciled himself. One is solely concerned with his object, his aim, his actual purpose."*

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<sup>128</sup> 54 SATC 271 at page 281.

Even when the taxpayer has not committed fraud or evaded tax, the courts, in determining whether penalties imposed should be remitted, ask whether there are “extenuating circumstances”.

In ITC 1518<sup>129</sup>, a fairly large penalty was imposed by the judge in spite of the fact that the court found that the taxpayer’s returns were not submitted as a result of the oversight of the auditors concerned. The Special Court held that even careless or thoughtless conduct on the part of the taxpayer falls within the ambit of section 76(1), but because the auditors were at fault rather than the taxpayer, “extenuating circumstances” did exist.

Again in ITC 1576<sup>130</sup>, a case in which the taxpayer had only disclosed 12% of his taxable income, the Special Court found that there was no intent on the part of the taxpayer to evade tax. The taxpayer had contended that his bookkeeper was to blame. The bookkeeper testified that the errors that had been made were entirely the result of his mistakes or negligence. Although the taxpayer had not succeeded in proving that there had been no fault on his part in the form of negligence, his reliance on the bookkeeper was regarded as an “extenuating circumstance.”

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<sup>129</sup> 54 SATC 113.

<sup>130</sup> 56 SATC 1.

It is submitted that the judiciary do not regard the fact that the revenue authorities have allowed a fraudulent claim for an expense as a deduction in the past, a claim which is made fraudulently thereafter, in itself as constituting “extenuating circumstances”<sup>131</sup>.

In the light of the above, the phrase “extenuating circumstances” will, for the purposes of this dissertation, refer to all circumstances, considerations or factors which are present and which influence or could have an influence on the fixing of a penalty in terms of section 76, whether or not there was an intention by the taxpayer to evade tax.

#### 5.4 **SUMMARY AND CONCLUSION**

The general meaning of the phrase “extenuating circumstances” is broader than that used in criminal law<sup>132</sup> and incorporates the often-used phrase “mitigating circumstances”<sup>133</sup>. It even extends to circumstances that arise subsequent to the default act or omission<sup>134</sup>. The state of mind of the defaulting taxpayer at the time that the act or omission was committed, and even subsequently, is vital. It should

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<sup>131</sup> ITC 1658, 61 SATC 231.

<sup>132</sup> CIR v Da Costa, 47 SATC 87.

<sup>133</sup> ITC 1612 , 59 SATC 180.

<sup>134</sup> ITC 1430, 50 SATC 51.

be established from the taxpayer's *ipse dixit* (subjective test) and be weighed and tested against the probabilities and inferences drawn from the established facts (objective factors)<sup>135</sup>.

Even in cases in which the court found that there had been no intent on the part of the taxpayer to evade tax, but that there had been carelessness or even negligence on his part, the courts refer to “extenuating circumstances” as a justification for the remission of penalties<sup>136</sup>. It can, therefore, be concluded that once penalties have been imposed, even in cases in which the taxpayer had not intended to evade the payment of tax, the factors that the court considers justifying the remission of a penalty are all included in the generic term “extenuating circumstances” or, in Afrikaans, “versagtende omstandighede”.

From the cases analysed so far, a preliminary list of what the courts regard as “extenuating circumstances” begins to emerge. The extent of the penalty will normally not be determined by a single factor. Rather, it is submitted as a general proposition that the greater the number of prevailing “extenuating circumstances” that can be identified in favour of the taxpayer, the larger the remission of the penalty will be.

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<sup>135</sup> ITC 1185, 35 SATC 122. See also ITC 1658, 61 SATC 231.

<sup>136</sup> ITC 1518, 54 SATC 113; ITC 1576, 56 SATC 1.

The following four chapters will analyse certain specific circumstances or defences pleaded which have been determined by South African courts to be “extenuating” for the purposes of section 76 of the Act.

For the remainder of this dissertation, the words “pleas”, “extenuating circumstances” and “defences” will be used interchangeably or in combination, as appropriate.

**CHAPTER 6**                    **RELIANCE ON PROFESSIONAL AND NON-  
PROFESSIONAL ADVISORS OR STAFF AS  
A DEFENCE OR AN “EXTENUATING  
CIRCUMSTANCE” FOR THE PURPOSES OF SECTION  
76 OF THE ACT**<sup>137</sup>

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**6.1**    **INTRODUCTION**

There can be no hard and fast rule for determining the appropriate penalty for any offence, but since few tax offences or other crimes for that matter, are truly original, their characteristic features repeat themselves regularly. So too, are the same “extenuating circumstances” presented to the courts with unfailing regularity as justification for the remission of penalties in terms of section 76.

The objective of this chapter and the three following chapters is to examine the common and in some cases, even the obscure or unusual “extenuating

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<sup>137</sup> This chapter is based on an article written by the author (G K Goldswain) entitled, “Reliance on Professional and Non-professional Advisors or Staff as a Defence to the Imposition of Penalties in Income Tax Matters”, *Meditari - Accountancy Research*, Volume 9, Butterworths, 2001, pages 137 - 154.

circumstances” and defences that taxpayers have presented and which have been or may be taken into account for the purposes of remission of penalties imposed in terms of section 76.

The reader may find that the same cases are discussed under several headings or defences or pleas. This is deliberate and assists in the analysis of what the courts regard as a complete defence or as an “extenuating circumstance” for the remission of penalties imposed. However, a different component of the case is discussed under each heading.

It is not intended that the circumstances to be discussed are regarded as exhaustive. New factors or circumstances may, in the future, come to be regarded as “extenuating” by the judiciary. In fact, it is submitted that the Constitution could be the catalyst for such a process in the future.

Nor is it intended to imply that if a factor is present which previously has been regarded as an “extenuating circumstance”, that it will be regarded as “extenuating” in all circumstances. In addition, aggravating circumstances may be an aspect in the case which leads the judge to the conclusion that the previously recognised “extenuating circumstances” should be completely ignored or given little weight. Accordingly, an analysis of factors that are regarded as “extenuating” must, of necessity, also involve an examination of aggravating factors.

The order in which possible defences or “extenuating circumstances” are discussed, is not intended to be in order of importance since no single factor will normally determine the extent of the penalty. Rather, as a general proposition, and as was submitted in the previous chapter, the greater the number of defences or “extenuating circumstances” which can be found to be present in favour of the taxpayer, the larger will be the remission of the penalty.

## **6.2 RELIANCE ON PROFESSIONAL AND NON-PROFESSIONAL ADVISORS OR STAFF**

### **6.2.1 Introduction**

One of the most common defences or “extenuating circumstances” pleaded in income tax matters is that the taxpayer relied upon his advisor, be it his lawyer, accountant, bookkeeper or even a member of staff, to assist him in the preparation of his accounting records and consequently his income tax records and the fact that inaccurate returns filed were due to them and not to any intention on the part of the taxpayer to evade taxes. Usually the taxpayer would allege in his defence that the professional advisor was negligent or that the member of staff was incompetent. Another aspect of this plea, which relates specifically to chartered accountants, is that Generally Accepted Accounting Practice (“GAAP”)

principles were applied in the valuation<sup>138</sup> and preparation of the taxpayer's financial statements and tax returns, and therefore, there was no intention by the taxpayer to evade taxes.

A further aspect to the defence is that the professional advice of a tax specialist in relation to tax planning opportunities, was honestly relied on by the taxpayer.

### **6.2.2 Approach of the courts**

The discussion below illustrates that the courts have not generally attempted to make a distinction between professional advisors, non-professional advisors or staff when a taxpayer attempts to plead reliance on someone else as a defence or as an "extenuating circumstance" to the imposition of penalties. Sometimes it is clear from the judgement that the court is referring to a professional advisor, but in most cases the courts use the generic terms "accountant" or "bookkeeper", which terms could include a professional advisor. Accordingly, the approach of the courts is analysed in terms of the following three defences:

- Reliance on Generally Accepted Accounting Practice or on a tax specialist. If this defence is relied upon, a professional

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<sup>138</sup> Included in the term "valuation" would be the valuation all assets (including stock or inventory and shares) and liabilities.

(an accountant or lawyer in the profession) would usually be involved.

- The incompetence, ignorance or negligence of advisors. The courts have referred to a “firm of accountants”, “accountant” or “bookkeeper”, which terms could encompass a professional advisor. Reliance on unqualified staff is also included in this category.
- Perpetuation of tax evasion previously devised and used by someone else. This category includes family members who also act as bookkeepers.

### **6.3 RELIANCE ON GENERALLY ACCEPTED ACCOUNTING PRACTICE OR ON A TAX SPECIALIST**

Reliance on Generally Accepted Accounting Practice was considered in ITC 1489<sup>139</sup>. The taxpayer’s auditor had used the 50% cost of stock method of valuation, which method had been used since the inception of the company. The taxpayer did not admit that its valuation was incorrect, but did not challenge the Commissioner’s valuation, because it was in the Commissioner’s discretion to

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<sup>139</sup> 53 SATC 99.

allow or not to allow a write-down of trading stock in terms of section 22(1) of the Act and such discretion was, and still is, not subject to objection or appeal<sup>140</sup>.

The contention was that the valuation was done in accordance with accepted accounting principles and, therefore, was in accordance with section 22(1). Although it was a very conservative valuation, it was argued that it was done because the company was a one-man business that relied on the expertise of its only shareholder. The worst scenario or calamity basis of valuation was therefore appropriate.

It was also contended that the basis of accounting for stock in 1984 was not as strict as it was in 1990 when the matter came before the Special Court and accountants were tacitly allowed to follow their heads in the valuation of stock. In 1983-1984, the entire issue of valuing stock was being reconsidered by the revenue authorities and by the accounting profession.

Mr Carl Schweppenhauser, a former Commissioner for Inland Revenue, and Mr Cronje, a Deputy Director in the Department, gave evidence in favour of the taxpayer to the effect that prior to 1984, taxpayers adopted various methods of

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<sup>140</sup> For a full discussion on the discretion of the Commissioner in terms of section 22(1) and the role of the Special Court and the High Court to review a discretion of the Commissioner which is not subject to objection and appeal, refer to footnote 89 above.

valuing stock. Furthermore, it was contended that the taxpayer could not be held accountable for the acts or omissions of his accountant unless he himself was to blame in some way.

Conradie J held that a taxpayer cannot make a virtue of adherence to an inappropriate accounting practice. There was no need to value the stock on a calamity basis. Hindsight revealed that it was inappropriate. The Commissioner had not been given an opportunity to exercise his discretion with regard to the amount by which the value of trading stock had been diminished, because he was not told on what basis the accounts had been prepared. By implication, section 22(1) requires proper disclosure, and to merely refer to the value of the closing stock figure as “net realisable value” is an “incorrect statement” for the purposes of section 76(1).

However, on the evidence presented, the judge was not prepared to find that the taxpayer was involved in a tax-evasion scheme. Rather, he found that the taxpayer culpably failed to enquire from his accountant why the year-end stock was valued at only half its cost, because that figure should “leap” from the financial statements at any businessman who could read. If the taxpayer had signed the financial statements without reading them, or if he did see the figures, but did not understand them, then he failed to display the degree of care that is expected of a businessman who conducts a business of the kind that had made him prosper.

In assessing the penalties to be applied, the court did not, by implication, take into account the reliance of the taxpayer on the accounts drawn up by the chartered accountant as an “extenuating circumstance”. It found that the evidence given by Mr Schweppenhauser, a former Commissioner for Inland Revenue, diminished the culpability of the accountant rather than the taxpayer.

Interestingly, the relevant factor taken into account in assessing the penalty was the loss of interest to the *fiscus*, namely the interest on the amount of tax which should have been paid, if the stock had been valued correctly. This loss was determined as R45 000 as opposed to the initial penalty of approximately R90 000 which was a penalty of 100% of the tax assessed. A penalty of R45 000 was accordingly imposed.

Regarding the finding of the judge, it is submitted that he incorrectly dismissed the evidence given to the court by the former Commissioner for Inland Revenue on the basis that, if it were accepted, it would diminish the culpability of the accountant, but would not diminish the culpability of the taxpayer. If the culpability of the accountant were diminished in such circumstances, it only stands to reason that the culpability of the taxpayer would also diminish, provided that the taxpayer had no intention to evade tax. After all, a taxpayer should be able to rely on a professional advisor.

The aspect of relying on a professional was, it is submitted, correctly dealt with in the United States case of Estate of Spruill v Commissioner<sup>141</sup>. The tax court had to determine whether the fraud penalty was appropriately applied to an understatement of estate tax resulting from a large undervaluation of property. The valuation in the return was determined with the advice of an attorney and an accountant and was based on an independent appraisal. The court, in rejecting the penalty imposed by the revenue authorities, had the following to say<sup>142</sup>:

*“When an accountant or attorney advises a taxpayer on a matter of tax law, such as whether a liability exists, it is reasonable for the taxpayer to rely on that advice. Most taxpayers are not competent to discern error in the substantive advice of an accountant or attorney. To require the taxpayer to challenge the attorney, to seek a “second opinion”, ... would nullify the very purpose of seeking the advice of a presumed expert in the first place . . .”*

Similar sentiments were expressed by Maritz J in ITC 91<sup>143</sup>. He was of the opinion that a court of law would not question a set of financial statements drawn up by an auditor of repute unless evidence was led by the Commissioner to the effect that there was a lack of *bona fides* on the part of the auditor.

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<sup>141</sup> 88 TC 1197 (1987).

<sup>142</sup> At page 1245.

<sup>143</sup> 3 SATC 235.

On the other hand, in ITC 1377<sup>144</sup>, Melamet J did not have to decide on the point, but nevertheless remarked that ITC 91 placed

*“. . . too high an effect on the production of correctly drawn and certified accounts. Such accounts may assist the taxpayer in discharging the onus of proof resting on him of establishing that the estimate of the Commissioner is wrong, but I am of the opinion that the mere production in evidence does not shift the onus of proof to the Commissioner to establish thereafter the correctness of his estimate and that the accounts are incorrect.”*

In view of the sentiments expressed by Maritz J and to a certain extent Melamet J, it is furthermore submitted that the judge in ITC 1489 should have attempted to be fair to both parties. If the judge had been inclined to find that the chartered accountant's valuation was “unreasonable”, then he should have indicated what valuation he regarded as “reasonable” or should have allowed the taxpayer and the Commissioner to agree on a reasonable valuation on which the penalty could be based<sup>145</sup>. If this had been done, then the penalty imposed which equated to the interest lost to the *fiscus*, may have been substantially lower.

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<sup>144</sup> 45 SATC 221 at page 227.

<sup>145</sup> The principle of allowing the taxpayer and the Commissioner to go back and agree on a “reasonable” valuation or apportionment, has often been applied in practice. See Ochberg v CIR, 6 SATC 1; Rand Ropes (Pty) Ltd v CIR, 13 SATC 1; CIR v Hickson, 23 SATC 243, ITC 1377, 45 SATC 221, as well as section 83(13)(a) of the Income Tax Act.

In the later Appellate Division case of KBI v Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk<sup>146</sup>, a case which has already been discussed previously in relation to unreasonable actions by the revenue authorities<sup>147</sup>, a similar situation arose. The taxpayer, a motor car dealer, whose stock consisted mainly of new and used cars as well as car parts, had depreciated the value of the motor car stock by 5% without mentioning such depreciation in his returns. Following an investigation into the taxpayer's affairs, the Commissioner for Inland Revenue issued additional assessments that imposed tax on the value by which the stock had been depreciated as well as a penalty of 50% of the additional tax imposed. It was common cause that the taxpayer's failure to mention the depreciation in his returns was not an attempt to evade tax and the issue before the court was whether penalties were payable as a result of the non-disclosure.

The Appellate Division held that the Special Court was correct in remitting the whole penalty, because in deciding whether a penalty should have been levied, the reasonableness or otherwise of the depreciation of the stock was obviously an important factor and, accordingly, also the reasonableness or otherwise of the Commissioner's decision not to approve the depreciation in terms of section 22(1). The Commissioner's decision not to allow the 5% depreciation was found to be unreasonable. In the light of the unreasonableness of the decision of the

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<sup>146</sup> 58 SATC 273.

<sup>147</sup> See paragraph 4.2.2 and footnote 89 above.

Commissioner, the Special Court did not have to consider the part played by the auditors in valuing the stock on hand at a value less than cost. The unreasonableness of the Commissioner's decision in relation to the 5% depreciation of the stock on hand at the year end, constituted a complete defence to the imposition of penalties.

In the Canadian case (Quebec Supreme Court) of Acme Slide Fastener Co v Knotted<sup>148</sup>, the Crown alleged that the taxpayer had understated its profits by understating the value of its closing stock. The Crown presented evidence to the effect that the monthly accounts presented to senior staff showed a higher stock valuation than the financial statements and the tax return, but expert accounting evidence was led on behalf of the taxpayer to the effect that the stock valuation was correct. In relying on the expert witness, the court laid down the fundamental test that should be applied when attending to accounting problems<sup>149</sup>:

*“A distinction must be drawn, at the outset, between poor accounting practices, which may be difficult to unravel, and false or deceptive statements in an income tax return.”*

It is submitted that the approach of the Quebec Supreme Court and the United States Tax Court, in the Acme Slide Fastener and the Sprawl Estate cases

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<sup>148</sup> [1962] CAC 320): 62 D.C. 261 (Que. S.C.).

<sup>149</sup> At page 326.

respectively, is the correct approach and should be followed in South Africa. The calculations for the valuation of stock and other liabilities, when done by a chartered accountant, are of necessity, based upon subjective decisions such as market conditions. If done *bona fide* and with due diligence, even if a different chartered accountant had come to a substantially different valuation, the valuation should not be challenged for the purposes of imposing penalties.

Perhaps the taxpayer in ITC 1489 would have won his case regarding the penalties imposed if, instead of calling an ex-Commissioner of Inland Revenue to testify on his behalf regarding the accounting problem of the valuation of stock, he had produced in his favour, independent expert evidence by a chartered accountant.

Regarding the case of a taxpayer honestly relying on a tax specialist, the recent decision in ITC 1725<sup>150</sup>, is instructive. The taxpayer had been advised by a tax specialist to enter into an unconditional agreement for the supply of feed for his cattle. The question before the Special Court was whether the taxpayer had in fact entered into an unconditional agreement for the supply of the feed. If so, he would be able to claim the cost of such feed as a deduction in terms of section 11(a) of the Act even though the feed had not been delivered by the end of the taxpayer's

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<sup>150</sup> 64 SATC 223.

year of assessment. If, on the other hand, the agreement for the purchase of the feed was conditional on delivery, then the expense would not have met the requirement of having been “actually incurred” for the purposes of section 11(a) and accordingly would not have been deductible at the end of the taxpayer’s year of assessment.

The Commissioner contended that the agreement was conditional, and therefore, that the expense claimed could not be deducted. He also contended that the taxpayer, by claiming an expense which was not justified, had committed a section 76 offence and accordingly, he imposed a penalty of 100% in addition to a section 89*quat* interest charge.

The Special Court agreed with the Commissioner that the feed agreement was a conditional agreement and that the taxpayer was not entitled to the deductions claimed in the relevant years of assessment.

However, as regards the imposition of penalties, the court was of the opinion that although it found against the taxpayer as regards its claim, the fact that the taxpayer had claimed the deduction on the basis of professional advice honestly given, such claim could not simply be treated as a form of tax evasion. The court

remarked that the concept of “actually incurred” as opposed to “actually paid” has vexed tax planners, courts and academic writers since the introduction of income tax and has, in short, been at the very root of legitimate tax planning. Accordingly, there was no justification for imposing a penalty in terms of section 76(1)(b).

Nevertheless, as regards the section 89 *quat* interest charge, the court held that the revenue authorities or State should not be forced to forego interest lost as there had been an exploitation of what was perceived to be a gap in the Act. The planning to obtain a deduction in the case, was ultimately no more than a tax avoidance strategy.

#### **6.4 INCOMPETENCE, IGNORANCE OR NEGLIGENCE ON THE PART OF ADVISORS**

Regarding the plea by a taxpayer that his accountant, bookkeeper or member of staff was incompetent or negligent, the courts have appeared to be inconsistent in respect of the reliance on such persons to be either a complete or partial defence or an “extenuating circumstance”.

In CIR v Da Costa<sup>151</sup>, the taxpayer, an immigrant of humble origin, entrusted his tax affairs to a firm of accountants that used a “short cut” method to determine his income. As a result, there was an under-declaration of income. Although conceding that the taxpayer had no intention to deceive, the Commissioner submitted that the taxpayer should be penalised for the deceit of his agents.

The Special Court found that the deceit of the accountants should be imputed to the taxpayer, but found at the same time that the reliance by the taxpayer on the accountant was an “extenuating circumstance” and substantially remitted the 100% penalty imposed by the Commissioner.

The Appellate Division was not convinced that the deceit of the accountant should be attributed to the taxpayer in the circumstances, but found that it was not necessary to decide the point, because the penalty imposed by the Special Court was reasonable. The Special Court had imposed a penalty of R3 000 in the place of the 100% penalty of approximately R16 000 imposed by the Commissioner.

Although not dealing with section 76 of the Act, but rather with the equivalent provision in the then Sales Tax Act<sup>152</sup>, the Special Court in ITC 1486<sup>153</sup> had to

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<sup>151</sup> 47 SATC 87.

<sup>152</sup> Section 23 of the now repealed Sales Tax Act, No.103 of 1978.

<sup>153</sup> 53 SATC 39.

decide on the point left unresolved by the Appellate Division in the Da Costa case, namely whether the intention of employees to evade tax should be imputed to the taxpayer. The court held that the intent of a few employees could not be imputed to the taxpayer, but some blameworthiness attached to the taxpayer in that the taxpayer failed to exercise proper supervision over its employees. The court was of the opinion that<sup>154</sup>:

*“If the Legislature had wished to attribute the intent of the employee to the taxpayer it could easily have so provided and in the absence of such provision this is not to be presumed. Halsbury’s Laws of England (4ed) vol 23 para 1588; Commissioner for Inland Revenue v Da Costa.”*

In ITC 1295<sup>155</sup>, the Special Court found the taxpayer to have been negligent or, if not negligent, that there was a lack of care by him in not making it his business to ensure that his accountant had available all the relevant information to complete his return correctly. In effect, the court correctly dismissed the reliance on the accountant as a defence. It confirmed the Commissioner’s penalty of 75%, although it regarded the penalty as somewhat severe.

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<sup>154</sup> At page 48.

<sup>155</sup> 42 SATC 19.

The taxpayer in ITC 1430<sup>156</sup>, who died some time before his appeal to the Special Court was heard, had contended that the non-disclosure of income in his return was attributable to his bookkeeper. The Special Court was unimpressed with the argument, because the taxpayer, himself a businessman, had also signed the accounts that reflected such round figures as to invite immediate question. No evidence was led to the effect that the taxpayer was unintelligent or unversed in the preparation of simple statements of income and expenditure. The Special Court could not find that the taxpayer intended to evade tax in spite of suspicions to the contrary, but did find that he was not entitled to shelter behind his accountant. Although it should not be regarded as an aggravating factor, the fact that the taxpayer was an intelligent businessman negated his defence that he had relied on his accountant.

ITC 1612<sup>157</sup> is informative regarding aggravating factors. The taxpayer, a professional man, had over a number of years failed to disclose certain income accruing to him from his professional body in his tax returns. The additional assessments realised additional tax of approximately R305 000 plus a 200% penalty of approximately R610 000.

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<sup>156</sup> 50 SATC 51.

<sup>157</sup> 59 SATC 180.

Even after the investigation by the revenue authorities had commenced and his books had subsequently been confiscated, the taxpayer submitted a false tax return for the 1989 fiscal year, again omitting the income received from his professional body during that fiscal year. In objecting to the 200% penalty imposed for that year, he contended that he had employed an accountant to complete his tax return for that year, but that the accountant was unable to do so correctly because his books had been confiscated by the revenue authorities.

The judge, far from regarding the employment of the accountant to complete his tax return to be a mitigating factor, regarded it to be a severely aggravating factor. His attitude was that the taxpayer was suggesting that the revenue authorities were somehow deliberately keeping the taxpayer's accountant away from the confiscated books whilst simultaneously demanding a return in respect of income for that year. He was satisfied that they were not doing so. In any event, in terms of section 74(5) of the Act, the taxpayer had the right to examine the books under the supervision of the Commissioner.

The judge commented<sup>158</sup> that, prior to the submission of the tax return, the taxpayer had almost all the information he needed from the confiscated books and therefore the complaint was quite absurd, because,

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<sup>158</sup> At page 187.

*“the information concerning the undisclosed cheques was not to be found in the books. Those cheques had been omitted from the books. That is the respect in which the 1989 return is false. It is false not because of lack of access to the books in Mr Tabbed’s possession. It is false because of the concealment by the appellant. Knowing that he was being investigated the appellant did not reveal the truth to Mr B. This, to my mind, shows a cynical determination to press his luck as far as it would hold. It shows no contrition and it also points incidentally, very clearly to the taking of the cheques having been deliberate.”*

In ITC 1518<sup>159</sup>, the judge imposed a fairly large penalty in spite of the fact that the court found that the taxpayers’ returns were not submitted due to the oversight of their auditors. The Special Court held that even careless or thoughtless conduct on the part of the taxpayer falls within the ambit of section 76(1), but because the fault was that of the auditors, “extenuating circumstances” did exist. The 200% penalty originally imposed by the Commissioner was reduced to 60%.

It does not appear as if the Special Court in that case even considered taking into account the *obiter dicta* of the Appellate Division in the Da Costa case<sup>160</sup> or the judgement in ITC 1486<sup>161</sup> to the effect that the fault of the accountant should not be

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<sup>159</sup> 54 SATC 113.

<sup>160</sup> 47 SATC 87.

<sup>161</sup> 53 SATC 39.

imputed to the taxpayer<sup>162</sup>. Perhaps the high penalty imposed was due to the fact that the Special Court was unhappy with the conduct of the taxpayer regarding other aspects of the case<sup>163</sup>.

It is submitted that if the Special Court was influenced by factors other than the intention of the taxpayers regarding the specific offence for which penalties could be imposed, then the Special Court misdirected itself and it is likely that, on review to a higher court, the penalty would have been substantially reduced<sup>164</sup>.

The Special Court in ITC 1540<sup>165</sup> found that the taxpayer had deliberately “creamed” off hundreds of thousands of rand without disclosure to the revenue authorities. The taxpayer had contended that the non-disclosure was the result of the dishonesty and incompetence of his previous accountant. The Commissioner had originally imposed a penalty of 100% of the additional tax liability of approximately R650 000. On objection, the Commissioner reduced the penalty

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<sup>162</sup> In which case no penalty or only a nominal penalty would have been payable.

<sup>163</sup> Excessive managerial remuneration was paid to certain trusts from a company in a scheme to avoid or reduce taxation. The general anti-tax avoidance provision, section 103(1), was successfully invoked against the taxpayer, but since section 103(1) is not a penal section, no penalties could be imposed.

<sup>164</sup> Refer to Chapter 4 especially paragraph 4.2.2 regarding the role of an Appeal Court in reviewing a decision of the Special Court.

<sup>165</sup> 54 SATC 400.

by 15%, that is, to 85%. On appeal to the Special Court, “extenuating circumstances” were found to have existed but the incompetence of the previous accountant was not specifically mentioned as one of the circumstances that contributed towards the remission of the penalty. The court confirmed the 85% penalty imposed by the Commissioner.

In CIR v BP Miller<sup>166</sup>, the taxpayer, a pharmacist, appointed a certain firm of accountants on the advice of his bankers to oversee his business accounts and to attend to his income tax returns. He testified that he gave his accountants all the information they required. However, when he was investigated, he realised that the correct figures had not been disclosed in his tax returns.

The Special Court determined the penalty with reference to the fact that the taxpayer at all times relied on his accountants and made all documentary evidence and bank statements available to them. The Cape Provincial Division confirmed the Special Court’s decision, which was to remit the penalty imposed by the Commissioner from approximately R250 000 (a 100% penalty or 50% remission) to approximately R125 000 (a 50 % penalty or 75% remission).

In ITC 1576<sup>167</sup>, the taxpayer only disclosed 12% of his taxable income. He contended that his bookkeeper was to blame. The bookkeeper testified that the errors that had been made were entirely attributable to his mistakes or negligence.

The Special Court held that there was no intention on the part of the taxpayer to evade tax. However, he had not succeeded in proving that there had been no fault in the form of negligence on his part. Nevertheless, the reliance on the bookkeeper was regarded as an “extenuating circumstance”. The Special Court reduced the original 125% penalty imposed by the Commissioner to 50%.

In ITC 1351<sup>168</sup>, the Special Court found the taxpayer’s attempted explanation for the non-declaration of certain income to be unsatisfactory<sup>169</sup>. Included in his defence was a contention that no penalties should have been imposed because he was unskilled in keeping proper accounts and that he had relied on his bookkeeper to do so.

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<sup>167</sup> 56 SATC 1.

<sup>168</sup> 44 SATC 58.

<sup>169</sup> He contended that certain amounts not disclosed in his return were winnings from horse racing and a loan from his brother-in-law but the evidence produced was contradictory and highly suspicious. It is submitted that even if the onus of proof had not been on the taxpayer, the same finding that the taxpayer was guilty of tax evasion would have been made.

No evidence was given by the bookkeeper in the taxpayer's defence and the court held that the taxpayer should inevitably be held responsible for what occurred even if part of the blame could conceivably have attached to his bookkeeper. The court confirmed the Commissioner's 100% penalty without looking for "extenuating circumstances", based on the incorrect principle that the Special Court is not entitled to interfere with the Commissioner's discretion if it had been exercised properly<sup>170</sup>.

In ITC 1577<sup>171</sup>, the taxpayer, a medical practitioner, failed to declare all his income. He contended that his firm of bookkeepers were negligent and that his staff had not informed him of the administrative problems involved. The Commissioner imposed a penalty of 100% of the additional tax liability amounting to approximately R136 000. His view was that the taxpayer intended to evade his liability for tax but that "extenuating circumstances" existed.

The Special Court held that the taxpayer had made a poor impression on the court and that he had tried to hide behind his bookkeepers and staff. It was specifically

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<sup>170</sup> See CIR v Da Costa, 47 SATC 87, where the reasoning of the judge in ITC 1351 was found to be faulty. See also Chapter 4, especially paragraph 4.2.1 in this regard.

<sup>171</sup> 56 SATC 236.

mentioned that the fact that he did not call his bookkeepers to testify on his behalf was one of the contributing factors that led to his failure to discharge the onus placed on him. In addition, he failed to discharge the onus of proving that he did not have a “direct intent” or “awareness of certainty” to evade tax and that, even on the most favourable approach to his case, he did not exclude the probability of having the intention to evade tax as understood by “awareness of possibility”.

In spite of confirming the Commissioner’s penalty of 100%, the Special Court did not make mention of any specific “extenuating circumstances” being found to justify the remission. The court had to assume and accepted that the Commissioner had originally found “extenuating circumstances” to justify the remission.

It is submitted that the Special Court in that case introduced a new and unjustifiable principle for establishing the intention of a taxpayer in relation to tax evasion, namely “awareness of possibility” (“moontlikheidsbewussyn”). This is purely an “objective test” of intention, whereas in the past, the Special Court had considered intention in relation to tax evasion as a “subjective test” (although objective factors could be considered, to confirm a taxpayer’s intention) and has

been reluctant to find that a taxpayer intended to evade taxation without clear evidence to that effect and in spite of suspicions to the contrary<sup>172</sup>.

In fact, as far as can be established, no court has subsequently used the purely objective test to determine the intention of the taxpayer. This is not surprising, because in 1992 the Appellate Division in CIR v Pick 'n Pay Employee Share Purchase Trust<sup>173</sup> considered the intention of a taxpayer from a subjective point of view. Smalberger JA was not concerned with the possibilities that the taxpayer could have foreseen. Rather, he was concerned with the taxpayer's objective and actual purpose. It therefore appears as if, in ITC 1577, the judge directly contradicted a decision of the Appellate Division.

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<sup>172</sup> See ITC 1295, 42 SATC 19, where the court was unable to find whether the taxpayer "deliberately refrained from asking any questions or whether he simply did not apply his mind to the matter at all." See also ITC 1430, 50 SATC 51, where the court was unable to establish that the taxpayer intended to evade taxation in spite of suspicions to the contrary. Also refer to CIR v BP Miller, 56 SATC 1; CIR v Da Costa, 47 SATC 87 and ITC 1486, 53 SATC 39 in this regard.

<sup>173</sup> 54 SATC 271. Smalberger JA at page 281 said:

*"In a tax case one is not concerned with what possibilities, apart from his actual purpose, the taxpayer foresaw and with which he reconciled himself. One is solely concerned with his object, his aim, his actual purpose."*

In KBI v Mabotsa<sup>174</sup>, the Special Court and the Supreme Court accepted that the blame attached to the taxpayer was minimal as a result of the ignorance of his bookkeeper, but nevertheless held that there is a duty on the taxpayer to ensure that his books and accounts are attended to by persons who have the necessary knowledge to do it properly. The Commissioner originally imposed a 100% penalty of approximately R43 000.

The Special Court reduced the amount to R4 000 on the basis that because the Commissioner froze the taxpayer's bank account he had to go out and borrow money to run his business. The R4 000 penalty was the interest lost to the *fiscus* after taking into account the interest paid by the taxpayer to a third party as a result of having to borrow money to run his business.

The Northern Cape Division of the Supreme Court (as it was then called), then increased the penalty to R20 000, indicating that the R4 000 penalty was inappropriate since too little attention was given to the fact that the loss of interest by the State was close to R20 000.

On the other hand, in ITC 1306<sup>175</sup>, the court found that no blame attached to the taxpayer who relied on his auditors to follow the correct procedure in the

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<sup>174</sup> 55 SATC 98.

<sup>175</sup> 42 SATC 139.

liquidation of his company. If the company had been properly wound up and liquidated in terms of the Companies Act<sup>176</sup>, instead of merely being deregistered, the liquidation dividends declared out of capital profits would have been tax free. Unfortunately, the auditors did not appreciate the fine distinction between a liquidation and a deregistration for income tax purposes when they deregistered the company. The Commissioner imposed penalties on the taxpayer for not declaring the dividends received as income. The court held that the reliance by the taxpayer on the auditors, who were ignorant of the law, constituted a complete defence and no penalties were imposed.

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<sup>176</sup> No. 61 of 1973.

## 6.5 PERPETUATION OF TAX EVASION PREVIOUSLY DEVISED AND USED BY SOMEONE ELSE

The Canadian case of R v Thetrault<sup>177</sup> is an example of a case in which the taxpayer contended that he had innocently relied upon an accounting method devised by a family member, his mother. The taxpayer had taken over the operation of a general store from his parents. His mother had estimated the gross profit of the store at 15% and had used that percentage for 20 years. When the taxpayer took over the store, his mother continued to use the method. A proper system of accounting was introduced, which gave him accurate results, but he continued to rely on his mother's method for tax purposes. When she could no longer prepare his returns, he took his books to an accountant to prepare his tax returns. The accountant's method showed a much higher profit than the taxpayer had expected and he refused to accept the calculations. Instead, he used his mother's method for his tax returns.

The court held that the taxpayer was entitled to rely on a method that had apparently been accepted by the revenue department for more than twenty years.

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<sup>177</sup> [1976] CTC 719.

In effect, the court appeared to favour the idea that the honest mistake of the taxpayer regarding the civil consequences of his method of accounting negated the intention to evade tax. The court went even further and said<sup>178</sup>:

*“Any person, of course, has the right to reject professional advice and in this case the accused did so, and in my view, did so on the basis of the apparent success of his reporting method up to that time in question.”*

It is not surprising then, that the taxpayer in ITC 1331<sup>179</sup> used a similar defence and succeeded to some extent. He and his wife perpetuated a system devised by his uncle and his bookkeeper to defraud the *fiscus* some time before he took over the business. The system estimated purchases rather than using the actual cost of the purchases.

The Special Court held that the taxpayer had had the intention to evade tax, but the fact that the taxpayer did not originate the scheme, but merely continued it, constituted “extenuating circumstances”.

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<sup>178</sup> At page 724.

<sup>179</sup> 43 SATC 76.

## 6.6 FINDINGS

### 6.6.1 Intention of the taxpayer – subjective or objective test?

It is submitted that, except for one decision which incorrectly introduced an objective test to establish the intention of a taxpayer regarding tax evasion<sup>180</sup>, the courts have consistently and correctly applied the subjective test for intention<sup>181</sup>. Accordingly, the courts are reluctant to find a taxpayer “guilty” of tax evasion, except in the most blatant and obvious cases<sup>182</sup>. Rather, the approach of the courts has tended to find that the taxpayer was “negligent”, “careless”, “thoughtless”, “culpable” or “failed to exercise proper supervision over its employees”.

### 6.6.2 Disclosure to advisors – honest disclosure v deliberate intention or attempt to evade tax

It has been established that good-faith reliance on an advisor, be it a professional, a non-professional or even a member of staff, may constitute a defence to a

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<sup>180</sup> ITC 1577, 56 SATC 236.

<sup>181</sup> ITC 1295, 42 SATC 19; ITC 1430, 50 SATC 51; CIR v BP Miller, 56 SATC 1; CIR v Da Costa, 47 SATC 87; and ITC 1486, 53 SATC 39.

<sup>182</sup> ITC 1612, 59 SATC 180, but see ITC 1577, 56 SATC 236 and ITC 1351, 44 SATC 58.

charge of tax evasion, provided that the taxpayer makes a complete and honest disclosure of all the relevant facts to such advisor. The taxpayer should also be able to demonstrate that he submitted his return without having any reason to believe that it was incorrect. If such conditions are met, then, even if there was an intention on the part of the professional advisor to defraud the *fiscus* without the knowledge of the taxpayer, such intention should not automatically be imputed to the taxpayer<sup>183</sup>.

A distinction should be drawn between a return prepared by an advisor with all the information at his disposal and a return submitted by an advisor that is based purely on figures produced by the taxpayer and without review. The latter situation cannot be regarded as an “extenuating circumstance”, because it is difficult to comprehend that the advisor should share any portion of blame for the inaccuracy of the return when the information supplied by the taxpayer is inaccurate. In such a case, the court would have to look for other “extenuating circumstances” to justify a remission of penalties imposed.

The defence is also easily rejected when it is only used as an afterthought to thwart the imposition of a penalty<sup>184</sup>.

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<sup>183</sup> CIR v Da Costa, 47 SATC 87 and ITC 1486, 53 SATC 39.

<sup>184</sup> ITC 1540, 54 SATC 400 and ITC 1295, 42 SATC 19.

It has also been established as a general principle that where a taxpayer has set out on a deliberate course of tax evasion, or there is a suspicion that he has done so, the reliance on an advisor, even if the advisor is negligent, does not usually constitute an “extenuating circumstance” for the purposes of section 76(2)(a)<sup>185</sup>. The one possible exception is where the taxpayer perpetuates an old scheme or system of tax evasion devised by someone else<sup>186</sup>.

In addition, the courts are sceptical of regarding the reliance on advisors as an “extenuating circumstance” when the objective factors indicate that the taxpayer is an intelligent and astute businessman<sup>187</sup>. However, if the advisor is willing to testify to the fact that he was solely or even partly to blame for the errors or omissions in the return, then the courts generally regard such an admission as an “extenuating circumstance”<sup>188</sup>.

### **6.6.3 Reliance on professional as opposed to non-professional advisors**

The courts have made it clear that it is incumbent on the taxpayer to ensure that his books and accounts are attended to by persons who have the necessary

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<sup>185</sup> ITC 1430, 50 SATC 51.

<sup>186</sup> ITC 1331, 43 SATC 76 and R v Thebault, [1976] CTC 719.

<sup>187</sup> ITC 1430, 50 SATC 51.

<sup>188</sup> ITC 1576, 56 SATC 1.

knowledge and skill to do the work properly<sup>189</sup>. Therefore, by implication, the appointment of and reliance on a professional advisor rather than on a non-professional advisor should lessen the blameworthiness or culpability of a taxpayer or even be regarded as a complete defence if an honest mistake had been made by the advisor<sup>190</sup>.

Specifically regarding the valuation, preparation and presentation of annual financial statements in accordance with Generally Accepted Accounting Practice, there is an indication that the courts regard a chartered accountant as an expert in this field and do not lightly disregard his opinion. In fact, the Special Court has postulated that a court of law would not question a set of financial statements drawn up by an auditor of repute unless evidence was led by the Commissioner to the effect that there was a lack of *bona fides* on the part of the auditor<sup>191</sup>.

Unreasonableness on the part of the Commissioner in questioning the valuation of stock done by an auditor in accordance with Generally Accepted Accounting

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<sup>189</sup> KBI v Mabotsa, 55 SATC 98.

<sup>190</sup> ITC 1306, 42 SATC 139.

<sup>191</sup> ITC 91, 3 SATC 235.

Practice has led the Appellate Division to conclude that no penalties should be imposed<sup>192</sup>.

In spite of the fact that the South African courts regard chartered accountants as experts in the field of valuation and presentation of financial statements, they still tend to find the taxpayer to be “negligent” or “culpable” for not having questioned the accountant’s valuation or presentation of the accounts<sup>193</sup>. On the other hand, the courts in other countries appear to be of the opinion that most taxpayers are not competent to question or challenge a professional’s advice or work. They have held that seeking a “second opinion” would negate the very purpose of seeking the advice of a professional in the first place<sup>194</sup>.

Perhaps it is time that the South African courts took heed of the foreign opinions expressed in this regard. It is submitted that our courts and the Commissioner, for that matter, should generally be prepared to accept the opinion of a chartered accountant in the field of valuation and presentation of financial statements

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<sup>192</sup> KBI v Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk, 58 SATC 273.

<sup>193</sup> ITC 1489, 53 SATC 99.

<sup>194</sup> Estate of Spruill v Commissioner, 88 TC 1197(1987) and Acme Slide Fastener Co v Knott, [1962] CTC 320.

provided that no fraud or *mala fides* is involved<sup>195</sup>. It is only in cases where the figures would “leap” out at the reader that they should even be questioned. If this principle were to be formally adopted by our courts and the Commissioner, and it is submitted that such a principle is in accordance with our Constitution<sup>196</sup>, no negligence or culpability could be imputed to the taxpayer if he had not obtained a second opinion. It does not matter that different accountants could come to a substantially different valuation or use a different way of presenting the financial statements of a taxpayer – the valuation and presentation of financial statements are, after all, the subjective opinions of the accountant, albeit, based on objective factors<sup>197</sup>.

Relying on professional advice honestly given cannot simply be treated as a form of tax evasion by the revenue authorities even where a court finds contrary to that which has been claimed as a deduction by the taxpayer<sup>198</sup>.

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<sup>195</sup> See ITC 91, 3 SATC 235 where similar sentiments were expressed.

<sup>196</sup> Section 33 of the Constitution.

<sup>197</sup> As is the case with penalties imposed. Different revenue offices impose different penalties for similar tax offences. The same applies to our courts. They sometimes disagree with the Commissioner’s opinion as to the *quantum* of the penalty which should be imposed in specific circumstances, but they are inclined to approve the penalty set by the Commissioner if the penalty is not wholly unreasonable. See ITC 1331, 43 SATC 76.

<sup>198</sup> ITC 1725, 64 SATC 223.

#### 6.6.4 Misdirection of courts

In a few instances, the Special Court has been inclined to misdirect itself either on a matter of principle<sup>199</sup> or has based its decisions on grounds unconnected with the crime or criminal<sup>200</sup>. On review, at the behest of the taxpayer, these types of decisions are normally reversed by a higher court or even criticised by a higher court in a later decision<sup>201</sup>.

#### 6.7 CONCLUSION

It may be said that the courts are fairly consistent in regarding the reliance on advisors and staff as either a complete defence to the imposition of penalties or an “extenuating circumstance” for the purpose of remitting penalties.

Even in the most blatant cases of tax fraud, it is unusual for a court to impose a 200% penalty<sup>202</sup>. However, telling lies to the court can be regarded as an aggravating factor, as the taxpayer found to his cost in ITC 1612<sup>203</sup>.

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<sup>199</sup> ITC 1577, 56 SATC 236 and ITC 1351, 44 SATC 58.

<sup>200</sup> ITC 1518, 54 SATC 113.

<sup>201</sup> CIR v Da Costa, 47 SATC 87.

<sup>202</sup> Unfortunately, the Commissioner usually attempts, in the first instance, to impose a large penalty, which results in the taxpayer having to look to the courts for relief.

<sup>203</sup> 59 SATC 180.

There is always hope for the taxpayer that, when the Commissioner has imposed a large penalty, an appeal to the Special Court will result in the reduction of the penalty or even no penalty being imposed if the defence pleads that the taxpayer relied on his advisor.

An advisor should never fall into the trap of allowing a taxpayer to submit false returns under his banner and without a disclaimer when he is not satisfied about the honesty of the taxpayer. Doing so can only lead to problems for both the taxpayer and his advisor.

**CHAPTER 7**                      **THE CONDUCT OF THE TAXPAYER - HOW THE**  
**CONDUCT OF A TAXPAYER CAN AFFECT THE LEVEL**  
**OF A PENALTY OR SANCTION IMPOSED IN TERMS**  
**OF SECTION 76 OF THE ACT**<sup>204</sup>

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**7.1**    **INTRODUCTION**

The following factors were examined to establish whether all or any of them constitute “extenuating circumstances” or are regarded as aggravating factors: the planning of the offence, the period for which it continued and its magnitude, the money available and how it was used, the motive of the taxpayer, assistance to the authorities during the investigation, a plea of guilty at the first opportunity, an indication of remorse, and how quickly the taxpayer paid off his tax liability.

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<sup>204</sup> This chapter is based on an article written by the author (G K Goldswain) entitled, “The conduct of the taxpayer - can the conduct of a taxpayer affect the level of a penalty or sanction imposed in income tax matters?”, to be published in Meditari - Accountancy Research, Volume 10, Butterworths, 2002, pages 71 - 85.

## 7.2 THE VAN DER WALT CASE<sup>205</sup>

Although the case of Van Der Walt v S<sup>206</sup> did not deal directly with section 76 of the Act but rather with the common law principles to be applied in dealing with cases of tax evasion after the Commissioner has imposed a 200% penalty in terms of section 76, it is informative regarding the factors or circumstances the judiciary regards as “extenuating” or “aggravating” for both statutory and common law purposes.

The taxpayer accepted the 200% penalty, amounting to some R423 000, imposed by the Commissioner and, to his detriment, did not object to the maximum penalty imposed<sup>207</sup>.

Thereafter, the Commissioner decided to take the matter further and he was charged with fraud under the common law. He pleaded guilty in the Magistrate’s Court, was convicted and was sentenced to pay a fine of R50 000 or serve a term

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<sup>205</sup> See paragraph 3.4.3 of this dissertation where the case was discussed in relation to common law fraud and whether a taxpayer can be “tried” for the same offence twice - in terms of section 76 of the Act as well as common law fraud.

<sup>206</sup> 52 SATC 186.

<sup>207</sup> In this regard, see the author’s comments in footnote 72 above.

of imprisonment of twelve-and-a-half years. In addition, he was given a suspended sentence of an effective twelve-and-a-half years imprisonment. He appealed to the Witwatersrand Local Division of the Supreme Court against the fine and suspended sentence.

The sentence of the magistrate was set aside by Schwartzman AJ who substituted a five-year sentence suspended for five years based on the fact that he had found “extenuating circumstances” to exist which mitigated his crime in terms of the common law. As regards the conduct of the taxpayer, he agreed that the magistrate had correctly found the following “extenuating circumstances” to be present in the case:

- when the investigations began, he confessed to the police;
- he pleaded guilty in court;
- he showed remorse for his crimes; and
- he was never guilty of dishonest conduct towards his clients.

As a negative or “aggravating” factor, the magistrate had found that the offence committed by the taxpayer was a serious offence planned and executed over a

number of years for the sole purpose of benefiting the appellant at the expense of the *fiscus*. It was in the circumstances a crime which affected the economic interests of the state and thereby the interests of the community.

The magistrate also found other “extenuating circumstances”, not related to the conduct of the taxpayer, to be present. These circumstances will be discussed under the appropriate headings.

It is submitted that the general approach of the magistrate (although he misguidedly imposed a heavy fine) and the judge regarding what constitutes “extenuating” and “aggravating” factors in relation to the conduct of the taxpayer, was and remains the correct approach.

### **7.3 SPECIFIC APPROACH OF THE COURTS**

#### **7.3.1 Planning, deliberation and duration of evasion**

The Canadian case of R v Bertrand<sup>208</sup>, illustrates why a person who is a professional in the income tax field and who systematically commits income tax

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<sup>208</sup> (1967) 67 DTC 5245 (Que. S. C.).

fraud should be treated more severely than an inexperienced taxpayer who occasionally tries to evade paying tax. The judge remarked<sup>209</sup>:

*“Whereas the offender is an accountant, who is not only acquainted with the Income Tax Act, but knows all the requirements and technicalities thereof, as it is an instrument which he uses in exercising his profession for the preparation of income tax returns for his clients;*

*“Whereas he deliberately falsified his returns for seven consecutive years;*

*“Whereas there is ground to distinguish between an inexperienced taxpayer who occasionally tries to evade part of his obligations and a professional, expert in the matter, who deliberately and systematically contravenes the Act.”*

The English Court in the case of R v Woodley<sup>210</sup>, dealt with the abuse of a special position by certain taxpayers who were directors and executives of a company. The difficulty faced by the court was to balance the need, on the one hand, to impose a severe sentence in order to reflect the seriousness of tax fraud, and on

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<sup>209</sup> At page 5247.

<sup>210</sup> (1979) 1 Cr. App. R. (S.) 14.

the other hand, to give the correct weight to mitigating factors<sup>211</sup>. The court had the following to say<sup>212</sup>:

*“This is a case of very considerable public importance . . . . Dealing, as the court is, with men of mature years, all of them of excellent previous character; all successful men in business of commerce and all successful through their own efforts rather than from assistance from outside or by any form of inherited advantage.*

*“But that said it has got to be faced that in an age of very high direct personal taxation, those who are directors and executives of limited companies and the like, those who by reason of their occupation enjoyed the privileges conferred by expense account facilities, as, indeed, they must do, are enjoying something which is denied to their fellows who are also taxpayers and they are under a heavy moral and legal obligation not to abuse their position . . . . In the final analysis the business of tax collecting cannot function in a complicated community such as ours save on the footing that the taxpayer will do his duty and tell the truth. That duty has been shamefully and extensively breached in the present case.”*

The South African courts have applied a similar philosophy in weighing-up the “aggravating” factors against the “extenuating circumstances” brought to the attention of the court for the purposes of punishment. This philosophy was clearly followed in ITC 1540<sup>213</sup>, where the taxpayer “creamed” off large sums of money

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<sup>211</sup> See Van Der Walt v S, (52 SATC 186, 1989 (2) SA 212(W)), where the court faced the same dilemma.

<sup>212</sup> At page 143.

<sup>213</sup> 54 SATC 400.

over a period of five years until he was investigated. During that period, he invested in property which he put into his own name. In mitigation, he pleaded that because he had registered the properties in his own name, it showed that he did not appreciate that what he was doing was wrong.

The court rejected this argument as a mitigating factor<sup>214</sup> but found the fact that the taxpayer had shown great business acumen which, together with the fact that he had been in the country for almost thirty years, negated his further plea that he was immigrant who was not fluent in the English language.

The court in ITC 1295<sup>215</sup> regarded the cumulative effect of “innocent” omissions as an “aggravating” factor although no actual or implied intention to evade taxation was imputed to the taxpayer. The court observed that<sup>216</sup>:

*“ . . . although there are explanations as to the individual omissions, one must, in my view, look at the cumulative effect of all the omissions. The investigation, although it might have started off as being only into the question of the profits from the sale of the B properties, gave rise to other disclosures – some of a trivial nature, others of a more serious nature. Therefore, while looked at individually there are explanations as to these*

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<sup>214</sup> Although it was not specifically stated, this plea was probably regarded as a “neutral” factor and therefore not taken into account.

<sup>215</sup> 42 SATC 19.

<sup>216</sup> At page 32.

*omissions, one cannot, to my mind, lose sight of the fact that in the case of each of the appellants the omissions went further than simply the profits on the sale of the B properties.”*

The appeal in this case involved two taxpayers and the judge remarked on the different business abilities of the taxpayers as follows<sup>217</sup>:

*“The first appellant certainly gave us the impression of being a reasonably astute businessman and a businessman of above average intelligence. He clearly has more than a working knowledge of the intricacies of operating holiday flats and of property transactions and would appear to have some knowledge, albeit perhaps limited knowledge, of some of the basic principles of taxation. The impression which we gained is that the first appellant either deliberately refrained from taking advice on whether or not these profits were taxable or was totally indifferent to the question of taking advice on this question since, having himself decided that the profits were not taxable, he no doubt had no desire whatever to be disillusioned by anybody on this score. We do accept, however, that he was bona fide of the belief that these profits would not attract tax.*

*“In so far as the second appellant is concerned, he knew very little, if anything, about the C profits and the transactions giving rise to them, since he left this entirely in the hands of the first appellant. We accept this evidence. It is quite clear that whilst the second appellant is no doubt a successful restaurateur and knows the business which he operates very well and runs very successfully, he is a person who has never paid much attention to the administrative and accounting side of any of the businesses with which he is concerned. He is a person who seems to us to have limited knowledge of accounting and matters connected therewith and is no doubt correct when he says that he has really paid very*

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<sup>217</sup> At pages 28 - 29.

*little attention to the balance sheets of the business, he being mainly concerned with the tangible profits made by him.”*

The penalty originally imposed by the Commissioner on the second appellant was some 15% lower than that imposed on the first appellant. Presumably, the Commissioner was of the opinion that the blameworthiness of the second appellant was not as serious as the first appellant. In referring to the differing business abilities of the appellants, the judge, in confirming the penalties imposed by the Commissioner, was presumably also weighing-up the blameworthiness of the appellants<sup>218</sup>.

Generally, it may be said that a sophisticated, premeditated and businesslike planned evasion of taxes over a long period of time should be contrasted with an isolated, impulsive and unsophisticated evasion of taxes<sup>219</sup>. Similarly, an “innocent” cumulative omission of income should be contrasted with a once-off “innocent” omission<sup>220</sup>. Taxpayers who are capable of planning sophisticated tax evasion over a long period of time or are able to abuse their special position to

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<sup>218</sup> The judge in ITC 1295, 42 SATC 19, was criticised by the court in CIR v Da Costa, 47 SATC 87, for applying a wrong principle regarding how the Special Court should approach an appeal for a remission of penalties. In spite of this criticism, it is submitted that the value of this case is not negated as regards the aspect of comparing the blameworthiness of taxpayers in similar circumstances but with differing business acumen.

<sup>219</sup> R v Bertrand, (1967), 67 DTC 5245 (Que. S. C.), ITC 1540, 4 SATC 400.

<sup>220</sup> ITC 1295, 42 SATC 19.

evade paying taxes, constitute a greater danger to the *fiscus* by reason of their greater abilities<sup>221</sup>. Their sophisticated planning gives them more time to reflect before they act. It indicates that there has been a deliberate choice to engage in tax evasion.

Premeditated tax evasion or abuse of a special position is generally treated in a more serious light than a once-off opportunity in which the offender merely takes advantage of an opportunity offered to him without any planning. It can be regarded as an “aggravating” factor or a factor which diminishes other compelling “extenuating” factors.

### 7.3.2 **Magnitude of the Evasion**

In criminal law, the magnitude of the crime affects the punishment that is ultimately imposed by a court. A petty theft, such as shoplifting, that only involves a few hundred rand, cannot be compared to a bank robbery involving millions of rand. The latter crime will dictate a more serious response by the courts. It indicates a deliberate intention to engage in criminal activities in which even a loss of life could be contemplated, as opposed to a petty theft in which the thief seizes an

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<sup>221</sup> R v Bertrand, (1967), 67 DTC 5245 (Que. S. C.); Van Der Walt v S, 52 SATC 186; R v Woodley, (1979) 1 Cr. App. R. (S.) 141).

opportunity knowing full well that it is highly unlikely that there could be loss of life involved in the crime.

Likewise, the magnitude of the tax involved in an offence committed under section 76(1) of the Act indicates a deliberate intention to evade the payment of tax rather than an “innocent” omission of taxable income. It accordingly elicits a more serious response from the court. This is so even where all other factors are equal<sup>222</sup>.

In effect, section 76(1) entrenches this principle as regards tax offences committed in terms of that section. The penalty to be imposed when all other factors are equal, is directly dependant on the magnitude of the tax evaded.

### **7.3.3 The use to which evaded taxes are put**

The use to which evaded taxes are put, could disclose “extenuating circumstances” or conversely “aggravating” circumstances. For example, the courts will normally distinguish between money spent on high living or building up

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<sup>222</sup> See ITC 1540, 54 SATC 400, where the taxpayer “creamed” off hundreds of thousands of rands on which R653 234 tax was evaded. A penalty of 85% was upheld by the Special Court which commented that the penalty erred on the side of leniency. In a case with virtually the same circumstances, the taxpayer in ITC 1331, 43 SATC 76, defrauded the *fiscus* of an amount of R126 590 on which a lesser penalty of 63,7% was imposed.

an asset portfolio and money spent for other purposes such as medical expenses or to support dependants living on the breadline.

In ITC 1540, Melamet J had the following to say regarding the purpose for which the evaded taxes were utilised<sup>223</sup>:

*“It is clear that the appellant was taking large sums of cash out of the butchery and using such cash to acquire assets in the name of a company and in his own name. . . It would appear therefore on the evidence that the appellant, over the years, creamed off large sums of money from his business to the detriment of the fiscus to build up investments for himself. It was suggested in argument that the fact that the properties were registered in his own name showed that he did not appreciate that he was doing wrong. This is a non sequitur if regard is had to the fact that the fiscus is dependent on accurate returns on which to base its assessments. I should point out further, that rental received from his properties was not included in his returns and it was therefore not possible from this source to establish the existence of the properties. The full amount of interest was also not included in the appellant’s returns of income.”*

On the other hand, the judge in CIR v Da Costa<sup>224</sup>, quoting with approval from the judgement of the Special Court *a quo*, referred to the taxpayer’s limited “means”, “life-style” and his “. . . single-minded devotion to the task of making a living for his wife and children”.

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<sup>223</sup> 54 SATC 400 at page 406.

<sup>224</sup> 47 SATC 8 at page 96.

### 7.3.4 Motive

The motive or intention with which a person commits a tax offence can have a bearing on the level of the penalty imposed in terms of section 76(1) of the Act.

In ITC 1489, Conradie J remarked in this regard<sup>225</sup>:

*“A full bench of the Transvaal Provincial Division held, in Commissioner for Inland Revenue v Di Ciccio, 1985 (3) SA 989 (T) (per Nestadt J as he then was), that no particular form of mens rea was required for a contravention of the provisions of s 76(1). The learned judge stated that as a general proposition it would suffice for the imposition of additional tax that an omission from a return was due to carelessness or inadvertence on the part of the taxpayer. ‘The question is’ the learned judge said ‘simply whether, objectively considered, there was an omission of an amount which ought to have been included or an incorrect statement’.”*

However, when the time comes for a court to decide on the extent of the penalty to be imposed, the establishment of the taxpayer’s motive (or lack of motive) as to why the offence was committed, play an important part.

ITC 1306<sup>226</sup> illustrates the point that when the taxpayer has no motive or intention to evade paying taxes, he will be treated leniently. The taxpayer wanted to

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<sup>225</sup> 53 SATC 99 at page 106.

<sup>226</sup> 42 SATC 147.

liquidate his company and declare the capital reserves of the company as a liquidation dividend. Liquidation dividends were not subject to tax at that time. The auditors, when approached to deal with the matter, distributed the assets as a dividend and then deregistered the company instead of formally liquidating the company in terms of the provisions of the Company's Act<sup>227</sup> and thereafter declaring a liquidation dividend. In his tax return, the taxpayer did not declare the liquidation dividends as having been received. The Commissioner imposed a penalty for this omission by the taxpayer. The taxpayer appealed against the penalty imposed to the Special Court.

The court held that a dividend received on deregistration of a company, even if declared out of capital profits, did not qualify for exemption from normal taxation<sup>228</sup>. However, because the auditors were to blame for following the wrong procedure<sup>229</sup>, the court held that there was no motive or intention to evade taxes and therefore the penalty should be remitted *in toto*.

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<sup>227</sup> No. 61 of 1973.

<sup>228</sup> This technical difference has never been remedied by the legislature. Nevertheless, in view of the fact that local dividends are exempt from tax in terms of section 10(1)(k), the problem is academic.

<sup>229</sup> The auditors, a branch of a large firm but located in a small town, were ignorant of the technical differences between the taxation consequences of a dividend arising on a liquidation as opposed to a deregistration of a company.

Similarly, in ITC 1609<sup>230</sup>, the Commissioner originally imposed a 100% penalty (subsequently reduced by him to 30%) on the taxpayer for failing to declare commissions which, in the opinion of the Commissioner, had accrued in the year prior to their reporting. The court found that the commissions had accrued in the prior year but remitted the penalty *in toto* because there was no intention to evade taxes nor was there any negligence on the part of the taxpayer and to impose penalties in such circumstances would be inappropriate.

On the other hand, it is submitted that a deliberate intent to evade taxes can reduce the moral blameworthiness of a taxpayer depending on the *bona fide* and justifiable motives of the taxpayer. Although the taxpayer lost his appeal in ITC 1423<sup>231</sup>, he raised a unique defence. He admitted that he deliberately under-declared his income but his motive for doing so was political. He contended that during the time of the liberation struggle in Zimbabwe, he had been approached by the liberation forces (Zanla) and ordered not to pay taxes to the Government of the day, because they were using the revenue from the taxes collected to prosecute the war against the liberation forces; that he did not sympathise with the Government of the day and, in order to deprive the Government of revenue which would in turn be used to combat the achievement of independence for Zimbabwe, he had deliberately set out to under-declare taxable income; that he gave a

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<sup>230</sup> 59 SATC 72.

<sup>231</sup> 49 SATC 85.

substantial sum of his income (in cash and material) to the liberation forces which fact could not be revealed to the revenue authorities as this would have meant automatic prosecution of the taxpayer. The taxpayer did not keep any record of his donations to the liberation forces on the ground that he feared prosecution if the records were found by the Government of the day.

Several credible witnesses testified on behalf of the taxpayer, including a former freedom fighter to whom he had given food and money on a regular basis and who, at the time of the trial, held high political office in the new Zimbabwean government. The judge, nevertheless, found that the taxpayer had not discharged the onus of proof that he qualified for indemnity from taxes and penalties in terms of legislation introduced subsequently by the new government. Accordingly, he confirmed the penalty imposed by the Commissioner. No reference was made in the case to the effect that the political convictions of the taxpayer constituted “extenuating circumstances” for the purposes of remission of penalties.

It is submitted that if a South African court were to be faced with a similar situation or set of circumstances, the court would probably regard the political convictions of the taxpayer with sympathy and regard them as “extenuating” for the purposes of section 76(2). Although the South African Constitution guarantees that a person should not be discriminated against regarding his political convictions, the nature

of the government in power at the time the case comes to court could determine the extent of the sympathy extended to the taxpayer by the court<sup>232</sup>.

### **7.3.5 Remorse - assistance to the revenue authorities during the investigation including a plea of guilty at the first opportunity**

The assistance given to the revenue authorities by the taxpayer during the investigation<sup>233</sup> as well as the taxpayer's admission at the first opportunity that he is guilty<sup>234</sup>, are generally regarded as "extenuating circumstances". On the other hand, obstruction, lies and false trails laid by the taxpayer during an investigation or even during a Special Court hearing, will not endear the taxpayer to either the revenue authorities or the courts, but such actions should not be regarded as "aggravating" for the purposes of sentencing<sup>235</sup>.

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<sup>232</sup> A similar situation could arise, for example, if all the members who belong to a right-wing organisation, deliberately decide not to pay any further taxes to the Government due to the fact that they believe that their political rights in South Africa are all but non-existent and that the government of the day are refusing outright their demand for the creation of a "boerestaat".

<sup>233</sup> ITC 1295, 42 SATC 19; ITC 1540, 54 SATC 400.

<sup>234</sup> Van Der Walt v S, 52 SATC 186.

<sup>235</sup> F G Gardiner and C W H Lansdown, "South African Criminal Law and Procedure", Volume 1, Juta & Co, Cape Town and Johannesburg, (4th edition), 1939, at page 500.

Nevertheless, the courts often refer to the unhelpfulness of the taxpayer during the course of their judgement as was seen in ITC 1351<sup>236</sup>, in which Friedman J referred to the evidence of the taxpayer as not entirely satisfactory. The taxpayer tried to explain the increase of his capital as winnings on horse racing, but his explanations were found to be contradictory. He also tried to convince the court that he only spent about R400 per month on living expenses. The judge dismissed this contention as follows<sup>237</sup>:

*“The appellant, during this period of time, was living with his wife in a flat some distance away from the A business. The appellant also had a son who, as I understood his evidence, was at least for some time in a boarding school. Bearing in mind rental, electricity, clothing, school fees, transport expenses, it is straining one’s credulity to believe that a husband, wife and child could have lived in the manner suggested by the appellant over this period of time, at a little over R400 per month. In these circumstances we are not satisfied, on the evidence of the appellant, that he received either of the two amounts to which his evidence rates, either in the manner described by him, or at all.”*

Reasons have been advanced as to why assistance to the revenue authorities and a plea of “guilty” at the first opportunity constitute “mitigating” factors for the purposes of punishment. One of the reasons advanced is that they are

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<sup>236</sup> 44 SATC 58.

<sup>237</sup> At page 61.

“manifestations of penitence”. Other reasons advanced include: the taxpayer should be rewarded for not embarking on a lengthy trial and thereby wasting the court’s time: a less heavy penalty would encourage “guilty pleas” by other taxpayers and that it is in the public’s interest since it saves the community a great deal of expense<sup>238</sup>.

See also ITC 1540<sup>239</sup>, where the court took into account the co-operation of the taxpayer in the subsequent investigation as a mitigating factor as opposed to the way the taxpayer was treated in ITC 1612<sup>240</sup>. In the latter case the court found the taxpayer to be unreliable and devious and he aggravated the position by cynically trying to press his luck to the extreme - he showed no contrition and the court confirmed the 200% penalty imposed by the Commissioner.

In 1999, Trevor Tutu was found guilty, in terms of section 75 of the Act, of failing to submit his returns for the 1996 and 1997 years of assessment as well as not furnishing his residential address to the revenue authorities. He was sentenced

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<sup>238</sup> See F G Gardiner and C W H Lansdown, “South African Criminal Law and Procedure”, Volume 1, Juta & Co, Cape Town and Johannesburg, (4th edition), 1939, at page 500.

<sup>239</sup> 54 SATC 400.

<sup>240</sup> 59 SATC 180.

to twelve months in jail or a R3 000 fine, half of the sentence being suspended for five years.

The magistrate, regarding the question of remorse, said:

*“The court must also take into account the fact that you did not show any remorse for your actions, and the sentence must be suitable for the offence, for people to see the seriousness of it.”*

When called to the witness stand to plead mitigation of sentence and asked why he was smiling, the defendant had replied: “Did you expect me to break down and cry?”

When asked whether he felt any remorse for what he had done, he answered: “How can I show remorse for something I have not done?”

The lawyer for the defendant informed the court that the tax summons was ignored because it was believed that the tax evasion charges were covered by the political amnesty the defendant was granted in 1997. It was contended that the Truth and Reconciliation Committee amnesty covered the tax evasion charges because the amnesty stated that it covered, “. . . any other offence or omission deriving from the contravention . . .”.

It was also contended that the defendant could not submit or surrender himself to the relevant authorities because he was a fugitive from justice - he was being sought until the time of his successful amnesty grant, for a bomb threat he had made at the East London airport in 1989<sup>241</sup>.

It is submitted that even if the defendant had only shown remorse at the time of sentencing by indicating that he now realised that he was wrong and that he was sorry for his actions, his fine would probably have been nominal rather than the R1 500 which he was obliged to pay. Nevertheless, his defence that because he had obtained political amnesty he was also covered from having to submit to the revenue laws, was novel and makes for interesting reading.

### **7.3.6 Remorse - Speed with which the Taxpayer Paid off his Liability**

The Canadian case of R v Maloney<sup>242</sup>, dealt with the question of what effect, if any, the payment of the tax in question prior to sentencing should have on a sentence. The accused taxpayer had paid the tax assessments in question shortly after they had been issued. The court held that the early payment should have little effect in mitigating the sentence.

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<sup>241</sup> Case reported in "The "Star" newspaper, Thursday, October 28, 1999.

<sup>242</sup> [1942] CTC 77 (Que. Sess. Ct.).

In South Africa, however, the early payment or settlement of the outstanding taxes could be considered as falling within the general concept of evidence of remorse and thereby qualify as a mitigating factor<sup>243</sup>. This applies in particular if, for example, the taxpayer realises or liquidates his assets, especially assets honestly obtained, and attempts to pay the outstanding taxes and penalties. After all, the behaviour of the taxpayer after a “crime” has been committed is usually a better indication of his character and attitude (remorse) than what his advisor says about him. It is also evidence of the fact that the taxpayer has not benefited from his crime which is also regarded as a mitigating factor<sup>244</sup>.

It does not matter that the taxpayer evaded taxes with deliberate intent or avoided taxes as a result of negligence, carelessness or by failing to supervise his employees correctly. If an offence has been committed in terms of section 76(1), the principle of remorse should still have an effect on the final punishment.

In ITC 1486<sup>245</sup>, the court weighed the fact that the taxpayer company had benefited from the fraud committed by the taxpayer’s employees against the fact that the

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<sup>243</sup> See F G Gardiner and C W H Lansdown, “South African Criminal Law and Procedure”, Volume 1, Juta & Co, Cape Town and Johannesburg, (4th edition), 1939, at page 500.

<sup>244</sup> Van Der Walt v S, 52 SATC 186.

<sup>245</sup> 53 SATC 39.

taxpayer had already paid off its tax liability. In effect, the settlement of the tax liability before appearing in court constituted a mitigating factor.

#### 7.4 **SUMMARY AND CONCLUSION**

The conduct of the taxpayer before, during and after the commission of a tax offence, has been examined. It has been established that the conduct of the taxpayer can influence the level of the penalty or sanction imposed, because the conduct may constitute “extenuating” or even aggravating circumstances.

It is clear that, if the taxpayer systematically commits income tax fraud or even “innocently” omits income over a number of years, he or she will be treated in a far more serious light than someone who only occasionally attempts to evade the payment of taxes. Similarly, a professional or a director of a company or a businessman who evades the payment of taxes with a sophisticated, premeditated and businesslike approach is held to be more culpable than an inexperienced taxpayer who uses an impulsive and unsophisticated approach.

The magnitude of the evasion also has a decided effect on the extent of the penalty imposed. The larger the evasion, the more severe the penalty<sup>246</sup>.

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<sup>246</sup> See section 76(1) and ITC 1540, 54 SATC 400.

The use to which the evaded taxes are put, can constitute “extenuating circumstances”. If the taxes evaded were used to provide support needed by a taxpayer’s family rather than being used for “high” living, “extenuating circumstances” could be found to be present in the former case<sup>247</sup>.

The motive of the taxpayer when evading taxes, could also play a part. Even a political motive could, in the future, be regarded as “extenuating” provided that the political motive is *bona fide*<sup>248</sup>.

There have been instances in which the assistance given to the revenue authorities during an investigation, a plea of “guilty” at the first opportunity and the speed with which the tax liability is settled, indicated remorse by the taxpayer, which factors were regarded as “extenuating”<sup>249</sup>. On the other hand, lies, obstruction, false trails or contesting a case without any real hope of succeeding or unnecessarily prolonging the trial of a relatively simple case, will not endear the taxpayer to the court. The words of Watkins LJ in R v Ford are instructive in this

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<sup>247</sup> Compare CIR v Da Costa, 47 SATC 87 with ITC 1540, 54 SATC 400.

<sup>248</sup> See ITC 1423, 49 SATC 85 and especially paragraph 6.3.4 above. See also sections 9 and 10 of the Constitution.

<sup>249</sup> ITC 1295, 42 SATC 19; ITC 1540, 54 SATC 400 and Van der Walt v S, 52 SATC 186.

matter. He said that a person who dishonestly cheats the revenue and lies when caught “must be led to expect punishment when the truth is laid bare”<sup>250</sup>.

Generally, therefore, it may be concluded that the conduct of the taxpayer, including his motives and a show of remorse, can in the appropriate circumstances, be regarded as “extenuating” for the purposes of remission of penalties both in terms of section 76(2) of the Act and the common law.

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<sup>250</sup> (1981) 3 Cr. App. R.(S.) 15.

**CHAPTER 8**                      **THE PERSONAL CIRCUMSTANCES OF THE**  
**TAXPAYER - AS A DEFENCE OR AS A PLEA OF**  
**“EXTENUATING CIRCUMSTANCES” FOR THE**  
**PURPOSES OF SECTION 76 OF THE ACT**

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**8.1**    **INTRODUCTION**

The personal circumstances of the taxpayer may also play an important part in determining the magnitude of the penalty to be imposed in terms of section 76 of the Act. Included under this category would be the following: education, literacy, low intelligence and naivete, financial means, ability to pay, loss of employment, hardship, insolvency and reliance on the taxpayer by dependants, age, infirmity, sickness, general poor health, anxiety and sanity, gender, lifestyle, intoxication, drugs, influence of others and provocation, previous good character (first offence) and loss of respect of the community, and the death, insolvency or liquidation of the taxpayer.

## 8.2 PERSONAL CIRCUMSTANCES - APPROACH OF THE COURTS

### 8.2.1 Education, literacy, low intelligence and naivete

As a general proposition, a person is not legally responsible for a contravention of a law if, at the time of the contravention, he was subject to a defect of mind recognised by law as sufficient to relieve him of responsibility for his actions<sup>251</sup>.

The taxpayer, depending on the severity of the defect of his mind, may plead such a reason as a defence or as an “extenuating circumstance” for the purposes of section 76 of the Act.

There must be some evidence that the disability of the mind was an operative cause of the failure to comply with the Act and this will be difficult to demonstrate where the surrounding evidence establishes that the accused otherwise functioned well in the business world.

In Da Costa's<sup>252</sup> case, it was seen that the court regarded the fact that the taxpayer only had “four to five years of schooling” and a “naivete, semi-literacy and simple-

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<sup>251</sup> See F G Gardiner & C W H Lansdown, “South African Criminal Law and Procedure”, Juta & Co, Ltd, Cape Town & Johannesburg, (4th Edition), 1939, Volume 1 at page 30.

<sup>252</sup> 47 SATC 87 at page 96.

“minded” confidence in an apparently reputable firm of accountants, as constituting “strong extenuating circumstances”.

The judge in ITC 1576<sup>253</sup>, took into account the fact that the taxpayer had only reached standard eight at school and could not read financial statements, as an “extenuating circumstance”. The Commissioner’s original penalty of 125% of the tax payable on the income not disclosed<sup>254</sup> plus interest payable in terms of section 89*quat*, was reduced by the Special Court, on appeal, to a flat 50% penalty. In addition, the judge precluded the Commissioner from raising a section 89*quat* interest charge as he felt that the 50% penalty in the circumstances was sufficient<sup>255</sup>.

In ITC 1331<sup>256</sup>, the taxpayer was born in a foreign country, had no regular schooling, could not even read his mother tongue, could not understand Afrikaans nor speak very much English. The Special Court regarded these factors as “extenuating”. However, the judge confirmed the Commissioner’s penalty of

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<sup>253</sup> 56 SATC 225.

<sup>254</sup> The taxpayer had only disclosed some 12% of the income which he had received.

<sup>255</sup> The taxpayer had also pleaded that he had relied on his bookkeeper who was negligent. In this regard, see paragraph 6.4 above.

<sup>256</sup> 43 SATC 76.

approximately R81 000, an effective penalty of some 63,7% of the tax on the income omitted<sup>257</sup>.

On the other hand, the judges in ITC 1489<sup>258</sup> and ITC 1351<sup>259</sup>, rejected as “extenuating” the fact that the taxpayers were unskilled in the task of keeping accounts. In the former case, the judge referred to the fact that the taxpayer was a “shrewd and successful businessman”<sup>260</sup> whilst in the latter case the judge found the taxpayer’s “shifting of ground”<sup>261</sup> during evidence, was not satisfactory.

Also in ITC 1540<sup>262</sup>, the court rejected the defence of the taxpayer that he was an immigrant and was not fluent in the English language. The Special Court confirmed the 85% penalty imposed by the Commissioner on the grounds that although he was an immigrant, he had been in South Africa for some thirty years,

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<sup>257</sup> The taxpayer had also pleaded that he had merely perpetuated a system devised by his uncle and his bookkeeper. See paragraph 6.5 above.

<sup>258</sup> 53 SATC 99.

<sup>259</sup> 44 SATC 58.

<sup>260</sup> At page 106.

<sup>261</sup> At page 61.

<sup>262</sup> 43 SATC 76.

he had shown some great business acumen and his lack of fluency had not hampered him<sup>263</sup>.

### **8.2.2 Financial means, ability to pay, loss of employment, hardship, insolvency and reliance by dependants on the taxpayer**

The poor financial circumstances of a taxpayer are generally regarded as “extenuating”. A fine should not “crush the accused and his family”<sup>264</sup>.

In Da Costa’s<sup>265</sup> case, it was acknowledged that “the means of the taxpayer clearly may be - and in the present case were - a relevant factor in determining the quantum of the reduced penalty”. In ITC 1295<sup>266</sup>, a judgement delivered prior to the Da Costa decision, the judge acknowledged that “a factor to be taken into account is the ability of each of the appellants to pay the amount of the penalties”.

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<sup>263</sup> The taxpayer in this case had also, to some extent, based his defence on the reliance on his bookkeeper. See paragraph 6.4 above.

<sup>264</sup> See the Canadian case of R v Thistle, [1974] C.SATC 798 (Ont. Co. Ct.).

<sup>265</sup> 47 SATC 87 at page 98.

<sup>266</sup> 42 SATC 19.

ITC 1430<sup>267</sup> raised an interesting problem. Before the taxpayer's appeal could be heard in the Special Court, he passed away. Evidence was led by the executor that the taxpayer's estate was insolvent.

The judge was of the opinion that the decision to remit penalties involves three factors: Punishment of the taxpayer, the deterrent effect upon him and the deterrent effect on other taxpayers.

He held that the court was not restricted to the factors present at the time of the assessment or the imposition of the penalties but could also look at the circumstances of the taxpayer from the time of the assessment or imposition of the penalty to the time the matter was heard in the Special Court, since the hearing before the Special Court is a *de novo* hearing<sup>268</sup>.

Because of the intervening death of the taxpayer, the first two factors regarding the remission of penalties, namely, the punishment of the taxpayer and the deterrent effect upon him, were no longer applicable. As regards the third factor, namely the deterrent effect upon other taxpayers, he was of the opinion that the remission of the penalties was hardly likely to come to the attention of many other taxpayers and, therefore, also was not applicable.

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<sup>267</sup> 50 SATC 51.

<sup>268</sup> The judge was following the Da Costa decision. See also Chapter 3 above.

The judge commented on the fact that if the penalties which the Commissioner had imposed were to be remitted, the estate would just be solvent. However, the insolvency of the estate did not take into account administration and liquidation expenses nor “has any provision been made for possible claims for maintenance by the taxpayer’s four minor children”<sup>269</sup>. The judge was of the opinion that the concurrent creditors of the estate or even the minor children of the deceased taxpayer would be punished instead of the deceased taxpayer if the estate were not solvent due to the fact that the penalties were not remitted.

He remitted the penalty *in toto* except for the amount of interest lost to the *fiscus*, an amount of approximately R21 000 as opposed to the original penalty imposed of approximately R97 000, which was, in effect, a 100% penalty.

He also commented that the Australian Income Tax Assessment Act provided for a “hardship’s committee” which could remit penalties in “serious hardship” or “ruinous circumstances”<sup>270</sup>.

*“In Australia there is by statute a ‘Hardships Committee’ which may remit assessed taxes wholly or in part. In terms of s 265 of the Income Tax Assessment Act 1974, this committee may even release a taxpayer from assessed tax where he has suffered such a loss or is in such circumstances that payment of the full amount of the tax would entail serious hardship. Furthermore in the case of the death of the taxpayer, tax may be remitted where payment thereof would entail serious hardship to his dependants. In terms*

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<sup>269</sup> At page 58.

<sup>270</sup> Also at page 58.

*of s 226 of that Act, however, the Commissioner has the power, similar to that conferred by s 76(2)(a) of our Act, to remit in whole or in part additional tax imposed as a penalty 'for reasons which he thinks sufficient.' One of the grounds upon which such remission has been granted, was where the penalty would 'prove a ruinous imposition.' Jolly v Federal Commissioner of Taxes (1935) 35 CLR at 214."*

Perhaps it would be a good idea for South Africa also to introduce legislation to provide for the creation of a "hardship's committee". If such a committee had been in existence in the then Rhodesia (now Zimbabwe), for example, the taxpayer in S v Lennon<sup>271</sup> would perhaps have been treated differently.

In that case, the taxpayer had attempted to import a motor vehicle into Rhodesia without payment of customs duty. He was an employee of the Rhodesian Railways and a senior official of the Rhodesian Railway Workers Union. He was due to retire in five years at the end of which period he would be entitled to a pension. In terms of legislation, no person who had been convicted of an offence involving theft, fraud or dishonesty and had been fined \$100 or more, could be an official of any trade union in Rhodesia within a period of five years from the date of his conviction. Because he was fined \$300 in addition to forfeiting his motor vehicle valued at \$1 800 and having to pay customs duty of \$603, he was not able

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<sup>271</sup> 35 SATC 101.

to complete his period of employment and thereby lost his pension. The total financial loss in this respect was estimated to be some \$50 000.

The taxpayer appealed against the \$300 fine on the grounds that the combined direct and indirect effects of the sentence were excessive and unreasonable in that they were disproportionate to the criminal conduct displayed by him and failed to have sufficient regard to the mitigating features of the evidence.

The majority of the court held that the fine of \$300 did not induce a sense of shock, and therefore, confirmed the \$300 fine. No account was taken of the indirect consequences of the taxpayer's conduct as a mitigating factor.

Beadle CJ, in his minority judgement, summed up the situation perfectly and, it is submitted, that his approach was in line with the way a South African Court should and would approach the matter if they are faced with a similar situation. He quoted with approval<sup>272</sup>, the general principle expounded by the Appellate Division in Ex parte Minister of Justice: in re Rex v Berger and Another<sup>273</sup>, that in assessing punishment: "Everything that adversely affects the accused in his person, his occupation or his property is part and parcel of the punishment inflicted upon him."

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<sup>272</sup> Beadle CJ at page 105.

<sup>273</sup> 1936 AD 334 at page 339.

He also came to the conclusion that the “rule of Berger’s case” was confirmed in R v Riley<sup>274</sup> by the Appellate Division<sup>275</sup> and consistently applied thereafter in the various Provincial Divisions of the South African Supreme Court. Nevertheless, Beadle CJ was of the opinion that the general rule should be tempered by approaching the matter as follows<sup>276</sup>:

*“If the moral blameworthiness of the crime is such that a court might reasonably impose a punishment which would not have the effect of bringing into force the provisions of the Act, then the court should impose such a punishment, rather than impose a punishment which might have such drastic financial consequences to the accused. If, on the other hand, the moral blameworthiness of the crime is so great that no court could reasonably impose a punishment which would not have the effect of bringing into operation the provisions of the Act, then a punishment which brings such provisions into operation must be imposed, notwithstanding the consequences to the accused.”*

Beadle CJ, in effect, came to the conclusion that the difference in moral blameworthiness between an offence which warrants a punishment of a fine of \$200 or \$300 and one which warrants a fine of \$90 is not so great “as to suggest that in the one case it is fitting that the appellant should forfeit another \$50 000

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<sup>274</sup> 1957(2) SA 407(AD).

<sup>275</sup> At page 411, Schreiner JA pointed out that to follow Berger’s Rule “tends towards leniency rather than harshness”.

<sup>276</sup> At page 107.

while in the other case it is not<sup>277</sup>. He accordingly recommended a fine of \$90 rather than the \$300 decided upon by the majority of the court.

Perhaps the taxpayer in this case, as, it is submitted, was the case in the Van der Walt matter<sup>278</sup>, was a victim of justice rather than a recipient of justice.

### **8.2.3 Age, infirmity, sickness, general poor health, anxiety and sanity**

Extreme old age or youth, infirmity, sickness, general poor health, anxiety, or insanity can constitute “extenuating circumstances” for the purposes of section 76(2). The pleading of such circumstances by a taxpayer may indicate that:

- the taxpayer did not fully understand his responsibilities under the Act; or
- the anxiety suffered by the taxpayer during an investigation by the revenue authorities, led to an emotional breakdown.

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<sup>277</sup> At page 112.

<sup>278</sup> 52 SATC 186.

Age, or general malaise due to sickness, in itself should not automatically be regarded as an “extenuating circumstance”<sup>279</sup>. Rather, the taxpayer must lead evidence to the effect that the disability was an operative cause of the failure to comply with the provisions of the Act. For example, an eight-year-old child would not be expected to know or understand his obligations under the Act. Neither would a fifty-year-old know his obligations under the Act if he has deteriorated to an advanced state of Alzheimer’s disease.

Nevertheless, the mere fact that the taxpayer is advanced in years has been regarded as a mitigating factor. In Da Costa’s<sup>280</sup> case, the fact that the taxpayer was a man of 59 years of age, was regarded as one of the mitigating factors. The effect of his age by itself and its influence upon the penalty imposed in that case was probably minimal. Nevertheless, it was a starting point for finding that “extenuating circumstances” existed for the purposes of remission of penalties<sup>281</sup>.

In the British case of R v Richards<sup>282</sup>, the Court of Appeal recognised that the age of the taxpayer, who was 67 years old, and the fact that he was in poor health,

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<sup>279</sup> In fact, section 9(3) of the Constitution prohibits discrimination, *inter alia*, on the basis of age.

<sup>280</sup> 47 SATC 87.

<sup>281</sup> See also Van Der Walt v S, 52 SATC 186, where the judge found that the taxpayer was a first offender who was 58 years of age, to be “extenuating”.

<sup>282</sup> [1971] Crim. L.R. 176.

could constitute mitigating factors. The Canadian Courts also recognise this principle<sup>283</sup>.

The British Courts have in addition, acknowledged that a long delay by the revenue authorities in determining a penalty or in bringing the matter to court, can cause anxiety to the taxpayer and even lead to an emotional breakdown. Such a situation could then be regarded as “mitigating”<sup>284</sup>. Although the South African Courts, to the author’s knowledge, have not been faced with this novel plea in tax matters, it is inevitable that it eventually will be pleaded and, it is submitted, may be recognised as an “extenuating circumstance”<sup>285</sup>.

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<sup>283</sup> See Rv Kresanowski, (1982), 83 D.T.C. 5393.

<sup>284</sup> See R v Francis, [1979] Crim. L. R. 261.

<sup>285</sup> Support for this submission can be found in section 33 (“just administrative action”) read together with section 35 (“arrested, detained and accused persons”) of the Constitution.

In addition, para. 12.2.8 of the “Third Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa”, Government Printer, Pretoria, 1995, at page 133, recommended that a principle of “timeousness” be recognised legislatively or at least in a “Code of Conduct” whereby “taxpayers have a right to expect that their affairs will be dealt with expeditiously”. This recommendation has not been adopted in the South African Revenue Services “Client Charter”, a copy of which is attached to every taxpayer’s return. The “Charter” states that the obligation is on the taxpayer to “timeously submit full and accurate information” without the corresponding obligation on the revenue services to deal with the taxpayer’s matters timeously. A copy of the “Client Charter” is attached as Appendix III to this dissertation.

#### **8.2.4 Gender, lifestyle, intoxication, drugs, influence of others and provocation**

Section 9(3) of the Constitution provides that the state may not unfairly discriminate "against anyone on one or more grounds including, race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief, culture, language and birth". It may be argued that if a court does take into account such factors then someone else is being discriminated against. For example, a female should theoretically not have a lower penalty imposed on her than her male counterpart who commits the same tax offence merely because she is a female.

Until a few years prior to the adoption of the Constitution, the income of a married woman, for income tax purposes, was treated as part of her husband's income. Since the change to separate taxation, there has been no reported case, as far as the author can establish, where a female taxpayer has had penalties imposed on her in terms of section 76 of the Act by the Special Court. This could be due to the fact that there are no errant female taxpayers who have been caught, a highly unlikely phenomenon, or due to the fact that the penalties imposed by the Commissioner are regarded as reasonable and sufficiently low that such taxpayers do not appeal to the Special Court to have such penalties reviewed. If this is the case and the Commissioner is treating errant female taxpayers

differently to their male counterparts, then he is probably acting under the reverse of what is known as “gender bias”.

If the reason for a lower penalty is merely due to the fact that the taxpayer is a female, all other circumstances being the same, then the fact that her male counterpart has a higher penalty imposed on him, such higher penalty could be regarded as unconstitutional and would, it is submitted, be altered on appeal to the Special Court.

Nevertheless, such a plea could be accepted by the courts, especially if it could be proved that a female taxpayer was under the influence of someone else, for example, a spouse, a lover, or an employer, and for that reason certain income was not disclosed in her return.

The lifestyle of the taxpayer and the fact that the taxpayer’s family might suffer as a result of a heavy penalty imposed, have also been regarded as “extenuating”<sup>286</sup>.

The courts, it is submitted, would strive to see that the impact of their penalty will fall on the taxpayer himself and not on the family. This does not mean to say that a rich person should have a more severe penalty imposed on him because he is

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<sup>286</sup> See Da Costa, 47 SATC 87 and ITC 1430, 50 SATC 51.

more able to pay or has a higher profile in society. Rather, taxpayers should be treated equally but an adjustment must be made for hardship where necessary<sup>287</sup>.

The effect of alcohol or drugs removes or weakens the restraints and inhibitions which normally govern conduct and impairs the faculty to appreciate the consequences of an act. It is also conducive to negligence. But unlike insanity, there is no diseased mind.

In the case of a taxpayer, this type of defence would be difficult if not impossible to plead in view of the fact that an intoxicated or drugged person would eventually become sober or drug free and thereafter have the faculties to reflect on his actions. If, for example, he filled in his tax return whilst intoxicated and omitted income from the return, and perhaps even submitted the return in an intoxicated state, when he became sober he would be able to reflect on what he did and

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<sup>287</sup> The author has already discussed the case of Van der Walt in paragraph 3.4.2 above and submitted that if the taxpayer in that case had appealed against the Commissioner's imposition of the maximum penalty of 200% in terms of section 76 of the Act to the Special Court (imposed because ostensibly the Commissioner could find no "extenuating circumstances" to be able to remit part of the penalty - yet both the Magistrate's Court and the Witwatersrand Local Division of the Supreme Court found compelling "extenuating circumstances" in his subsequent common law fraud trial for tax evasion), the penalty would have been substantially reduced. Perhaps the Commissioner was being discriminatory in imposing the full penalty merely because of the taxpayer's station in life and that he was more able to pay the fine.

approach the revenue authorities to correct the return. If he did nothing when sober and reflected on the matter knowing that he had submitted false information, then at the very least his actions would be negligent if not fraudulent.

Provocation is based essentially on the emotion of anger. Anger, in itself is not an excuse for committing an offence. However, it may be a factor which mitigates the punishment.

In order to illustrate this defence, it is instructive to look at a real life situation which has been exaggerated to illustrate the applicability of a plea of provocation. A taxpayer may have been investigated by the revenue authorities who then assessed him for allegedly not paying over the correct PAYE. They imposed a penalty of 100% on the alleged underpayment of PAYE. The taxpayer had good reason to believe that he had paid the correct amount of PAYE and accordingly objected and subsequently appealed against both the assessment for PAYE and the penalty imposed.

On the “pay-now-argue-later” principle, the revenue authorities demanded payment immediately. When payment was not forthcoming, the revenue authorities obtained a court order to freeze all the taxpayer’s bank accounts<sup>288</sup>. As

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<sup>288</sup> See section 88 of the Act read together with section 19 of the Act - the Constitutional Court found that the equivalent of these sections in the Value Added Tax Act, No 89 of 1991 (dealing with the pay-now-argue-later

a result, the taxpayer's business went into liquidation and the taxpayer was put under severe financial strain. In addition, he also lost his house and most of his other possessions.

The taxpayer was so angry with the revenue authorities that he vowed and carried out his vow, never to pay another cent in tax to them. He deliberately filed false returns by omitting income which he had subsequently earned from consulting work done by him. As a result he was once again investigated by the revenue authorities and this time the revenue authorities imposed the full 200% penalty on the omitted income. He appealed to the Special Court against the latest "excessive" penalty imposed.

The taxpayer, in the interim, after he had been caught (subsequent to the PAYE matter) for not declaring income in his return, had appeared before the Special Court regarding the PAYE matter. That court had decided in favour of the taxpayer and his frozen bank accounts were immediately released.

It is submitted that a Special Court would have found the actions of the revenue authorities regarding the PAYE matter as provocative in the extreme and

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principle) were constitutional. See Metcash Trading Ltd v CIR, 63 SATC 13. The court did not have to deal with the freezing of a taxpayer's bank accounts, which, it is submitted, is conduct by an administrative officer which is unacceptable and unconstitutional. See also paragraph 8.3.5 below where the matter of unlawful conduct on the part of an administrative officer is briefly discussed. A full discussion on this matter is considered to be beyond the scope of this dissertation.

regarded the anger which the taxpayer felt towards the revenue authorities as constituting “extenuating circumstances” and remitted or reduced the penalty substantially<sup>289</sup>.

### **8.2.5 Previous good character (first offence) and loss of respect of the community**

The fact that the offending taxpayer was of previously good character and that the offence was his first offence<sup>290</sup>, could be a motivating factor justifying a less severe sentence than it would otherwise be especially where there is the possibility of a custodial sentence.

In the Van der Walt<sup>291</sup> case, the magistrate had regard to the fact that the taxpayer was not guilty of any dishonesty towards his clients and that his clients and those with whom he was associated in public life regarded him as a respected and honourable member of society. The magistrate believed that these factors

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<sup>289</sup> Refer to the circumstances in Lennon's case, discussed in paragraph 8.2.2 above where the indirect financial consequences of the penalty imposed were out of all proportion to his actions. It is submitted that if the taxpayer felt angry and was provoked by the way he was treated by the revenue authorities and especially by the then Rhodesian Appellate Division in that case, no-one would have been surprised.

<sup>290</sup> First offence in this context does not necessarily refer only to a tax offence in terms of the Act, but to all offences, especially serious criminal offences such as fraud. It would not include minor offences such as a traffic parking ticket.

<sup>291</sup> 52 SATC 186 at page 192.

contributed towards mitigating the level of the penalty which he would impose on the defendant. The Supreme Court, on appeal, agreed that those factors constituted mitigating circumstances to be taken into account in sentencing the defendant<sup>292</sup>.

As regards the loss of respect of the community in which the defendant operates, M A Rabie and S A Strauss, in their book "Punishment"<sup>293</sup> are of the opinion that:

*"In fact, merely being convicted of a crime is already for many persons a sufficient punishment to deter them from future criminal behaviour."*

Perhaps the reason for the Commissioner taking the taxpayer in the Van der Walt case through the criminal court system and charging him with common law fraud was to achieve this very purpose. Any punishment which he received in addition to the loss of respect in his local community was probably regarded as a bonus to the revenue authorities.

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<sup>292</sup> For a more detailed analysis of this case, refer to paragraph 3.4.2 above.

<sup>293</sup> M A Rabie and S A Strauss, "Punishment; An Introduction to Principles", Johannesburg, Lex Patria, (3rd edition) 1981 at page 26.

**8.2.6 Death, insolvency or liquidation of the taxpayer**

The death of a taxpayer before a penalty is imposed by the Commissioner in terms of section 76(1), is considered a complete defence to the imposition of penalties. In ITC 1461<sup>294</sup>, Leveson J held that:

*“The right to punish the wrongdoer passed on the death of the deceased and there is no provision, either at common law or in terms of the Income Tax Act, whereby the penalty is transmissible to the beneficiaries of the deceased’s estate, ie the wrongdoer’s estate and no basis upon which the penalty can be exacted from those beneficiaries or, for that matter, from the representative taxpayer.”*

Even after penalties have been imposed by the Commissioner and the taxpayer dies before any appeal is heard in the Special Court, the Special Court would be inclined to take this factor into account especially where there are minor dependants involved, as an “extenuating circumstance”<sup>295</sup>.

In ITC 1699<sup>296</sup>, the Zimbabwean Special Court remitted the penalties *in toto* in the case where the taxpayer, a company, went into liquidation during the time between the imposition of the penalty and the time the Special Court heard the

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<sup>294</sup> 51 SATC 165 at pages 167-168.

<sup>295</sup> See ITC 1540, 43 SATC 76.

<sup>296</sup> 61 SATC 479.

appeal against the imposition of penalties. It was held that the subsequent events in the case (the provisional liquidation) justified the remission of the penalties.

### 8.3 CONCLUSION

The personal circumstances of the taxpayer, especially where the taxpayer is deceased, can constitute a full defence against the imposition of penalties<sup>297</sup>. An impairment of a persons mind due to age (a minor) or a disease (Alzheimer's disease) can also constitute a complete defence depending on the severity of the impairment since in these cases the taxpayer does not have the necessary *mens rea* or intention to evade taxes.

Even when the taxpayer intended to evade taxes, the reasons behind the intention to evade, could constitute "extenuating circumstances". This is especially so in cases of extreme provocation where the taxpayer does not feel that he is being treated fairly by the revenue authorities

The mere lack of intelligence or education or language barrier which does not affect the business acumen of the taxpayer cannot constitute a full defence but may be regarded as an "extenuating circumstance"<sup>298</sup>.

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<sup>297</sup> ITC 1461, 51 SATC 165.

<sup>298</sup> Da Costa v CIR, 47 SATC 87; ITC 1576, 56 SATC 225 and ITC 1331, 43 SATC 76.

The financial means of the taxpayer or the fact that the taxpayer has minor dependants, who rely on him for support, can also constitute “extenuating circumstances”<sup>299</sup>.

The previous good character of the taxpayer and the loss of the respect of the community in which a person lives, also constitutes “extenuating circumstances”<sup>300</sup>.

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<sup>299</sup> ITC 1430, 50 SATC 51, Da Costa v CIR, 47 SATC 87.

<sup>300</sup> Van der Walt v S, 52 SATC 186.

**CHAPTER 9**                      **OTHER MISCELLANEOUS DEFENCES OR**  
**“EXTENUATING CIRCUMSTANCES” PLEADED FOR**  
**THE PURPOSES OF SECTION 76 OF THE ACT**

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**9.1**    **INTRODUCTION**

Other miscellaneous defences or “extenuating circumstances” which may be raised include: ignorance of the law, *bona fide* belief or mistake of fact, oversight, following the wrong advice, destruction of records, prevalence of crime, impropriety by investigating officers and entrapment, loss of interest to the *fiscus*, permissible deductions, *de minimus non curat lex*, physical impossibility of complying with the law and necessity.

**9.2**    **MISCELLANEOUS DEFENCES AND “EXTENUATING CIRCUMSTANCES” -**  
**APPROACH OF THE COURTS**

**9.2.1**    **Ignorance of the law, *bona fide* belief or mistake of fact, oversight,**  
**following wrong advice**

In Gardiner and Lansdown’s “South African Criminal Law and Procedure” it is stated that<sup>301</sup>:

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<sup>301</sup> See F G Gardiner & C W H Lansdown, “South African Criminal Law and Procedure”, Juta & Co, Ltd, Cape Town & Johannesburg, (6th Edition),

*“if ignorance of law were generally admitted as a valid ground of excuse for unlawful conduct, the administration of law would become impracticable.”*

However, in Blower v Van Norden<sup>302</sup>, Innes CJ aptly stated that:

*“There come times in the growth of every living system of law when old practice and ancient formulae must be modified in order to keep in touch with the expansion of legal ideas, and to keep pace with the requirements of changing conditions. And it is for the courts to decide when the modifications, which time has proved to be desirable, are of a nature to be effected by judicial decision, and when they are so important or so radical that they should be left to the Legislature.”*

These were prophetic words in 1909 and the Appellate Division in S v De Blom<sup>303</sup> decided in 1977, that ignorance of the law may even provide an excuse for otherwise criminal behaviour based on the precept that legal policy demands the abolition of a principle that is manifestly unjust in the majority of cases.

In tax matters, the South African courts tend to view an honest, but mistaken, apprehension of the tax consequences of a course of conduct, as a complete defence (since there can be no intention or *mens rea* by the taxpayer to commit

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1957, Vol 1 at page 60.

<sup>302</sup> 1909 T.S. 890 at page 905.

<sup>303</sup> 1977(3) SA 513(AD).

a tax offence). This is particularly so where mistakes arise out of advice given by qualified professionals.

In ITC 1306<sup>304</sup>, the taxpayer followed the advice of his auditor in the deregistration of his company. He was taxed on the dividends received on deregistration and penalties were imposed by the Commissioner. If, instead of a mere deregistration of the company, the taxpayer had formally liquidated the company, the same dividends would have been received tax free. The court regarded the fact that the taxpayer had relied on a firm of auditors in a small town to handle his affairs and as a result the wrong course of action was followed, as constituting a complete defence<sup>305</sup>.

In ITC 1576<sup>306</sup>, the court reduced the penalty imposed by the Commissioner, from 125% to 50% in spite of the fact that the taxpayer had only disclosed some 12% of his taxable income. A large add-back to taxable income arose as a result of a highly technical distinction between the meaning of repairs, which could be claimed in terms of section 11(d) of the Act, and improvements which did not qualify for a deduction. The court accepted the taxpayer's plea that in the case of

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<sup>304</sup> 42 SATC 139.

<sup>305</sup> See also paragraph 6.4 above where this aspect is discussed in greater detail.

<sup>306</sup> 56 SATC 1.

the wrong classification of the expenditure (ignorance or misinterpretation of the law), the taxpayer had no intention to evade tax. However, there were other worrying factors in the case which precluded a further reduction in penalties.

Similar reasoning was followed by the Special Court in ITC 1725<sup>307</sup> which went even further. It stated that even when a court finds to the contrary to that which has been claimed by the taxpayer, such claim cannot simply be treated as tax evasion especially where the interpretation of whether such a claim is deductible or not, has vexed tax planners, courts and academic writers alike and was honestly claimed by the taxpayer on the basis of professional advice given<sup>308</sup>.

In ITC 1377<sup>309</sup>, the taxpayer, a garage owner who also owned and raced horses from time to time, was investigated by the revenue authorities and was found by them to have not declared an amount of some R27 000, the amount he received from winning a totaliser jackpot, in his return. A small penalty of approximately R600 was imposed in terms of section 76 of the Act.

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<sup>307</sup> 64 SATC 223.

<sup>308</sup> See paragraph 6.6.3 above for a fuller discussion on this aspect.

<sup>309</sup> 45 SATC 221.

The taxpayer appealed against both the inclusion of the jackpot win of R27 000 as being of a capital nature and the penalty imposed. He argued that to win the jackpot, he had to predict the winners of each of the last four races of a meeting. He had spent R390 on that particular jackpot ticket which gave him 780 combinations. He also claimed that he spent approximately R350 per month on such jackpots. Accordingly, he contended that the win was fortuitous and thus of a capital nature.

The court held that since he was a professional punter (he also placed other bets of approximately R900 per month with bookmakers), all his earnings from horse racing activities were taxable including any totaliser wins. However, as far as the penalty imposed was concerned, the court remitted the full amount on the basis that the omission to disclose his jackpot winnings derived, not from an intention to avoid tax, but from the appellant's *bona fide* belief that such winnings were of a capital nature.

The court referred the matter back to the Commissioner to raise fresh assessments having regard to the finding in respect of the penalty and to any expenditure that might have been incurred by the taxpayer in the pursuit of his activities as a professional punter in relation to placing bets on jackpots.

It is submitted that the taxpayer in ITC 1508<sup>310</sup>, was probably treated more fairly and leniently by the Zimbabwean Court than taxpayers had previously been treated in that court<sup>311</sup> - perhaps because she was a female. The taxpayer, an unmarried female secretary in the Ministry of Foreign Affairs, had been posted to the Zimbabwean embassy in France. She purchased a Mercedes Benz some three months prior to her recall to Zimbabwe. She never drove the vehicle in France. Approximately six weeks after her return to Zimbabwe, she sold the vehicle making a profit of some \$92 000. Her salary was only \$12 000 per annum at the time.

The Commissioner of Taxes contended that at the time the appellant entered into the transaction and throughout until she sold the vehicle her motive was to resell it in Zimbabwe in order to generate a profit and accordingly the profit was taxable. He therefore raised an assessment and, in addition, because she had failed to disclose in her return the income so earned, he imposed a penalty of approximately \$53 000.

Although she appeared to advance good reasons for the profit made on the disposal of the vehicle being capital in nature, the court held otherwise. The

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<sup>310</sup> 53 SATC 442.

<sup>311</sup> See ITC 1423, 49 SATC 85 and S v Lennon, 35 SATC 101.

merits of her case, as far as the capital or revenue nature of the profit is concerned and the court's conclusions in this regard, are not discussed as they are considered to be beyond the scope of this dissertation.

However, as far as the penalty was concerned, the taxpayer admitted that she had not declared the income from the sale of the car in her return for the relevant year but said that she was not aware that she was required to do so. She contended that her failure to do so was not because she wanted to evade the payment of income tax but because she was unaware that it would or could be regarded as part of her gross income.

The court held that the taxpayer had established that she genuinely was not aware that the purchase price she received on the sale of her car was an amount which she was obliged to reflect in her income tax return. The penalty was accordingly remitted *in toto*.

### **9.2.2 Destruction of records**

In appropriate and compelling circumstances, the loss or destruction of a taxpayer's records could, it is submitted, constitute a defence or be regarded as an "extenuating circumstance" for the purposes of section 76 of the Act. For example, a fire or other natural disaster could be the cause of a taxpayer's

financial records being destroyed. However, should the taxpayer honestly try to reconstruct the records which are later found to be inaccurate and a penalty is imposed, such penalty should be remitted by the Special Court.

This defence or plea, has to the knowledge of the author, only been raised in a round about manner in our court system in ITC 1612<sup>312</sup>, where the defence was rejected on the basis that the complaint by the taxpayer that the revenue authorities had confiscated his financial records and books and that, therefore, he was unable to supply accurate returns thereafter, was absurd. The matter was also dealt with in passing by the judge in Kahn v CIR<sup>313</sup>.

### 9.2.3 Prevalence of crime

The prevalence of tax evasion in the community, or its absence, is a factor which is not normally referred to when the taxpayer is punished in terms of section 76 of the Act. The contradiction which is inherent in such punishment is that one is punishing a particular offender in order to make him an example for others who have committed similar offences (or intend to commit similar offences) but have not been caught.

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<sup>312</sup> 59 SATC 180. See also paragraph 6.4 above for a fuller discussion on the case.

<sup>313</sup> 1 SATC 170.

It is submitted that it is the Commissioner's policy to initially impose a large penalty on the taxpayer when confronted with a section 76 offence. On appeal to the Special Court, it has been seen from the majority of cases already discussed in this dissertation, that the penalty originally imposed, has been substantially reduced.

Presumably, one of the Commissioner's reasons for initially imposing a large penalty is to deter other taxpayers from committing similar offences. However, this is where such an argument falls flat. The tax affairs of the taxpayer are subject to the secrecy provisions of section 4 of the Act. It is only in very limited circumstances that the Commissioner may divulge information relating to the taxpayer to a third party. But this divulging of information does not extend to the public at large other than in general terms such as in a newspaper report which states that a taxpayer, not named, committed an offence in terms of section 76 of the Act and a penalty of 100% was imposed<sup>314</sup>.

Therefore, should the Commissioner impose a large penalty in terms of section 76 on the taxpayer and give as his reason for the imposition of such a large

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<sup>314</sup> This aspect will not be discussed further since it has already been discussed briefly in paragraph 5.2 above. In addition, it is considered to be beyond the scope of this dissertation.

penalty that he wanted to make an example of the taxpayer to deter other potential tax offenders from doing likewise, it is submitted that this aspect of the penalty amounts to unreasonable conduct on the part of the Commissioner and is therefore unconstitutional<sup>315</sup>. It is submitted that the Special Court may, on the other hand, take such a factor into account in determining the penalty to be imposed. This is especially so in the case of the High Court where the proceedings are not secret and are open to the general public.

Nevertheless, it is further submitted that the overriding question in punishing a particular taxpayer, should be: What penalty should this offender receive for this offence?

Of course, the potential deterrent effect of imposing a fine in terms of sections 75 or 104 of the Act, may be considered. These offences, as has been mentioned previously<sup>316</sup>, are statutory offences and punishment can only be effected after a conviction has been obtained in a court of law.

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<sup>315</sup> See paragraph 8.3.5 below where the conduct of the revenue authorities is discussed. Unreasonable conduct by the revenue authorities is *prima facie* unconstitutional.

<sup>316</sup> See paragraph 3.3 above.

The other option available to the Commissioner is to lay a complaint with the Attorney-General and prosecute the offender for common law fraud as was done in the Van der Walt case<sup>317</sup>. The case received tremendous publicity in the local and national papers<sup>318</sup>.

Gubbay JA in COT v CW (Pvt) Ltd<sup>319</sup>, summed up the situation regarding arbitrary administrative action by revenue authorities, as follows:

*I can do no better in this context than to borrow the words of Justice Jackson in Railway Express Agency v People of the State of New York (1948) 336 US 106 at 113-114, that –*

*‘ . . . nothing opens the door to arbitrary action so effectively as to allow those officials to pick and choose only a few to whom they will apply legislation and thus to escape the political retribution that might be visited upon them if larger numbers were affected. Courts can take no better measure to assure that laws will be just than to require that laws be equal in operation.’”*

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<sup>317</sup> See paragraph 3.4 above.

<sup>318</sup> The recent pre-emptive statements by the revenue authorities regarding the alleged tax fraud that businessman Dave King and soccer supremo Irvin Khoza have committed have received wide publicity. However, this pre-emptive strike by the revenue authorities may, it is submitted, backfire on them. It appears as if several of their constitutional rights have been violated (freezing bank accounts, demanding information from them which constitutes a violation of their right to remain silent and not incriminate themselves, etc.) The revenue authorities may already have gone too far in their zeal to punish these alleged tax evaders.

<sup>319</sup> 52 SATC 77 at page 86.

These sentiments, it is submitted, apply equally to some of the defences or pleas mentioned below where the conduct of the revenue authorities is inappropriate.

#### **9.2.4 Impropriety by investigating officers and entrapment**

The defence of impropriety by investigating officers is fundamentally a constitutional issue. As frequently mentioned already, constitutional issues are considered to be beyond the scope of this dissertation. Nevertheless, for the sake of completeness, the constitutional issues pertaining to this defence will be discussed briefly.

Until the implementation of the Constitution and even subsequently, questions regarding the approach to the pursuit and punishment of tax offenders have frequently been raised by taxpayers and the courts. Prior to the promulgation of the Constitution, very little could be done by either the taxpayer or the courts to limit the powers of the revenue authorities to investigate a suspected tax offender. For example, the power was granted to the revenue authorities in terms of the previous section 74(3)<sup>320</sup> to enter a taxpayer's premises at any time of day, search

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<sup>320</sup> Now repealed and replaced by section 74D which ostensibly is in line with the Constitution in that the fundamental rights of the individual granted in terms of the Constitution are limited in terms of section 36. However, although the section is *prime facie* constitutional, the conduct of the revenue officials is still subject to all the Bill of Rights clauses.

those premises and seize any documentation found on those premises and retain such seized documents. No judge or magistrate's authority was necessary to initiate such entry, search and seizure - the Commissioner could grant this power (in writing or by telex) which in all other spheres of the law could normally only be granted by a judge or magistrate.

In addition, the power granted in terms of the previous section 74(2)(a)<sup>321</sup>, which allowed the Commissioner to interrogate a taxpayer and require him to give evidence under oath, was also questionable.

In this regard, Rudolph and Another v CIR<sup>322</sup>, (search and seizure under the old section 74(3) of the Act) and Podlas v Cohen and Bryden NNO and Others<sup>323</sup>, (interrogation in terms of section 152 of the Insolvency Act, 24 of 1936), which upheld the constitutionality of search and seizure legislation and interrogation under oath, are instructive. The actions of the administrative officials concerned in those cases took place just prior to the introduction of the Constitution. In fact, in the Rudolph case, the invocation of the search and seizure provisions by the

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<sup>321</sup> Now repealed and replaced by section 74C. The same comments mentioned in footnote 320 above in relation to the conduct of the revenue officials, are also applicable for this section.

<sup>322</sup> 59 SATC 399.

<sup>323</sup> 1994(4) SA 662(T).

Commissioner had occurred only a matter of days before the Constitution became law in 1993.

However, different and conflicting decisions were reached in Wehmeyer v Lane NO and Others<sup>324</sup>, (interrogation in terms of section 415(3) of the Companies Act, 61 of 1973) and in Mandela and Others v Minister of Safety and Security and Others<sup>325</sup>, where the actions of the administrative officials also took place just prior to the introduction of the Constitution.

In Mandela's case, the court granted an interdict in favour of the former Deputy Minister of Arts and Culture, in circumstances where her right to privacy was invaded and the police seized documents from her home in connection with criminal charges to be brought against her. The police were forced to return all documents seized in the raid, even documents which allegedly incriminated her because no evidence was placed before the magistrate that the companies referred to in the warrants had been involved in an offence; that the documents to which the warrants related were involved in an offence; or that the documents could possibly be on the applicant's premises. It did not matter that the search and seizure operation actually revealed incriminating evidence against Mrs Mandela.

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<sup>324</sup> 1994(4) SA 441(C).

<sup>325</sup> 1995(2) SACR 397(W).

Recognising that the powers granted in terms of the previous section 74 were now unconstitutional in terms of the Constitution, the section was substantially amended in 1997 to purportedly comply with the Constitution.

Even with the amendments to section 74, especially the replacement of section 74(3) by section 74C and section 74(4) being replaced by section 74D, the revenue authorities must be very circumspect in their conduct, which is still subject to the individual's rights in terms of the Constitution. Unreasonable behaviour or not following the correct procedures or even asking for a search warrant which is vague either to the offence committed or as to the tax documents they wish to seize, is unconstitutional.

It is submitted that the Mandela case has succeeded in extending, by way of the Constitution, South African law to embrace a precept well established in the United States - that the "fruits of the poisoned tree" or illegally obtained evidence may not be admitted and used as evidence against a taxpayer.

As far as this defence is concerned for the purposes of section 76 of the Act, the onus is on the taxpayer to give a reasonable explanation for his default. If the conduct of the Commissioner was such that the taxpayer's rights in terms of the Constitution were violated, then it is submitted that this defence could succeed.

The defence of entrapment also has as its basis the Constitution in that the conduct of the revenue authorities or their agents is unreasonable.

Burchell and Hunt state that<sup>326</sup>,

*“it is not the entrapment of a criminal upon which the law frowns, but the seduction of innocent people into a criminal career by its offices is what is condemned.”*

And to excuse, “ the criminal design must have originated with the official”<sup>327</sup>.

Prior to the introduction of the new Constitution, this defence was hardly likely to succeed in that the offence was committed voluntarily and not as a result of compulsion or necessity<sup>328</sup>. Nevertheless, the entrapment could have been treated as an “extenuating circumstance.”

With the Constitution in place, it is submitted that entrapment evidence which is used as a basis to establish possible other violations or omissions of a taxpayer,

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<sup>326</sup> Burchell and Hunt, “South African Criminal Law and Procedure”, Volume 1, Juta & Co., Cape Town, 1976 (Second Impression) at page 322.

<sup>327</sup> Also at page 322.

<sup>328</sup> See the basis of this defence discussed in paragraph 9.2.8 below.

is tainted evidence in terms of our Constitution and could provide a complete defence against penalties being imposed.

### 9.2.5 Loss of interest to *fiscus*

This is not really a defence but a plea by the taxpayer that should any penalties be raised, the penalties so raised should be limited to the interest lost to the *fiscus*. This plea is especially effective in situations where there was no intention by the taxpayer to evade tax.

A reading of the relevant cases and decisions on penalties imposed in terms of section 76 of the Act, indicates that where the facts of the case warrant it, the court has imposed a penalty which equates to the amount of interest lost to the *fiscus*. The court thereafter precludes the Commissioner from raising, in addition, a section 89*quat* interest charge. Correspondingly, if a section 89*quat* interest charge is upheld by the Special Court and there is very little blame attached to the taxpayer, the courts are not inclined to impose any penalty in terms of section 76.

In ITC 1331<sup>329</sup>, the court was of the opinion,

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<sup>329</sup> 43 SATC 76 at page 87.

*“that a factor which should properly be taken into account in the exercise of the discretion as to the percentage or amount by which the prescribed additional tax should be remitted is 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.”*

In ITC 1430<sup>330</sup>, the court took into account the subsequent death of the taxpayer and the insolvency of his estate, after penalties had been imposed by the Commissioner, as “extenuating circumstances”. Nevertheless, the court held that the state had lost interest on the additional tax from the respective dates of the original assessments to the respective dates of the revised assessments; and that, approving ITC 1331, remission should not include interest lost to the state.

In ITC 1461<sup>331</sup>, however, the court refused to impose a penalty in circumstances where the Commissioner had originally imposed penalties after an investigation into a deceased estate. The Commissioner’s representative had argued, relying on ITC 1430, that at the very least, a penalty should be imposed which equated to the loss of interest to the *fiscus*. The court held that any amount imposed in terms of section 76 was a penalty and that the court would not countenance the imposition of a penalty against a representative taxpayer.

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<sup>330</sup> 50 SATC 51.

<sup>331</sup> 51 SATC 165.

Similarly in ITC 1489<sup>332</sup>, the court regarded the loss of interest to the *fiscus* as a relevant factor and reduced the imposed penalty from R89 173 to R45 000.

In ITC 1576<sup>333</sup>, the Commissioner raised interest in terms of section 89*quat* in addition to a penalty. The court was of the view that a penalty of 50% of the additional tax was appropriate in the circumstances of the case and would be sufficient compensation for the State's loss of interest and therefore the Commissioner was precluded from imposing a further section 89*quat* interest charge.

In KBI v Mabotsa<sup>334</sup>, the loss of interest to the *fiscus* was some R17 000. The Special Court, in assessing the penalty, ignored the loss of interest to the *fiscus* and only imposed a penalty of R4 000. The Commissioner appealed to the Supreme Court against the low penalty imposed. The Supreme Court of the Northern Cape held that the court *a quo* paid too little attention to the loss of interest suffered by the State; in fact, the court *a quo* had made no provision whatsoever in its penalty for the loss of interest on the part of the State.

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<sup>332</sup> 53 SATC 99.

<sup>333</sup> 56 SATC 225.

<sup>334</sup> 55 SATC 98.

The court held, further, that it is only right and proper that a taxpayer must at least pay the loss of interest suffered by the State as otherwise he could be better off with a fine than had he paid the proper tax in time. Accordingly, the fine of R4 000 imposed by the court *a quo* was not appropriate and the fine imposed by the Commissioner of 100% of the additional tax payable was excessively heavy and that a reasonable and appropriate fine in the circumstances was R20 000.

In ITC 1725<sup>335</sup>, no penalty was imposed but a section 89*quat* interest charge was imposed as there had been an exploitation of what was perceived to be a gap in the Act.

#### **9.2.6 Permissible deductions**

In this defence, the taxpayer would argue that he did not disclose certain gross income or made a false statement because his expenses equalled the income not declared or that the false statement did not result in a decrease in taxable income since other permissible deductions could be claimed, such as wear and tear allowances, cleaning expenses, casual labour costs, etc.

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64 SATC 223.

In such a case, the question of permissible deductions tends to indicate that there was no intention by the taxpayer to evade taxes. This is typically so in a hobby situation.

In ITC 1377<sup>336</sup>, the court sent the matter back to the Commissioner to reassess and to take into account the expenses incurred by the taxpayer which were to be off-set against the totaliser jackpot won by a professional gambler and not declared as income.

#### **9.2.7 The *de minimus non curat lex* principle**

If a taxation offence is committed which is of a trifling nature, the community is not really affected and would not be prejudiced if no penalties are imposed. For example, if a taxpayer submits his return one month later than he should have, then in terms of section 76(1)(a), the Commissioner is entitled to impose a penalty of 200% on the tax chargeable on his taxable income as assessed.

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<sup>336</sup> 45 SATC 221.

The offence is, it is submitted, of a trifling nature and the Commissioner should not impose a penalty if that was the first time that the taxpayer submitted a return late.

However, the penalty is usually computer driven and a fairly substantial penalty is imposed, depending on the taxes assessed. Is there any reason that the late submission of a return by someone who is assessed to taxes for R100 000 who may have already settled such tax liability (by paying provisional tax) is penalised R10 000 whereas someone who is only assessed to taxes of R10 000 and who has not yet settled his liability, should only have a penalty of R1 000 imposed?

This is, it is submitted, where the *de minimus non curat lex* principle should apply and both taxpayers should be treated equally. In fact, no real harm has been done in either instance. Penalties generated by computers should be reviewed by a natural person for reasonableness before being sent out. This would prevent unnecessary administrative irritations for both the revenue authorities and the taxpayer and is in accordance with section 33 of the Constitution<sup>337</sup>.

#### **9.2.8 Physical impossibility of complying with the law and necessity**

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<sup>337</sup> This would prevent unnecessary objections being filed in this respect.

The principle of *lex non cogit ad impossibilia*, or it was impossible to comply with the law, can constitute a good defence in criminal law. It is submitted that such a defence or plea could succeed in taxation matters in the appropriate circumstances. Burchell and Hunt are of the opinion that<sup>338</sup>,

*“the defence of impossibility is relevant where it was impossible for the accused to comply with a positive injunction of the law, whereas necessity is applicable where his claim is that he could not help doing an act prohibited by law.”*

The impossibility must be absolute. For example, the failure to pay taxes because the taxpayer is in jail, is not an excuse. The taxes could be paid by an agent. In R v Hoko<sup>339</sup>, the taxpayer was, in addition to being in prison, poor. The Southern Rhodesian (as it was then known) Supreme Court held that that was not an excuse for not paying the taxes. It is submitted that at the very least a South African court would regard the unfortunate circumstances that the taxpayer found himself in, as “extenuating”.

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<sup>338</sup> Burchell and Hunt, “South African Criminal Law and Procedure”, Volume 1, Juta & Co., Cape Town, 1976 (Second Impression) at page 294.

<sup>339</sup> 1941 SR 211.

Some excuses which have succeeded overseas in value-added tax matters have been<sup>340</sup>:

- The financial director broke his neck and his back and was paralysed in both arms following a motor accident.
- The managing director's wife, who was the company secretary, eloped with the financial manager and the managing director was unable to complete his returns.

Unsuccessful excuses have been<sup>341</sup>:

- A managing director said he could not sign cheques because he was depressed.
- An accountant got married and went on honeymoon. When he returned to work he said that he had other things on his mind.
- The taxpayer said its accountant kept all the records in Chinese and when he left his successor could not read Chinese.

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<sup>340</sup> Penelope Webb, "More Excuses", Accountancy SA, June 2002, page 29.

<sup>341</sup> Also from Penelope Webb's article at page 29.

Burchell and Hunt set out the requirements for the defence of necessity as follows:<sup>342</sup>

- (a) A legal interest of the accused must have been endangered
- (b) by a threat which had commenced or which was imminent but which was
- (c) not caused by the accused's fault: and, in addition, it must have been
- (d) necessary for the accused to avert the danger; and
- (e) the means used for this purpose must have been reasonable in the circumstances.

The danger of death or serious bodily harm must be compelling. However, the fear of a lesser injury to the person or his close family or the threat of damage to property is probably sufficient.

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<sup>342</sup> At page 285.

In R v Canestra<sup>343</sup>, it was held that the threat of mere pecuniary loss such as losing one's employment or livelihood, is insufficient for a full defence of necessity in criminal matters. However, the threat to one's employment or livelihood would, it is submitted, virtually present a full defence or at the very least a substantial reduction in penalties imposed under section 76 of the Act.

A good example to illustrate this defence would be to alter the facts slightly from that which took place in ITC 1423<sup>344</sup>. Assume that the taxpayer in that case had been threatened with his life by the freedom fighters in the then Rhodesia not to pay taxes, then it is submitted that such a threat would have been a complete defence against the imposition of penalties.

Marital coercion, it is submitted, would also fall within this category of defence or plea.

### 9.3 CORPORATE TAX EVASION

A great deal of difficulty arises when a court is faced with corporate tax evasion.

The judge in CIR v Richmond Estates (Pty) Ltd<sup>345</sup>, referred to a company as,

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<sup>343</sup> 1951(2) SA 317(AD).

<sup>344</sup> 49 SATC 85. For a full discussion on this case, refer to paragraph 7.3.4 above.

<sup>345</sup> 20 SATC 355 at 361.

*“an artificial person ‘with no body to kick and no soul to damn’ and the only way of ascertaining its intention is to find out what its directors acting as such intended.”*

The question is whether similar or the same defences or “extenuating circumstances” can be pleaded for a corporation as for an individual?

The Canadian Courts treat a corporation in a manner similar to an individual. The author of “Sentencing”, Clayton C Ruby, submits that the Canadian Courts take the following into account when punishing a corporation<sup>346</sup>:

- The size and character of the corporation and its position in the marketplace<sup>347</sup>.

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<sup>346</sup> Clayton C Ruby, “Sentencing”, (4th ed.), Butterworths Canada Ltd. 1994, Toronto and Vancouver, at pages 312-313.

<sup>347</sup> In R v Armco Canada Ltd and Nine Other Corporations (No 2), 24 CCC (2nd) 147 (ONT. S. C.) at pages 149-150, the judge had the following to say:

*“To fine a large corporation can hardly be said to be punishment or a deterrent unless the fine is substantial. Realistically it cannot be said that the stigma of conviction and penalty to a large corporation, or even some smaller corporations, will reflect unfavourably on their corporate images in the business world or with the consumer public which, in the final analysis, this whole process is designed to protect. However, on occasion, unfortunately, relatively unimportant personal offenders or small businessmen operating as one shareholder corporations may suffer consequences out of all proportion to those suffered by the large impersonal corporations whose executive offices and*

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- The relative wealth of the corporation as well as its relative poverty where this is a factor.
- The fact that the corporate character and ownership may change over a period of time<sup>348</sup>.
- Corporate offenders view a fine like any other business expense.
- Reliance upon professional advice may provide a complete defence or may constitute a “mitigating” factor.

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*guiding personalities are relatively anonymous.”*

<sup>348</sup> In Adam Clark Co. Ltd., (1983), 9 WCB 137 (Ont. CA), the shares in the company were sold to persons who had no knowledge of the previously illegal activities of the company. The fact that the present shareholders were not involved in the previous illegal activities was a relevant factor in deciding the magnitude of the fine. However, it did not obviate the need for a sentence that would act as a deterrent to others and make it clear to corporations that they must properly supervise their employees in the performance of their duties. See the similar sentiments expressed by the court in ITC 1486, 53 SATC 39 as regards the duty of management to supervise employees properly.

- A difficulty arises as to how to apportion blame and accordingly punishment between the individual as opposed to the corporation<sup>349</sup>.

In ITC 1486<sup>350</sup>, the Commissioner imposed the maximum penalty on the taxpayer, a company, in terms of section 19(3) of the Sales Tax Act<sup>351</sup>, the sales tax equivalent of section 76 of the Act. The court held that as is the case in section 76 of the Act, it is not possible to attribute the intent of the employees to evade taxes, acting contrary to the instructions of the taxpayer, to the taxpayer. In regarding to determining the penalty to be imposed, it held that consideration must be given to the blameworthiness of the appellant. In this case it consisted of not exercising proper supervision over the activities of the employees and not checking to see that the systems it had introduced and laid down were followed. The court also referred to the deterrent factor to other potential wrongdoers, and

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<sup>349</sup> The court in R v Oriental Bowl, et al, (1983) 83 DTC 5342 (Sask. Prov. Ct.) at page 5344, had the following to say regarding the circumstances in that case:

*“To impose a heavy fine on an inanimate object like the company is just to invite the officers and directors of the company, who are the real instigators behind the crime of tax evasion by the company, to allow the company to default on the payment of the fine, letting the company go into receivership which might be to the detriment of bona fide creditors of the company.”*

<sup>350</sup> 53 SATC 39.

<sup>351</sup> No 103 of 1978.

reduced the penalty of some R600 000 originally imposed by the Commissioner, to a flat R200 000.

It is submitted that the South African courts, like the Canadian courts, would allow a corporate tax offender to plead the same or similar defences or “extenuating circumstances” as an individual who is faced with a penalty. However, the very specific personal defences such as education, age, lifestyle, etc., may not be available to the corporate offender especially where the corporate offender is a medium to large company and the tax offence committed is perpetrated by employees of the corporation, acting on their own accord with no assistance or direction from the major shareholders.

On the other hand, the individual shareholder who abuses the corporate veil to commit tax offences for his own benefit, may still be able to plead the personal defences or “extenuating circumstances” available to individual taxpayers. But as has been pointed out already, the taxpayer who sets out on a deliberate and systematic path leading to tax evasion usually can expect harsher penalties being imposed than a “spur of the moment” decision to evade taxes<sup>352</sup> because such conduct is regarded as an aggravating factor. Any personal “extenuating circumstances” pleaded must then be balanced against the aggravating factors.

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<sup>352</sup> Refer to Chapter 7 of this dissertation where this aspect was discussed. See also ITC 1658, 61 SATC 231.

#### 9.4. CONCLUSION

As far as other miscellaneous defences are concerned, ignorance of the law, a *bona fide* belief, following the wrong advice<sup>353</sup>, destruction of financial records<sup>354</sup>, the *de minimus non curat lex* principle or arguing that the income was not disclosed because the income was covered by permissible deductions<sup>355</sup>, and physical impossibility of complying with the law or necessity, can either be regarded as a complete defence or at the very least, constitute “extenuating circumstances”.

Provocation or impropriety by the investigating officers of the taxpayer in appropriate circumstances (constitutional defences) should, it is submitted, be seen in the same light and also be treated as “extenuating circumstances”.

Nevertheless, it appears as if the starting point for the judiciary, in the level of the penalty to be imposed where a complete defence is not available, is the loss of interest to the *fiscus*<sup>356</sup>.

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<sup>353</sup> ITC 1306, 42 SATC 139; ITC 1576, 56 SATC 1; ITC 1725, 64 SATC 223; ITC 1377, 45 SATC 221; ITC 1508, 53 SATC 442.

<sup>354</sup> ITC 1612, 59 SATC 180.

<sup>355</sup> ITC 1377, 45 SATC 221.

<sup>356</sup> Refer to paragraph 9.2.5 above.

This chapter also briefly examined the aspect of corporate tax evasion and it was concluded that the same or similar defences and plea of “extenuating circumstances” as are available to individual taxpayers, extends to the corporate tax offender.

**CHAPTER 10      CONCLUSION**

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**10.1      BACKGROUND - TAX EVASION, THE BASIC CAUSE**

More than 230 years ago, Adam Smith wrote<sup>357</sup>:

*“An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment too, in proportion to the very circumstances which ought to alleviate it, the temptation to commit the crime.”*

At the time when Adam Smith penned these words, at some date between 1766 and 1776, he may just as well have been referring to income tax matters rather than customs duty<sup>358</sup>. The very fact that a government imposes tax at an unreasonably high rate on income is probably the root cause of tax evasion on

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<sup>357</sup> Adam Smith, *An Enquiry into the Nature and Causes of the Wealth of Nations*, 1776, Book 5, Chapter 2, Part 1.

<sup>358</sup> Ironically, he accepted the position of Commissioner of Customs in Edinburgh in 1778, only some two years after publication of his book, *“Wealth of Nations”*.

a large scale - the temptation is too great for most taxpayers who see the opportunity not to disclose their true income in the belief that they will not be caught, or if caught, will not be harshly punished.

One of the reasons for this attitude is that tax evasion is regarded as a white-collar crime and, instead of being treated with revulsion, is tolerated if not openly condoned and applauded by the public at large. The Government on the other hand, justifiably treats the collection of taxes as of prime importance and through the legislature, provides for substantial pecuniary penalties to be imposed on those taxpayers who are caught cheating on their taxes.

## **10.2 SECTION 76 OFFENCES - TAX PLANNING OR TAX EVASION**

The South African revenue authorities may only impose a penalty in terms of section 76 of the Act if one of the offences listed in that section has actually been committed. But whether a person has committed a section 76 offence or not, is sometimes open to debate.

One of the major problem areas in this regard, is to establish whether a taxpayer has embarked on a scheme of tax planning and tax avoidance on the one hand (for which the only possible sanction is interest chargeable in terms of section 89*quat*) or tax evasion or has simply engaged in negligent behaviour regarding

his tax responsibilities on the other hand (for which penalties in terms of section 76 may be imposed). When the fine line between these concepts is breached by the taxpayer, he will usually find himself in contravention of section 76 and automatically be subject to penalties.

The breaching of the line is sometimes difficult to establish. Our legislature, judiciary (as well as their counterparts elsewhere in the world) and academic writers have grappled with this problem over a long period of time.

We have judicial dicta to the effect that a taxpayer may arrange and plan his affairs insofar as he legally can in order to reduce his tax burden. However, our politicians and revenue officials continually criticise the taxpayer's right to do so and are constantly trying to tighten up perceived loopholes in our tax system. A previous Minister of Finance<sup>359</sup> even coined a new word "avoison", to describe the actions of taxpayers who enter into tax avoidance schemes, a word recognised neither in dictionaries nor by the judiciary.

In fact, the South African judiciary recognises that tax planning and tax avoidance are legal although the Rhodesian Appellate Division (as it was then known) in COT v Ferera<sup>360</sup> adopted an unusually high moral stance and referred to tax

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<sup>359</sup> The Honourable Mr Barend Du Plessis (as he then was).

<sup>360</sup> 38 SATC 66.

avoidance as an evil. Morality, it is submitted, is outside the ambit of law generally, but especially so in tax law and it is unlikely that the South African judiciary would ever endorse such sentiments.

It must not be forgotten that taxes are exacted or expropriated by the State from a taxpayer. Taxes are not voluntary contributions and as Lord President Clyde stated, a taxpayer is not under<sup>361</sup>,

*“the smallest obligation, moral or otherwise, so as to arrange his legal relations to his business or his property as to enable the Inland Revenue to put the largest possible shovel into his stores.”*

### 10.3 THE CONSTITUTIONALITY OF PUNITIVE MEASURES

In order to punish taxpayers who are errant in their tax affairs, the South African legislature and the revenue authorities have employed similar legislation and techniques to those successfully used in foreign jurisdictions. However, it is submitted that certain of the techniques borrowed and used by our revenue authorities, fail to live up to the Constitution, are unethical and indefensible<sup>362</sup>.

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<sup>361</sup> Ayrshire Pullman Motor Services & Ritchie v I. R. Commrs, (1929) 14 T.C. 754 at page 763.

<sup>362</sup> Search and seizure, freezing bank accounts, etc. We have seen that even in cases where it was clear that the taxpayer did not intend to evade taxes but relied on professional advice honestly given, the revenue authorities tend to treat the taxpayer as a serious tax offender and impose large

Their continued use sets a dangerous precedent and cause not only loss of respect for the revenue authorities but also resentment and revolt against the tax system as a whole, resulting in further large scale tax evasion.

The South African revenue authorities must be seen to be nothing but a fair and impartial collector of taxes which are properly due to the State in terms of legislation in force from time to time. Intimidation is not justifiable. Open and frank communication between the revenue authorities and the taxpayer is a necessity.

Of major concern is the apparent unwillingness of the revenue authorities to accept that they may be wrong on a matter of principle or even their complete disregard of a previous judgement of the High Court of Appeal in their zeal to punish a taxpayer<sup>363</sup>. The Katz Report recommended that a "Code of Conduct" based on the United Kingdom Code of Practice and embodied generally in section 33 of the Constitution, be introduced to make both the revenue authorities and the taxpayer aware of the revenue authorities' obligation not to pursue unreasonable positions and to compensate the taxpayer when a serious

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penalties which penalties are ultimately remitted *in toto* on appeal to the Special Court. See ITC 1725, 64 SATC 223.

<sup>363</sup> See ITC 1331, 43 SATC 76; CIR v Da Costa, 47 SATC 87; KBI v Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk, 58 SATC 273.

mistake is made by them<sup>364</sup>. Some eight years later, this recommendation has still not been implemented. Without the implementation of this recommendation and its complementary sanction, it is submitted that the revenue authorities have a licence to act unreasonably when it suits them.

#### **10.4 ALTERNATIVE DISPUTE RESOLUTION PROCEDURES**

Perhaps the newly introduced conditions and procedures for alternative dispute resolution (“ADR”)<sup>365</sup> have the potential to reduce friction between the revenue authorities and the taxpayer provided that the revenue authorities do not attempt to misuse this procedure and contravene a taxpayer’s fundamental and constitutional rights. At the first sign of irregularities or contempt by the revenue authorities regarding the ADR procedures, the taxpaying public and especially their tax advisors, will be reluctant to follow this route and a good opportunity will have been lost to resolve conflict situations.

#### **10.5 THE REVERSE ONUS IN SECTION 82**

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<sup>364</sup> See Chapter 4, paragraph 4.2.3.

<sup>365</sup> Section 107B and the October 2002 release by the Minister of Finance setting out the circumstances under which the Commissioner may settle disputes with taxpayers (see Appendix II) .

The reverse onus placed on the taxpayer in terms of section 82 of the Act in situations where substantial pecuniary penalties may be imposed, is a matter of grave concern. The revenue authorities need merely allege a contravention of section 76 of the Act and then it is up to the taxpayer to discharge the onus on a balance of probabilities that no offence has been committed.

Any penalty initially imposed, is of an administrative nature (although, on appeal, the Special Court may substitute its own decision for that of the Commissioner) and is not based on the proven “guilt” of the taxpayer. The reverse onus in penalty situations is fundamentally flawed and, it is submitted, unconstitutional.

It is a procedure which allows for the abuse of a taxpayer’s fundamental and constitutional rights by the revenue authorities. The abuse may specifically take the form of the revenue authorities immediately imposing a large penalty on the taxpayer without first listening to the taxpayer’s side of the story (abuse of the *audi alteram partem* principle) and then deciding on an inappropriate penalty in cases where they consider, without proper evidence, that the taxpayer has committed a section 76 offence. Other abuses may take the form of the revenue authorities flying in the face of a High Court decision, or not taking into account “extenuating circumstances” recognised by our judiciary when imposing a penalty.

It is submitted that it will only be a matter of time before the reverse onus in these matters will be challenged on a constitutional basis by an adversely affected taxpayer<sup>366</sup>. In order to pre-empt such a challenge, it is submitted that South Africa should follow the trend of the United States of America, the United Kingdom and Canada, in only allowing the revenue authorities to impose a relatively low administrative penalty on an errant taxpayer in the first instance. Thereafter the alleged offender can be prosecuted in a normal court of law for any additional penalty or sanction with the burden of proof reverting to the revenue authorities. This would leave the way open for the South African judiciary to follow the overseas judiciary and impose a prison sentence on the worst tax offenders<sup>367</sup>.

## **10.6 SUMMARY OF FINDINGS**

### **10.6.1 Main focus of the study**

This dissertation has had as its main focus the types of defences or pleas which an errant taxpayer may advance in order to obtain a remission of penalties

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<sup>366</sup> See discussion on the possible unconstitutionality of the reverse onus in penalty situations in paragraph 3.2 and footnote 52 above.

<sup>367</sup> The United States of America has even used this procedure to incarcerate well known criminals for tax fraud because they have been unable to convict such persons of charges such as murder, extortion, robbery, etc. Al Capone is one of the well known recipients of this type of justice.

imposed in terms of section 76. Specific attention was paid to the general meaning of the words “extenuating circumstances”, which circumstances must be present before there can be a remission of penalties in the case of tax evasion<sup>368</sup>.

### 10.6.2 Subjective test

The specific factors which may constitute “extenuating circumstances”, defences or pleas were discussed in detail and specific conclusions reached<sup>369</sup>. Further detailed conclusions in this regard are therefore deemed unnecessary. Nevertheless, the general conclusion which may be reached is that the judiciary are very liberal in their interpretation of “extenuating circumstances”. Probably, because of the very harsh penalties prescribed for tax evasion and with the taxpayer at an unfair advantage regarding the reverse burden of proof, the judiciary have endeavoured to lessen the burden of the taxpayer and thereby the extent of the penalty, by including in the interpretation of “extenuating circumstances”, factors not normally taken into account in criminal law cases.

Our judiciary consistently applies the subjective test in attempting to establish the intention of the taxpayer when evaluating whether the taxpayer intended to evade

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<sup>368</sup> See Chapter 5.

<sup>369</sup> See Chapters 6, 7, 8 and 9.

tax. They are reluctant to find that a taxpayer deliberately evaded tax except in the most blatant and obvious cases. Rather, the approach of the judiciary has tended to find that the taxpayer was “negligent”, “careless”, “thoughtless”, “culpable” or “failed to exercise proper supervision over its employees”<sup>370</sup>.

### 10.6.3 Fixing of penalties

The judiciary, in fixing a penalty, even in cases where no tax evasion is involved, tend to refer to “extenuating circumstances” as a reason for the remission of penalties. However, section 76(2)(a) does not require “extenuating circumstances” to be present for a remission of penalties in cases where no tax evasion is involved - the person exercising the discretion is left to decide the extent of the remission “as he may think fit”.

It is submitted that the judiciary are dealing with the problem of remission of penalties in a correct and proper way - it compels the judicial officer imposing the penalty to give proper and valid reasons for his decision. Any “extenuating circumstances” pleaded, forces the judicial officer to weigh up the main

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<sup>370</sup> Except in ITC 1577, 56 SATC 236, when an objective test was used. It is submitted that there is no room for a purely objective test in establishing intention for the purposes of section 76(2)(a). See paragraph 6.6.1 above.

purposes of punishment mentioned by Davis AJA in R v Swanepoel<sup>371</sup>, namely, deterrence, prevention, reformation and retribution, and balance them against the “extenuating circumstances” accepted as valid and compelling.

#### 10.6.4 Types of “extenuating circumstances” taken into account

The singular and most commonly pleaded and recognised “extenuating circumstance” or defence, has been the reliance by the taxpayer on professional or non-professional advisors or staff<sup>372</sup>.

Other important “extenuating circumstances”, defences or pleas advanced include:

- the conduct of the taxpayer before, during and after the commission of an offence, especially motive, remorse, planning, magnitude and duration of an offence<sup>373</sup>;

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<sup>371</sup> 1945 AD 444 at 445.

<sup>372</sup> See Chapter 6.

<sup>373</sup> See Chapter 7.

- the personal circumstances of the taxpayer, especially the death, financial means and intelligence of the taxpayer<sup>374</sup>; and
- ignorance of the law, negligence and carelessness of the taxpayer<sup>375</sup>.

“Extenuating circumstances”, defences and pleas based generally on the provisions of the Constitution will, it is submitted, also be recognised in the future<sup>376</sup>.

It is further submitted that the greater the number of “extenuating circumstances”, factors present, or defences or pleas accepted, the greater will be the remission of the ultimate penalty imposed. However, the starting point in imposing a penalty appears to be the loss of interest to the *fiscus* unless there are

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<sup>374</sup> See Chapter 8.

<sup>375</sup> See Chapter 9.

<sup>376</sup> See paragraph 7.3.4 generally and the author’s comments in relation to ITC 1423, 49 SATC 85 in that paragraph, in particular.

compelling reasons not to impose interest, for example, the taxpayer is dead or interest in terms of section 89*quat* is imposed instead.

#### 10.6.5 **Discretion: the Commissioner and the judiciary**

An interesting and vital thread which can be seen running through most of the cases discussed, is the power of the judiciary to substitute its own discretion for that of the Commissioner<sup>377</sup> and their reliance on precedent to guide them in imposing a fair penalty on the errant taxpayer.

The discretion granted to the Commissioner and to the judiciary to impose or remit penalties in terms of section 76 does not imply unbridled power. Both should be guided by past judicial decisions<sup>378</sup>. This tends to promote coherence and consistency and hence justice by reducing the scope for partiality, caprice or prejudice.

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<sup>377</sup> See Chapter 4 in this regard.

<sup>378</sup> In KBI v Mabotsa, 55 SATC 98, the court held that although the Commissioner for Inland Revenue and the Special Court have an unfettered discretion to impose a fine and the legislature does not prescribe any specific norms as to how this discretion must be exercised, such norms have, to a great extent, been set out by our courts and should be followed wherever possible.

### 10.6.6 Achieving a fair result

The accumulated wisdom and experience of judges who have wrestled with similar problems in the past, not only in tax matters but in all spheres of the law, provide safer guidelines than an individual revenue official without that assistance. An exercise of an arbitrary or biased penalty either imposed by the Commissioner or substituted by the Special Court for that of the Commissioner's, will constitute either an irregularity or a misdirection since it may result in either an excessive penalty or even too lenient a penalty being imposed.

An excessive penalty can be overturned even though there has been no discernable irregularity or misdirection. This occurs when the person vested with the discretion fails to take into account circumstances which he should have taken into account or even if taken into account, assessing the value or weight to be given to such circumstances, incorrectly. Overemphasis of any one of the triads of the offence, the taxpayer and the interests of society are grounds for

appeal to the Special Court or grounds for review by the High Court of the Special Court's decision<sup>379</sup>.

Van Heerden JA in Da Costa v CIR<sup>380</sup>, remarked that the punishment must fit the crime, in tax matters no less than elsewhere.

Misdirection can, *inter alia*, take the following form:

- A taxpayer should only be punished for the offence committed - other aspects of the case which the court is not happy with, should not play a part<sup>381</sup>.

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<sup>379</sup> In KBI v Mabotsa, 55 SATC 98, the Commissioner imposed a 100% penalty which was subsequently reduced on appeal to the Special Court to R4 000. On appeal by the Commissioner to the Appellate Division, it was held that the original penalty imposed by the Commissioner was too high whilst the penalty of R4 000 substituted by the Special Court was regarded as too low. Instead, a penalty of R20 000 was substituted which equated to the interest lost to the *fiscus* of some R17 000. The Special Court was found to have misdirected itself since it had not taken the interest factor into account.

<sup>380</sup> 47 SATC 87.

<sup>381</sup> See ITC 1518, 54 SATC 113, where it appears as if the taxpayer was harshly punished for aspects not directly related to tax evasion.

- Substantially different punishments are imposed on co-offenders whose offence and personal circumstances are essentially similar<sup>382</sup>.
- Failure to take into account the means of the taxpayer or even failure to inquire about them - penalties in general must be within the offenders' ability to pay<sup>383</sup>.
- Imposing a sentence which takes into account the fact that a taxpayer has benefited from his fraud whereas he has not benefited at all<sup>384</sup>.
- A court which fetters its discretion by acting under the direction of another person or body not empowered to

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<sup>382</sup> See ITC 1295, 42 SATC 19, where the court, it is submitted, correctly distinguished the blameworthiness of each taxpayer involved and imposed different penalties.

<sup>383</sup> See ITC 1461, 51 SATC 165 and ITC 1430, 50 SATC 51. See also Da Costa v CIR, 47 SATC 87, where the Commissioner's representative even argued that financial means should not be taken into account when remitting penalties. The court decided that the financial means must play a part in the size of the penalty to be imposed.

<sup>384</sup> Compare the cases of ITC 1423, 49 SATC 85 and S v Lennon, 35 SATC 101, where the Rhodesian Court (as it was then known), in the author's opinion, treated the taxpayers rather harshly. It is submitted that a South African Court would probably have been more accommodating to the affected taxpayers.

decide the issue. This does not mean that a court must not take into account public opinion - it is one of the considerations - but it must not blindly follow a particular policy while ignoring other relevant considerations.

Consistency, with the help of previous well reasoned judicial decisions in setting the level of penalties, is the ideal principle and leads to fairness as required in our Constitution. It makes the principle of discretion tolerable. However, on the other hand, blindly following precedent conflicts with the discretion necessary for a fair and proper punishment for an offence committed. Considerations of individualism and justice can outweigh the ideal of consistency but general statements by our judiciary to the effect that the penalty must depend on the circumstances of each case tends to be overworked and provides little guidance for other courts or revenue officials.

A proper evaluation and careful balancing of all the relevant aspects is necessary to achieve a fair result. In effect, the person imposing the penalty must find the answer to two basic questions, namely,

- what principles are relevant; and
- what weight is to be attached to the relevant principles.

The principle of regarding a first offence, or age, or lack of education as an “extenuating factor” is relevant. But little weight is given to these factors if the lack of education or mature years did not hamper the taxpayer in his business dealings or in his intention to evade taxes. A deliberate path of tax evasion can, in fact, be regarded as an aggravating factor<sup>385</sup>.

The weight to be given to each principle can also be influenced by the background, social values, experience, and moral and penal philosophy of the person imposing the penalty. Nevertheless, the person empowered to impose penalties should not allow himself to be unduly influenced by his own upbringing and prejudices.

One of the final elements in punishment is that of mercy. Holmes JA in S v V<sup>386</sup>, referred to it as “an element of justice itself”. In S v Harrison<sup>387</sup>, the judge had expressed similar sentiments: “Justice must be done, but mercy, not a sledgehammer, is its concomitant.” Napoleon’s famous dictum that mercy is not mercy if deserved, is apposite.

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<sup>385</sup> See Van Der Walt v S, 52 SATC 186 and ITC 1540, 54 SATC 400.

<sup>386</sup> 1972(3) SA 611(A) at page 614.

<sup>387</sup> 1970(3) SA 684(AD) at page 686.

The revenue official or judicial officer must impose a penalty which is rational and effective. To do this, he must have information on the offender, *inter alia*, his purpose or even lack of purpose, his blameworthiness (negligence, reliance on advisors), family background, environment in which he grew up (even political background) and his financial resources. Without these factors being taken into account, a penalty imposed cannot be predicted - it becomes a shot in the dark - it is intuitive and usually unfair rather than scientific and predominately fair.

Mullins J in ITC 1430<sup>388</sup>, had some harsh words to say about the penalty's committee for imposing a 100% penalty on a taxpayer who had subsequently died.

*"It seems to this court . . . that the penalty fixed by the committee in Pretoria . . . was excessively severe, was – having regard to the relationship it bore to the maximum penalty imposable – arbitrary and unreasonable and that taking all the circumstances into account and without setting off with any mathematical precision interest which might have been earned by the taxpayer from the tax withheld over the years against that which the full R15 590,00 paid by the taxpayer as a penalty might have yielded to the revenue, an appropriate penalty should not exceed the sum of R3 000,00. Such an amount, which cannot conceivably be regarded as trifling to a 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."*

Punishment involves the balancing of different and often competing values - legal training and experience are indispensable qualities and, it is submitted that perhaps only legally qualified revenue officers with sufficient practical experience in that field, should chair a penalty or hardship committee.

Wheatcroft, commenting on the English Special Commissioners said that they are,<sup>389</sup>

*"one of the curiosities of the English Constitution. They break many of the accepted conventions of judicial procedure. They sit in private, their procedure is informal, they often act on unsworn evidence, and worst of all, they are permanent employees of one party to every dispute they try."*

It is submitted that this statement is true, at present, of the South African revenue officials who are tasked with imposing penalties on errant taxpayers. They do not appear to have always taken previous norms of punishment, as recommended by our judiciary, into account when imposing penalties in terms

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<sup>389</sup> Modern Law Review, May 1955, Volume 18, page 209.

of section 76<sup>390</sup>. It has already been mentioned that their arrogance in automatically imposing a large penalty before hearing representations by the taxpayer, is not in line with administrative law nor the Constitution.

This confrontational attitude leads to disputes and loss of respect by the taxpayer. This is especially so where a penalty imposed by the revenue official is subsequently substantially reduced or even remitted *in toto* on appeal to the judiciary.

The judiciary, fortunately, is our watchdog over the excesses or even the perceived excesses of the revenue authorities. This watchdog role, it is submitted, will increase over the next few years when taxpayers who are aware of their rights in terms of the Constitution, will challenge every action of the revenue authorities, including their arbitrary imposition of penalties.

In spite of the foregoing, we must accept what was said by the judge in R.v Dhlumayo and Another<sup>391</sup>: “No judgement can ever be perfect and all embracing.”

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<sup>390</sup> The result, as has been seen in many of the cases discussed and analysed, is usually a substantial reduction in the penalty imposed, on appeal, to the Special Court.

<sup>391</sup> 1948(2) SA 677(A) at page 702.

Nevertheless, disparity in punishment at the appeal level is likely to be less marked than at the trial level and especially so at the revenue level if for no other reason than fewer judicial officers are involved.

## 10.7 AREAS FOR FUTURE RESEARCH

The scope of this dissertation has been such that a discussion on several important ancillary issues related to the imposition and remission of penalties in terms of section 76, have, of necessity, been limited. In some cases, these related issues have only been mentioned and not discussed. In other cases, the related issues were, by design, not even mentioned. These areas need further research so that a complete picture can be obtained regarding the fundamental rights of a taxpayer during the course of a tax investigation by the revenue authorities and the potential imposition of penalties in terms of section 76 of the Act.

The areas relating to a taxpayer's fundamental rights are mainly embodied in the Constitution or in the common law but many of the rights so embodied still need to be interpreted by the judiciary in relation to tax matters. The areas identified for further research (not in order of importance) in this regard, include, *inter alia*:

- the demand for information from a taxpayer by the revenue authorities:

- the powers of search and seizure by the revenue authorities:
- the *audi alteram partem* doctrine:
- the freezing of a taxpayer's bank account without reference to or authority from the judiciary:
- the application of the so-called "pay-now-argue-later" principle by the revenue authorities:
- the delegation of the Commissioner's power to impose penalties:
- the admissibility of hearsay evidence:
- the applicability of privileged communications, especially between an attorney or advocate and his client and between spouses:
- the right of access to documents and evidence in the possession of the revenue authorities and the discovery of documents:
- the Alternative Dispute Resolution procedures:

- the reverse onus of proof: and
- the awarding of costs:

## 10.8 **CONCLUSION**

Finally, it may be concluded that an errant or for that matter an innocent taxpayer, going from a situation of fighting a losing battle on the merits of a case, may find himself suddenly fighting a winning battle on punishment. But he can only succeed in this if he or his representative is aware of all the possible factors, defences or pleas which have already been pleaded or could be pleaded in the future<sup>392</sup>. These factors, defences or pleas must be brought to the attention of the revenue authorities in the first instance, and the judiciary thereafter, if the matter goes on appeal. Knowledge in this area is vital and may result in a taxpayer being a recipient of justice rather than a victim of justice.

## **APPENDIX I**

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<sup>392</sup> See ITC 1658, 61 SATC 231, where the taxpayer failed to plead any “extenuating circumstances” other than advancing the reason for his false claim for overseas travelling expenditure as business related expenditure, was because the revenue authorities had allowed such false claims as a deduction in the past. It is submitted that if the taxpayer had pleaded any of the “extenuating circumstances” already recognised by the judiciary, for example, ignorance of the law, in addition, the full 200% penalty would probably have been reduced.

## OFFENCES IN TERMS OF SECTIONS 75 AND 104 OF THE ACT

### Section 75 - Penalty on default.

- (1) Any person who—
- (a) fails or neglects to furnish, file or submit any return or document as and when required by or under this Act; or
  - (b) without just cause shown by him, refuses or neglects to—
    - (i) furnish, produce or make available any information, documents or things;
    - (ii) reply to or answer truly and fully, any questions put to him; or
    - (iii) attend and give evidence,
 as and when required in terms of this Act; or
  - (c) fails to show in any return made by him any portion of the gross income received by or accrued to or in favour of himself or fails to disclose to the Commissioner, when making such return, any material facts which should have been disclosed; or
  - (d) fails to show in any return prepared or rendered by him on behalf of any other person any portion of the gross income received by or accrued to or in favour of such other person or fails to disclose to the Commissioner when preparing or making such return, any facts which, if so disclosed, might result in increased taxation; or
  - (e) obstructs or hinders any officer in the discharge of his duties; or
  - (f) without just cause fails to comply with the provisions of section 70A, 70B, 73A, 73B or 73C;
  - (g) submits or furnishes a false certificate or statement under section seventy-three; or
  - (h) holds himself out as an officer engaged in carrying out the provisions of this Act; or
  - (i) obtains approval of any project as a qualifying strategic industrial project in terms of section 12G of the Act, where such approval was based on any fraudulent information provided or material misrepresentation made by that person, or
  - (j) without just cause fails to comply with the provisions of section 99, where that person has been declared to be the agent of any other person as contemplated in that section,
- shall be guilty of an offence and liable on conviction to a fine or to imprisonment for a period not exceeding 24 months.

- (2) The Commissioner may, subject to such conditions as he may determine, and in respect of such books (other than ledgers, cash books and journals) or documents as he may specify, authorize the retention of any book or document referred to in subsection (1) in a form acceptable to him in lieu of the original thereof.
- (3) Any person who has been convicted under subsection (1) of failing to furnish any return, information or reply, shall, if he fails within any period deemed by the Commissioner to be reasonable and of which notice has been given to him by the Commissioner, to furnish the return, information or reply in respect of which the offence was committed, be guilty of an offence and liable on conviction to a fine of R50 for each day during which such default continues or to imprisonment without the option of a fine for a period not exceeding 24 months.

#### **Section 104 - Offences and penalties.**

- (1) Any person who with intent to evade or to assist any other person to evade assessment or taxation—
  - (a) makes or causes or allows to be made any false statement or entry in any return rendered in terms of this Act, or signs any statement or return so rendered without reasonable grounds for believing the same to be true; or
  - (b) gives any false answer, whether verbally or in writing, to any request for information made under this Act by the Commissioner or any person duly authorized by him or any officer referred to in section three; or
  - (c) prepares or maintains or authorizes the preparation or maintenance of any false books of account or other records or falsifies or authorizes the falsification of any books of account or other records; or
  - (d) makes use of any fraud, art or contrivance whatsoever, or authorizes the use of any such fraud, art or contrivance,shall be guilty of an offence and liable on conviction to a fine or to imprisonment for a period not exceeding five years.
- (2) Whenever in any proceedings under this section it is proved that any false statement or entry is made in any return rendered under this Act by or on behalf of any taxpayer or in any books of account or other records of any taxpayer, that taxpayer shall be presumed, until the contrary is proved, to have made that false statement or entry or to have caused that false statement or entry to be made or to have allowed it to be made with intent to evade assessment or taxation, and any other person who made any such false statement or entry shall be presumed, until the contrary is proved, to have made such false statement or entry with intent to assist the taxpayer to evade assessment or taxation.

**APPENDIX II****ALTERNATIVE DISPUTE RESOLUTION PROCEDURES****SECTION 107B - Settlement of dispute.**

- (1) The Minister may by regulation prescribe the circumstances under which the Commissioner may, notwithstanding any provision of this Act, settle a dispute between the Commissioner and a taxpayer in whole or in part, where such a settlement would be to the best advantage of the state.
- (2) The Minister must prescribe the requirements for the reporting by the Commissioner of any dispute which has been settled in whole or in part by the Commissioner, as contemplated in subsection (1).
- (3) Where any dispute between the Commissioner and the person aggrieved by an assessment has been settled, as contemplated in subsection (1), the Commissioner may, notwithstanding anything to the contrary contained in this Act, alter that assessment for purposes of giving effect to that settlement.
- (4) Any altered assessment contemplated in subsection (3) shall not be subject to objection and appeal.

**SOUTH AFRICAN REVENUE SERVICE**

R. No.

OCTOBER 2002

**CIRCUMSTANCES UNDER WHICH THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE MAY SETTLE A DISPUTE BETWEEN THE COMMISSIONER AND ANY PERSON, AS CONTEMPLATED IN SECTION 107B OF THE INCOME TAX ACT, 1962 (ACT NO. 58 OF 1962), AND SECTION 93A OF THE CUSTOMS AND EXCISE ACT, 1964 (ACT NO. 91 OF 1964)**

By virtue of the power vested in me by section 107B of the Income Tax Act, 1962, and section 93A of the Customs and Excise Act, 1964, I, Trevor Andrew Manuel, Minister of Finance, hereby prescribe in the Schedule hereto the circumstances under which the Commissioner for the South African Revenue Service may settle a dispute between the Commissioner and any person, notwithstanding any provision contained in the relevant Act or any other Act administered by the Commissioner, where such a settlement would be to the best advantage of the state.

**T. A. MANUEL, MP**  
**MINISTER OF FINANCE**

**SCHEDULE*****Definitions***

1. For the purposes of these regulations, any word or expression to which a meaning has been assigned in the Act shall, unless the context otherwise indicates, bear the meaning so assigned, and.

“dispute” means a disagreement on the interpretation of either the relevant facts involved or the law applicable thereto;

“SARS” means the South African Revenue Service;

“settle” means to resolve a dispute by compromising any disputed liability, otherwise than by way of either the Commissioner or the person concerned accepting the other party’s interpretation of the facts or the law applicable to those facts, and “settlement” shall be construed accordingly.

***Purpose of these regulations***

2. (1) The basic principle in law is that it is the duty of the Commissioner to assess and collect taxes, duties, levies, charges and other amounts according to the laws enacted by Parliament and not to forgo any such taxes, duties, levies, charges or other amounts properly chargeable and payable.
  - (2) Circumstances may, however, require that the strictness and rigidity of this basic principle be tempered where it would be to the best advantage of the state.
  - (3) The purpose of these regulations is, therefore, to prescribe the circumstances whereunder it would be inappropriate and whereunder it would be appropriate that the basic rule be tempered and a decision be taken to settle a dispute.

***Circumstances where the Commissioner may not settle a dispute***

3. It will be inappropriate and not to the best advantage of the state to settle a dispute, where, in the opinion of the Commissioner,
  - (a) the action on the part of the person concerned which relates to the dispute, constitutes intentional tax evasion or fraud and no circumstances contemplated in regulation 4 exist;
  - (b) the settlement would be contrary to the law or a clearly established practice of SARS on the matter, and no exceptional circumstances exist to justify a departure from the law or practice;
  - (c) it is in the public interest to have judicial clarification of the issue and the case is suitable for this purpose;

- (d) the pursuit of the matter through the courts will significantly promote compliance and the case is suitable for this purpose; or
- (e) the person concerned has not complied with the provisions of any Act administered by the Commissioner and the Commissioner is of the opinion that the noncompliance is of a serious nature.

***Circumstances under which the Commissioner may settle a dispute***

4. (1) The Commissioner may, where it will be to the best advantage of the state, settle a dispute, in whole or in part, on a basis that is fair and equitable to both the person concerned and SARS, having regard to *inter alia*.
- (a) whether that settlement would be in the interest of good management of the tax system, overall fairness and the best use of SARS's resources;
  - (b) the cost of litigation in comparison to the possible benefits with reference to
    - (i) the prospects of success in a court;
    - (ii) the prospects of the collection of the amounts due; and
    - (iii) the costs associated with collection;
  - (c) whether there are any complex factual or quantum issues in contention, or evidentiary difficulties which are sufficient to make the case problematic in outcome or unsuitable for resolution through the alternative dispute resolution procedures or the courts;
  - (d) a situation where a participant or a group of participants in a tax avoidance arrangement has accepted the Commissioner's position in the dispute, in which case the settlement may be negotiated in an appropriate manner required to unwind existing structures and arrangements; or
  - (e) whether the settlement of the dispute will promote compliance by the person concerned or a group of taxpayers or a section of the public in a cost-effective way.
- (2) In instances where.
- (a) the amounts involved in the settlement is of such a magnitude that it will have a substantial impact on the national revenue collections; or
  - (b) the settlement is based on local or regional socio-economic reasons, the Commissioner may only settle a dispute after consultation with the Minister of Finance.

***Process of settlement***

5. (1) A dispute may be settled, as contemplated in regulation 4, by the Commissioner personally or any SARS official delegated by the Commissioner for that purpose.
- (2) The Commissioner or the relevant delegated SARS official must ensure that he or she does not have, or did not at any stage have, a personal, family, social, business or financial relationship with the person concerned.

***Agreement in terms of which dispute is resolved***

6. (1) All disputes settled in whole or in part, as contemplated in regulation 4, must be evidenced by a written agreement between the parties in the format as may be prescribed by the Commissioner and must include details on how each particular issue was settled, relevant undertakings by the parties, treatment of that issue in future years, withdrawal of objections and appeals and payment arrangements.
- (2) The Commissioner has the right to recover any outstanding amounts in full where the person concerned fails to adhere to any agreed payment arrangement.
- (3) Any settlement will be conditional upon full disclosure of material facts known to the person concerned at the time of settlement.

***Rights and obligations of person concerned***

7. (1) The person concerned should at all times disclose all relevant facts in discussions during the process of settling a dispute.
- (2) The written agreement will represent the final agreed position between the parties and will be in full and final settlement of all or the specified aspects of the dispute between the parties.
- (3) SARS must adhere to the terms of the agreement, unless it emerges that material facts were not disclosed to it or there was fraud or misrepresentation of the facts.
- (4) Subject to regulation 8, SARS must adhere to the secrecy obligation on the information relating to a person concerned and SARS may not disclose the terms of any agreement to third parties unless authorised by law or by the person concerned.
- (5) SARS must, where the dispute is not ultimately settled, explain the further rights of objection and appeal to the person concerned.

***Reporting requirements***

8. (1) The Commissioner must.
  - (a) maintain a register of all disputes settled in the circumstances contained in these regulations; and
  - (b) fully document the process in terms of which each dispute was settled, which document must be signed on behalf of the Commissioner and the person concerned.
- (2) The Commissioner must on an annual basis provide to the Auditor-General and to the Minister of Finance a summary of all disputes which were settled in whole or in part during the period of 12 months covered by that summary, which must.
  - (a) be in such format which, subject to section 4(1)(b) of the Act, does not disclose the identity of the person concerned, and be submitted at such time as may be agreed between the Commissioner and the Auditor-General or Minister of Finance, as the case may be; and

- (b) contain details of the number of disputes settled or part settled, the amount of revenue forgone and estimated amount of savings in costs of litigation, which must be reflected in respect of main classes of taxpayers or sections of the public.

## APPENDIX III

### **SARS CLIENT CHARTER - EXTRACTED FROM REVENUE FORM IT12 (ANNUAL RETURN OF INCOME FOR INDIVIDUALS)**

This charter is a commitment to the tax-paying public that SARS aims to deliver a professional, effective and efficient client service.

#### **Your rights and obligations**

##### **You are entitled to expect SARS**

###### **To help you**

- by being courteous at all times
- to understand your rights and obligations
- by continuously upgrading the quality of our service
- by being accessible

###### **To be fair**

- by expecting you to pay only what is due under the law
- by treating everyone equally
- by ensuring everyone pays their fair share

###### **To protect your Constitutional rights**

- by keeping your private affairs strictly confidential
- by furnishing you with reasons for decisions taken
- by applying the law consistently and impartially

###### **If you are not satisfied, you may**

- request that your tax affairs be re-examined
- exercise your right to object and appeal
- request that we advise you of the procedures to be followed in lodging an objection and appeal

###### **In return, your obligations are to**

- be honest
- timeously submit full and accurate information
- pay your tax on time and in full
- encourage others to pay their tax

###### **When all pay their fair share, everyone will benefit**

**APPENDIX IV****EXTRACT FROM THE PROMOTION OF ADMINISTRATIVE JUSTICE ACT, NO. 3 OF 2000****SECTION 6 - Judicial review of administrative action.**

- (1) Any person may institute proceedings in a court or a tribunal for the judicial review of an administrative action.
- (2) A court or tribunal has the power to judicially review an administrative action if—
  - (a) the administrator who took it—
    - (i) was not authorised to do so by the empowering provision;
    - (ii) acted under a delegation of power which was not authorised by the empowering provision; or
    - (iii) was biased or reasonably suspected of bias;
  - (b) a mandatory and material procedure or condition prescribed by an empowering provision was not complied with;
  - (c) the action was procedurally unfair;
  - (d) the action was materially influenced by an error of law;
  - (e) the action was taken—
    - (i) for a reason not authorised by the empowering provision;
    - (ii) for an ulterior purpose or motive;
    - (iii) because irrelevant considerations were taken into account or relevant considerations were not considered;
    - (iv) because of the unauthorised or unwarranted dictates of another person or body;
    - (v) in bad faith; or
    - (vi) arbitrarily or capriciously;
  - (f) the action itself—
    - (i) contravenes a law or is not authorised by the empowering provision; or
    - (ii) is not rationally connected to—
      - (aa) the purpose for which it was taken;
      - (bb) the purpose of the empowering provision;
      - (cc) the information before the administrator; or
      - (dd) the reasons given for it by the administrator;
  - (g) the action concerned consists of a failure to take a decision;

- (h) the exercise of the power or the performance of the function authorised by the empowering provision, in pursuance of which the administrative action was purportedly taken, is so unreasonable that no reasonable person could have so exercised the power or performed the function; or
  - (i) the action is otherwise unconstitutional or unlawful.
- (3) If any person relies on the ground of review referred to in subsection (2) (g), he or she may in respect of a failure to take a decision, where—
- (a)
    - (i) an administrator has a duty to take a decision;
    - (ii) there is no law that prescribes a period within which the administrator is required to take that decision; and
    - (iii) the administrator has failed to take that decision,institute proceedings in a court or tribunal for judicial review of the failure to take the decision on the ground that there has been unreasonable delay in taking the decision; or
  - (b)
    - (i) an administrator has a duty to take a decision;
    - (ii) a law prescribes a period within which the administrator is required to take that decision; and
    - (iii) the administrator has failed to take that decision before the expiration of that period,institute proceedings in a court or tribunal for judicial review of the failure to take the decision within that period on the ground that the administrator has a duty to take the decision notwithstanding the expiration of that period.

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