March 2021

SARS: No more catch-up adjustments

Aligned with the emphasis on taxpayer compliance noted during the 2021 Budget Speech delivered on 25 February 2021, it is important that we highlight a recent Tax Court case judgement which upheld SARS' assessment against the non-compliance of a corporate taxpayer.

The Tax Court judgement (number 24674) dated 25 November 2020 (**the court case**) was recently released on the South African Revenue Service's (**SARS**) website. (Please click here to access the document). The court case came about as a result of a corporate taxpayer's appeal against SARS' decision to impose an understatement penalty (**USP**) at a rate of 15% on the grounds of *"no reasonable grounds for tax position taken"*. The taxpayer's appeal related solely to the percentage of the USP levied by SARS, i.e. the taxpayer conceded that it was incorrect in its approach to applying a 'catch up' adjustment.

Background to the court case

The taxpayer, a South African tax resident company, had submitted its 2016 tax return (**ITR14**) which was selected for audit by SARS. Based on SARS' audit findings, an adjustment of R17 564 368 was made which resulted in an overall tax adjustment of R4 918 023. The taxpayer had claimed an allowance for wear and tear of R54 305 235, which included a 'catch-up' adjustment of R17 564 368 in respect of prior years of assessment and which was incorrectly not claimed in the taxpayer's 2015 and previous ITR14s.

What did SARS contend?	What did the taxpayer contend?

- Tax is an annual event and therefore expenses and/or allowances must be claimed in the year during which such expenses or assets are actually incurred.
- Therefore, the taxpayer may not in law claim a catch-up of wear and tear expenses that it was supposed to have claimed in the preceding years.
- SARS regarded the disallowed amount of R17 564 368 as an understatement[1] in terms of the TAA.
- Consequently, a 50% USP (amounting to R2 459 011) was levied because there were *"no reasonable grounds for the tax position taken"*. There was prejudice to the *fiscus* and there was no *bona fide* and/or inadvertent error made by the taxpayer.

- When the tax registers were created, it was determined that the tax base of assets was R17 564 368 higher than what it should have been. It was impractical to re-open prior periods as no tax registers were maintained then.
- The taxpayer agrees with SARS' findings with regards to the claiming of the allowances in respect of prior years. Accordingly, the dispute relates to the USP.
- As the taxpayer had an assessed loss (before and after the over-claimed wear and tear adjustment), there was no loss to the *fiscus* due to the error (i.e. SARS was not prejudiced).
- If the court finds that there was an understatement, then it resulted from a *bona fide* inadvertent error.

What did the court find?

- The taxpayer deliberately decided to claim an allowance for wear-and-tear which was not claimable in that year. There was no *bona fide* inadvertent error as the taxpayer had other avenues, which were not pursued. Ignorance of the law is no excuse, the taxpayer should have been aware of the provisions of the TAA and Income Tax Act[2].
- The taxpayer had not acted on professional advice received therefore the USP couldn't be reduced.
- In terms of the overstated loss, it had the potential to reduce the taxpayer's tax liability in relation to future profits. It was sufficient if SARS proved that there was a risk of prejudice or a potential risk from the taxpayer's conduct. Prejudice does not *only* refer to an immediate final impact, in terms of case law[3] (which was not disputed by the taxpayer), the word prejudice also includes prospective or potential prejudice.
- Based on the above, the court was compelled to uphold SARS' assessment including the 50% USP.

Do you have any questions?

[1] In terms section 221 of the Tax Administration Act No. 28 of 2011 (**TAA**).

[2] Income Tax Act No. 58 of 1962, as amended

[3] Wavelengths Construction CC v The Commissioner for the South African Revenue Service (Case No. 24622)

We are able to assist you with determining the appropriate tax consequences and preferred approach based on your specific circumstances.

Contact us

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Regards
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Notes

[1] In terms section 221 of the Tax Administration Act No. 28 of 2011 (**TAA**)
[2] Income Tax Act No. 58 of 1962, as amended
[3] Wavelengths Construction CC v The Commissioner for the South African Revenue Service (Case No. 24622)