

# Tax & Exchange Control



ALERT | 7 November 2024

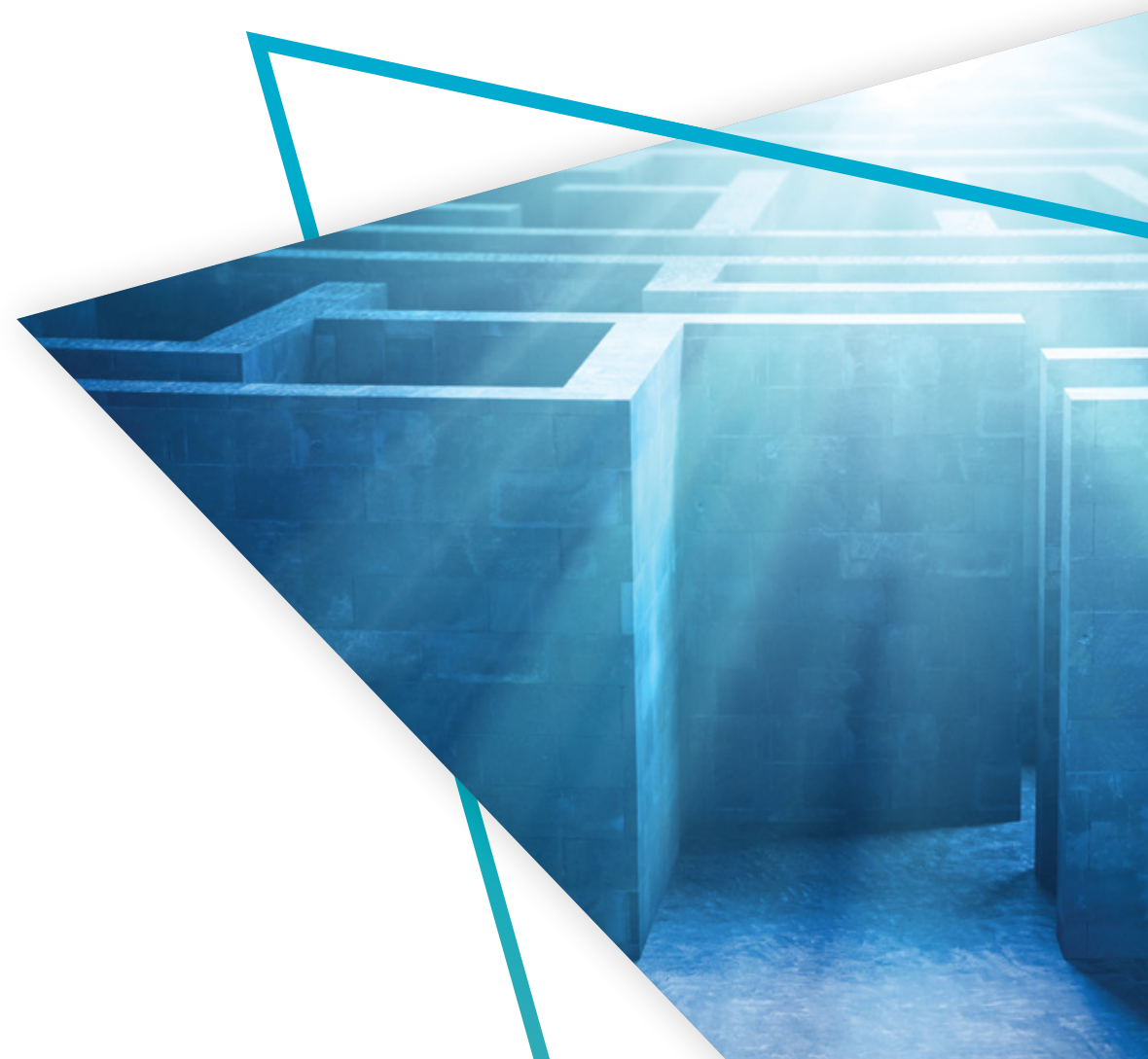
## In this issue

### SOUTH AFRICA

Understatement penalties and the benefit of tax opinions: A review of the *Thistle Trust* saga



For more insight into our expertise and services



## Understatement penalties and the benefit of tax opinions: A review of the *Thistle Trust* saga

We previously reported on the judgment by the Supreme Court of Appeal (SCA) in the case of *CSARS v The Thistle Trust* (516/2021) [2022] ZASCA 153 (7 November 2022) in our [Tax alert](#) of 24 November 2022. We also specifically focused on the issue of understatement penalties that arose in that case in our [Tax alert](#) of 1 December 2022.

The matter ultimately went on appeal to the Constitutional Court (CC), and the judgment in *The Thistle Trust v Commissioner for the South African Revenue Service* [2024] ZACC 19 was issued on 2 October 2024. For the purposes of this article, we again only focus on the issue of understatement penalties.

### The understatement penalty regime

In terms of section 222(1) of the Tax Administration Act 28 of 2011 (TAA), the South African Revenue Service (SARS) must impose an understatement penalty in the event of an "understatement" by a taxpayer. However, no understatement penalty may be imposed if the understatement results from a *bona fide* inadvertent error.

An understatement is defined in section 221 of the TAA as any prejudice to SARS that results from, among other things, failure to submit a return, an omission from a return, an incorrect statement in a return, or failing to pay tax if no return is required.

The penalty percentage is determined with reference to a table in section 223(1) of the TAA, which sets out certain categories against which the taxpayer's relevant behaviour or the amount involved must be measured.

These include "*substantial understatement*", "*reasonable care not taken in submitting return*", "*no reasonable grounds for tax position taken*" and "*gross negligence*".

Once it is established that there was in fact an understatement, the imposition of an understatement penalty by SARS is mandatory, and the preeminent question that remains is the category that applies.

As mentioned, a taxpayer may escape liability if it can be shown that the understatement resulted from a *bona fide* inadvertent error.

In terms of section 223(3) of the TAA, a taxpayer may also escape liability (at least for a substantial understatement) if the taxpayer was in possession of a qualifying tax opinion.

In terms of section 102(2) of the TAA, the burden of proving the facts on which SARS based the imposition of an understatement penalty is on SARS.

**TAX & EXCHANGE CONTROL  
ALERT**

## Understatement penalties and the benefit of tax opinions: A review of the *Thistle Trust* saga

CONTINUED



### Background to the case

The taxpayer was a beneficiary of other trusts. Upon receipt of certain distributions of capital gains from such trusts, it in turn distributed the amounts to its own beneficiaries.

The taxpayer applied the so-called conduit principle to these transactions, which resulted in the beneficiaries accounting for the capital gains tax, and not the taxpayer.

In applying the conduit principle, the taxpayer relied on a tax opinion that it had obtained regarding the interpretation of section 25B of the Income Tax Act No 58 of 1962 (ITA) and paragraph 80 of the Eighth Schedule to the ITA, and the application thereof to the transactions.

SARS disagreed with the taxpayer's position and treatment of the transactions for tax purposes, and raised an additional assessment against the taxpayer in respect of capital gains tax.

SARS also imposed understatement penalties, specifically on the basis of "reasonable care not taken in completing return" or "no reasonable grounds for tax position taken".

The taxpayer disputed the matter, and the case was later heard before the Tax Court.

The Tax Court found in favour of the taxpayer on the merits.

### SCA decision

SARS appealed to the SCA, where the court found in favour of SARS on the merits. However, SARS was not successful in respect of the understatement penalties.

The taxpayer had argued that, in relying on the opinion (which turned out to be incorrect), it had made a *bona fide* inadvertent error.

The court noted the following:

*"SARS initially adopted the position that, in the light of the legal opinion, it should be concluded that the Thistle Trust had consciously and deliberately adopted the position it took when it elected to distribute the amounts of the capital gains as it did. However, during the argument before us, counsel for SARS conceded, correctly, that the understatement by the Thistle Trust was a bona fide and inadvertent error as it had believed that section 25B was applicable to its case. Though the Thistle Trust erred, it did so in good faith and acted unintentionally. In the circumstances, it was conceded that SARS was not entitled to levy the understatement penalty."*

## Understatement penalties and the benefit of tax opinions: A review of the *Thistle Trust* saga

CONTINUED

The suggestion is that where a taxpayer “consciously and deliberately” adopts a position, which turns out to be incorrect, it can constitute a *bona fide* inadvertent error if it did so “in good faith and acted unintentionally”.

This seems to differ from the narrow approach that SARS has taken in its Guide to Understatement Penalties (Issue 2) in respect of *bona fide* inadvertent errors and opinions:

*“Additionally, an error that reflects an opinion that is intentionally obtained cannot be said to be bona fide inadvertent, or, using some of the synonyms above, a real involuntary mistake. The opposite is actually true, especially when, as in this case, the opinion is merely congruous with the error that had already been made. Be that as it may, even when the true source of an error is the inadvertent interpretation of the opinion, the default, omission, incorrect statement, failure to pay the correct tax, or impermissible avoidance arrangement itself would have been made voluntary.”*

SARS’ general narrow approach in respect of *bona fide* inadvertent errors is also exemplified by the following statement in its guide: “From the foregoing, it seems likely that the only errors that may fall within the *bona fide* inadvertent class are typographical mistakes – but only properly involuntary ones.”

### CC decision

The taxpayer appealed to the CC in respect of the decision on the merits, and SARS entered a cross-appeal in respect of the understatement penalties.

The CC granted the taxpayer’s application for leave to appeal, but dismissed the appeal and ultimately found in favour of SARS on the merits.

However, the CC also dismissed SARS’ application for leave to cross-appeal in respect of the understatement penalties and the meaning of “*bona fide* inadvertent error”. In dealing with this application, the court made some important remarks.

While acknowledging the importance of the matter for the public, the court was reluctant to entertain the matter on the basis that the Tax Court did not decide the issue of penalties, and in the SCA it appears that SARS had made a concession.



## Understatement penalties and the benefit of tax opinions: A review of the *Thistle Trust* saga

CONTINUED

In addition, in the court's view, SARS did not have a strong case against the taxpayer in respect of penalties.

SARS had categorised the taxpayer's behaviour as either "*reasonable care not taken in completing return*" or "*no reasonable grounds for tax position taken*" in terms of the table in section 223(1) of the TAA. In this regard the court pointed out that SARS bears the onus of proving the facts that would bring the understatement within these categories, and that it did not have reasonable prospects of discharging this onus.

In respect of the "*no reasonable grounds for tax position taken*", the court was of the view that the tax position was taken on legal advice, and that it was reasonable, even if found to be incorrect. The Tax Court initially even upheld the position in a reasoned judgment.

In respect of "*reasonable care not taken in completing return*" SARS tried to argue that the tax advice received had warned that SARS had a contrary view on the issue. The suggestion is that the taxpayer should have ignored the advice received and followed SARS' position. By not doing so the taxpayer did not take reasonable care. The court dismissed this argument, as it was based on an assumption or proposition that a taxpayer cannot act reasonably if it follows advice on the interpretation of tax legislation that is different from SARS' stated position on the interpretation of tax legislation.

Ultimately the court concluded that SARS would fail on the issue of penalties simply based on the facts to be proven, irrespective of the correct interpretation of the meaning of "*bona fide inadvertent error*".

### Conclusion

The CC's decision may arguably have left the SCA's judgment on the issue of penalties in somewhat of an uncertain state. Specifically, it may be debated as to whether the SCA's reasoning stands as precedent on the issue of what constitutes a *bona fide* inadvertent error. There is also the suggestion that SARS had actually made a concession in the SCA.

Be that as it may, the CC's decision has highlighted the role that a tax opinion can play in resisting the imposition of understatement penalties by SARS.

Being in possession of a tax opinion (even if it is not a qualifying tax opinion in terms of section 223(3) of the TAA) can still play a role in excluding a taxpayer from some of the relevant behavioural categories.

Essentially, SARS has to prove, for example, that the taxpayer did not take reasonable care in completing its return, that there were no reasonable grounds for the tax position taken, or that the taxpayer was grossly negligent.

Being in possession of a reasoned tax opinion, even if ultimately wrong, can prevent SARS from discharging the onus of proving that the taxpayer is guilty of the alleged behaviour.

**Heinrich Louw**



## OUR TEAM

For more information about our Tax & Exchange Control practice and services in South Africa and Kenya, please contact:



### Emil Brincker

Practice Head & Director:  
Tax & Exchange Control  
T +27 (0)11 562 1063  
E [emil.brincker@cdhlegal.com](mailto:emil.brincker@cdhlegal.com)



### Gerhard Badenhorst

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1870  
E [gerhard.badenhorst@cdhlegal.com](mailto:gerhard.badenhorst@cdhlegal.com)



### Jerome Brink

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1484  
E [jerome.brink@cdhlegal.com](mailto:jerome.brink@cdhlegal.com)



### Petr Erasmus

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1450  
E [petr.erasmus@cdhlegal.com](mailto:petr.erasmus@cdhlegal.com)



### Dries Hoek

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1425  
E [dries.hoek@cdhlegal.com](mailto:dries.hoek@cdhlegal.com)



### Alex Kanyi

Partner | Kenya  
T +254 731 086 649  
+254 204 409 918  
+254 710 560 114  
E [alex.kanyi@cdhlegal.com](mailto:alex.kanyi@cdhlegal.com)



### Heinrich Louw

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1187  
E [heinrich.louw@cdhlegal.com](mailto:heinrich.louw@cdhlegal.com)



### Lena Onyango

Partner | Kenya  
T +254 731 086 649  
+254 204 409 918  
+254 710 560 114  
E [lena.onyango@cdhlegal.com](mailto:lena.onyango@cdhlegal.com)



### Howmera Parak

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1467  
E [howmera.parak@cdhlegal.com](mailto:howmera.parak@cdhlegal.com)



### Stephan Spamer

Director:  
Tax & Exchange Control  
T +27 (0)11 562 1294  
E [stephan.spamer@cdhlegal.com](mailto:stephan.spamer@cdhlegal.com)



### Tersia van Schalkwyk

Tax Consultant:  
Tax & Exchange Control  
T +27 (0)21 481 6404  
E [tersia.vanschalkwyk@cdhlegal.com](mailto:tersia.vanschalkwyk@cdhlegal.com)



### Varusha Moodaley

Senior Associate:  
Tax & Exchange Control  
T +27 (0)21 481 6392  
E [varusha.moodaley@cdhlegal.com](mailto:varusha.moodaley@cdhlegal.com)



### Abednego Mutie

Senior Associate | Kenya  
T +254 731 086 649  
+254 204 409 918  
+254 710 560 114  
E [abednego.mutie@cdhlegal.com](mailto:abednego.mutie@cdhlegal.com)



### Nicholas Carroll

Associate:  
Tax & Exchange Control  
T +27 (0)21 481 6433  
E [nicholas.carroll@cdhlegal.com](mailto:nicholas.carroll@cdhlegal.com)



### Puleng Mothabeng

Associate:  
Tax & Exchange Control  
T +27 (0)11 562 1355  
E [puleng.mothabeng@cdhlegal.com](mailto:puleng.mothabeng@cdhlegal.com)

**BBBEE STATUS:** LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

**PLEASE NOTE**

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

**JOHANNESBURG**

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.  
Dx 154 Randburg and Dx 42 Johannesburg.  
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E [jhb@cdhlegal.com](mailto:jhb@cdhlegal.com)

**CAPE TOWN**

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.  
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E [ctn@cdhlegal.com](mailto:ctn@cdhlegal.com)

**NAIROBI**

Merchant Square, 3<sup>rd</sup> floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.  
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114  
E [cdhkenya@cdhlegal.com](mailto:cdhkenya@cdhlegal.com)

**STELLENBOSCH**

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.  
T +27 (0)21 481 6400 E [cdh Stellenbosch@cdhlegal.com](mailto:cdh Stellenbosch@cdhlegal.com)

©2024 14079/NOV

