Reliance on professional and non-professional advisors or staff as a defence to the imposition of penalties in income tax matters

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Abstract

Many taxpayers rely on their advisors to look after their tax affairs. In spite of this reliance, taxpayers still find themselves in default for the purposes of section 76(1) of the Income Tax Act and additional tax (referred to as a “penalty” by the judiciary) is imposed.

This article examines whether the reliance by a taxpayer on his advisor, be it his accountant, bookkeeper or even a member of staff, can constitute a complete or partial defence to the imposition of additional tax in terms of section 76(1) or be regarded as an “extenuating circumstance” for the purposes of remission of additional tax in terms of section 76(2)(a).

Key words

Section 76(1) of the Income Tax Act
Remission of penalties
Extenuating circumstances
Reliance on advisors

1 Introduction

Many taxpayers rely on advisors, professional or otherwise, to manage their tax affairs. In spite of this reliance, taxpayers still find themselves in default for the purposes of section 76(1) of the Income Tax Act, No. 58 of 1962 (“Act”). As a result, additional tax (hereinafter referred to as a “penalty”, because the judiciary generally use this term interchangeably with the words “additional tax” for the purposes of Section 76 (CIR v Da Costa (29 SATC 79)) of up to 200% of the normal tax properly chargeable may be imposed.
Section 76(1) provides as follows:

“A taxpayer shall be required 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.”

When legislation imposes a large or harsh penalty, it normally also provides relief from the imposition of such penalties when certain conditions are met. Section 76 follows this principle and section 76(2)(a) provides as follows:

“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.”

The general meaning of “extenuating circumstances” for the purposes of remission of penalties imposed in terms of section 76(1) of the Income Tax Act, No. 58 of 1962 (“Act”) on a defaulting taxpayer will not be analysed, because it is regarded as beyond the scope of this article. The purpose of this article is to examine whether the reliance by a taxpayer on his advisor, be it his accountant, bookkeeper or even a member of staff, to assist him in the preparation of his accounting records and consequently his income tax records, can constitute a complete or partial defence to the imposition of additional tax in terms of section 76(1) or be regarded as an “extenuating circumstance” for the purposes of remission
of penalties in terms of section 76(2)(a), if such records are found to be incorrectly prepared.

Usually, the taxpayer would allege in his defence that his 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 principles were applied in the valuation and preparation of the taxpayer’s financial statements and tax returns, and therefore there was no intention on the part of the taxpayer to evade tax.

This article has been undertaken in an attempt to inform taxpayers and their advisors of the extent to which the judiciary regards the reliance on an advisor as a defence or as an “extenuating circumstance” for the purposes of determining the penalties to be imposed in terms of Section 76. Knowledge of the limits of a plea of this nature should assist such persons when they are faced with a similar problem.

2 Research method

The research method adopted, consists of a literature review, analysis of the relevant provisions of the Act, together with court decisions, both local and foreign, which relate, directly and indirectly, to the objective.

3 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 this article in terms of the following three defences:

- Reliance on Generally Accepted Accounting Practice. If this defence is relied upon, a professional (an accountant or lawyer in the profession), but not necessarily a tax specialist, 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 “staff” is also included in this category.

1 The term ‘valuation’ would include the valuation of all assets (including stock or inventory and shares) and liabilities.
Perpetuation of tax evasion previously devised and used by someone else. This category includes family members that also act as “bookkeepers”.

3.1 Reliance on Generally Accepted Accounting Practice

Reliance on Generally Accepted Accounting Practice came up for consideration in *ITC 1489* (53 SATC 99). The taxpayer’s auditor had used the 50% cost of stock method of valuation, which 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 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. 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 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 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.

2 Although the discretion of the Commissioner in terms of section 22(1) is not subject to objection and appeal, the Transvaal *Supreme Court in KBI v Transvaalse Suikerkorporasie Bpk* (47 SATC 34:43) came to the conclusion that the Special Court may review the discretion of the Commissioner even where the discretion of the Commissioner is not subject to objection and appeal. Against this conclusion, contrast the decision of Melamet J in *ITC 1400* (47 SATC 169) where it was held that in the case where a Commissioner’s discretion is not subject to objection and appeal, the review proceedings may only be heard in the Supreme Court. It is submitted that the Suikerkorporasie decision is the better decision (since it was, after all, given by a higher court). Nevertheless, it is most improbable that the discretion of the Commissioner would be overturned on review. Even unreasonableness on the part of the Commissioner is not normally regarded as a ground for review. Rather, the taxpayer must prove *mala fides* on the part of the Commissioner or that the Commissioner failed to properly apply his mind to the matter or acted from improper motives (see the Suikerkorporasie case).
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 that 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.

Regarding 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. It is furthermore submitted that if the culpability of the accountant were diminished in such circumstances, then the culpability of the taxpayer would also diminish, provided that the taxpayer had no intention to evade tax.

The Tax Court, in the United States case of Estate of Spruill v Commissioner (88 TC 1197 (1987)), 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, had the following to say (88 TC 1197:1245):

“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 (3 SATC 235). 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.

On the other hand, in ITC 1377 (45 SATC 221: 227), 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 that 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."

It is furthermore submitted that the judge in ITC 1489 (53 SATC 99) 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 to be ‘reasonable’ or should have allowed the taxpayer and the Commissioner to agree on a reasonable valuation on which the penalty could be based.3

In the later Appellate Division case of KBI v Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk (58 SATC 273), 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 stock by 5% without mentioning such depreciation in the 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

3 The principle of allowing the taxpayer and the Commissioner to 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); and ITC 1377 (45 SATC 221) as well as section 83(13)(a) of the Income Tax Act.
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 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 constituted a complete defence.

In the Canadian case (Quebec Supreme Court) of *Acme Slide Fastener Co v Knott* ([1962] CTC 320), 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 as follows the fundamental test that should be applied when attending to accounting problems ([1962] CTC 320:326):

“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 *Spruill Estate* cases 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

4 In footnote 3 above, it was stated that even where there has been unreasonableness on the part of the Commissioner, a court is unlikely to overturn a decision of the Commissioner on review when he has exercised his discretion in terms of the Act and such discretion granted is not subject to objection and appeal. This does not mean that in the case where penalties have been imposed, which imposition is subject to objection and appeal, the court will not look to the underlying reason for the penalty. If the underlying reason is found to be unreasonable, the court will appropriately adjust the penalty. It does not mean that the court will interfere with the underlying unreasonable original discretion, but it may occur as in the *Gekonsolideerde Sentrale* case.
bona fide and with due diligence, even if a different chartered accountant would have come to a substantially different valuation, the valuation should not be challenged for the purposes of imposing penalties.

Perhaps the taxpayer in ITC 1489 (53 SATC 99) would have won his case in regard to 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 in the form of a chartered accountant.

3.2 Incompetence, ignorance or negligence on the part of advisors

In regard to 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 reliance on such persons to be either a complete or partial defence or an “extenuating circumstance”.

In CIR v Da Costa (47 SATC 87), 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.

Although not dealing with section 76 of the Income Tax Act, but rather with the equivalent provision in the then Sales Tax Act (section 23 of the Sales Tax Act, No.103 of 1978), the Special Court in ITC 1486 (53 SATC 39) had to 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 employees. The Court was of the opinion that (53 SATC 39:48):

“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
In *ITC* 1295 (42 SATC 19), 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 Special 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.

The taxpayer in *ITC* 1430 (50 SATC 51), 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 (59 SATC 180) is informative in regard to aggravating factors. The taxpayer, a professional man, had over a number of years failed to disclose income from his professional aid funds in his tax returns. The additional assessments realised additional tax of approximately R305 000 plus a 200% penalty of approximately R610 000. 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 aid fund during that fiscal year. In objecting to the 200% penalty imposed for that year, he contended to the Court 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 (59 SATC 180:187) 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

"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 (54 SATC 113), 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.

It does not appear as if the Special Court even considered taking into account the obiter dicta of the Appellate Division in the Da Costa case (47 SATC 87) or the judgement in ITC 1486 (53 SATC 39) to the effect that the fault of the accountant should not be imputed to the taxpayer. Perhaps this course of action was due to the fact that the Special Court was unhappy with the conduct of the taxpayer regarding other aspects of the case.

It is submitted that if the Special Court were influenced by factors other than the intention of the taxpayers in regard to 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.

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5 In which case no penalty or only a nominal penalty would have been payable.
6 Excessive managerial remuneration was paid to certain trusts from a company in a scheme intended to avoid or reduce tax. The general anti-tax avoidance provision, section 103(1), was successfully invoked against the taxpayer, but because section 103(1) is not a penal section, no penalties could be imposed.
The Special Court in *ITC 1540* (54 SATC 400) 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. Although the Court found “extenuating circumstances” to have existed and imposed a penalty of less than 200%, the incompetence of the previous accountant was not specifically mentioned as one of the circumstances that contributed towards the remission of the penalty.

In *CIR v BP Miller* (56 SATC 1), 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* (56 SATC 1), 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”.

In *ITC 1351* (44 SATC 58), the Special Court found the taxpayer’s attempted explanation for the non-declaration of certain income to be unsatisfactory. He contended that certain amounts that had not been 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, namely that the taxpayer was guilty of tax evasion, would have been made.

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7 He contended that certain amounts that had not been 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, namely that the taxpayer was guilty of tax evasion, would have been made.
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.8

In ITC 1577 (56 SATC 236), 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 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 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 a penalty of less than 200%, the Special Court did not make mention of any “extenuating circumstances” being found to justify the remission.

It is submitted that in that case the Special Court 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.9

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 (54 SATC 271) 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

8 See CIR v Da Costa (47 SATC 87) in which the judge’s reasoning in ITC 1351 was found to be faulty.
9 See ITC 1295 (42 SATC 19) in which 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) in which the Court was unable to establish that the taxpayer intended to evade tax 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.
It therefore appears as if, in *ITC 1577* (56 SATC 236), the judge directly contradicted a decision of the Appellate Division.

In *KBI v Mabotsa* (55 SATC 98), the Special 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 that have the necessary knowledge to do it properly.

On the other hand, in *ITC 1306* (42 SATC 139), the Court found that no blame attached to the taxpayer that relied on his auditors to follow the correct procedure in the liquidation of his company. If the company had been properly wound up and liquidated in terms of the Companies Act, No. 61 of 1973, 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.

### 3.3 Perpetuation of tax evasion previously devised and used by someone else

The Canadian case of *R v Thetrault* ([1976] CTC 719) 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

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10 Smalberger JA (54 SATC 271:281) 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.”

11 Dividends received from a South African source are now exempt from tax in terms of section 10(1)(k) of the Act.
method that had apparently been accepted by the Revenue Department for more than twenty years. 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 ([1976] CTC 719:724):

“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.”

Although this statement appears facetious or tongue in cheek, it is highly unlikely that the Court intended it that way.

It is not surprisingly that the taxpayer in _ITC_ 1331 (43 SATC 76) 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 an intention to evade tax, but the fact that the taxpayer did not originate the scheme, but merely continued it, constituted “extenuating circumstances”.

4 Findings

4.1 Intention of the taxpayer – subjective or objective test

It is submitted that, except for one decision that incorrectly introduced an objective test to establish the intention of a taxpayer in regard to tax evasion (_ITC_ 1577 (56 SATC 236)), the courts have consistently and correctly applied the subjective test for intention (_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)). Accordingly, the courts are reluctant to find a taxpayer “guilty” of tax evasion, except in the most blatant and obvious cases (_ITC_ 1612 (59 SATC 180)), but see _ITC_ 1577 (56 SATC 236) and _ITC_ 1351 (44 SATC 58)). Rather, the approach of the courts has tended towards a finding that the taxpayer was “negligent”, “careless”, “thoughtless”, “culpable” or “failed to exercise proper supervision over its employees”.

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12 Compare this decision to that in _ITC_ 1540 (54 SATC 400) in which similar circumstances were argued, but the court was not inclined to regard them as “extenuating”.
4.2 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 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 (Da Costa (47 SATC 87) and ITC 1486 (53 SATC 39)).

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 (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) (ITC 1430 (50 SATC 51)). The one exception is when the taxpayer perpetuates an old scheme or system of tax evasion devised by someone else (ITC 1489 (53 SATC 99); ITC 1331 (43 SATC 76) and R v Thebrault ([1976] (CTC 719)).

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 (ITC 1430 (50 SATC 51)). 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” (ITC 1576 (56 SATC 1)).
4.3 Reliance on professional v 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 that have the necessary knowledge and skill to do the work properly (KBI v Mabotsa (55 SATC 98)). 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 a mistake were made by the advisor (ITC 1306 42 SATC 139)).

Specifically in regard to 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 (ITC 91 (3 SATC 235)). Unreasonableness on the part of the Commissioner in questioning the valuation of stock done by an auditor in accordance with Generally Accepted Accounting Practice has led the Appellate Division to conclude that no penalties should be imposed (KBI v Gekonsolideerde Sentrale Ondernemingsgroep (Edms) Bpk, (58 SATC 273)).

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 (ITC 1489 (53 SATC 99)). 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 (Estate of Spruill v Commissioner (88 TC 1197(1987)) and Acme Slide Fastener Co v Knott ([1962] CTC 320)).

Perhaps it is time that the South African courts took heed of the opinions expressed in this regard in other countries and accepted that if a court is generally prepared to accept the opinion of a chartered accountant in the field of valuation and presentation, then so, too, is the taxpayer, without imputing any negligence or culpability to him if he does not obtain 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 or presentation of financial statements are, after all, the subjective opinions of the accountant, albeit, based on objective factors.
4.4 Misdirection of courts

In a few instances, the Special Court has been inclined to misdirect itself either on a matter of principle (ITC 1577 (56 SATC 236) and ITC 1351 (44 SATC 58)) or has based its decisions on grounds unconnected with the crime or criminal (ITC 1518 (54 SATC 113)). On review, at the behest of the taxpayer, these types of decisions are normally reversed by a higher court or even criticised by the higher court in a later decision (CIR v Da Costa (47 SATC 87)).

5 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 (unfortunately, the Commissioner usually attempts, in the first instance, to impose a large penalty, which results in the taxpayer looking to the courts for relief). However, telling lies to the court can be regarded as an aggravating factor, as the taxpayer found to his cost in ITC 1612 (59 SATC 180).

There is always hope for the taxpayer that, when the Commissioner has imposed a large penalty, an appeal to the courts will result in the reduction of the penalty or even of 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 trouble for both the taxpayer and the advisor.

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