Special or unusual defences or “extenuating circumstances” that may be pleaded for the purposes of remission of penalties in income tax matters

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Abstract
The general meaning of “extenuating circumstances” for the purposes of section 76(2)(a) of the Income Tax Act, No. 58 of 1962, (the “Act”), was discussed by the current author in a previous article in this research journal. Certain defences or pleas and their effect on the level of penalties imposed by the judiciary were also analysed in previous articles in this research journal. These defences and pleas include reliance on a tax advisor, bookkeeper, accountant or member of staff and the conduct of the taxpayer before, during and after committing an offence.

This article specifically examines those special or unusual defences or “extenuating circumstances” that may influence the level of a penalty that is imposed in terms of section 76 of the Act for offences that are committed in terms of that section.

Key words
Section 76 of the Income Tax Act
Penalties
Extenuating circumstances
Mitigating circumstances

Trefwoorde
Versagende omstandighede

1 This article is based on a chapter of the author’s dissertation entitled Remission of Penalties in Income Tax Matters that was submitted for the degree of Magister Computationis at the University of South Africa.
1 Introduction

Most scholars learnt about the Rosetta Stone in history lessons at school. They learnt (but have probably forgotten) that it was inscribed in three languages in 196 BC.

The stone was unearthed by one of Napoleon's officers in 1799 near the town of Rosetta in northern Egypt. Because one of the languages inscribed on the stone is ancient Greek, a language still studied by scholars and academics today (the other two languages were hieroglyphics (at the top) and demotic (at the bottom)), it enabled the deciphering of the other two languages. As a result, a great number of ancient Egyptian writings that have survived to the present day, can be deciphered, telling us the true story of life in ancient Egypt (Microsoft Encarta Online Encyclopedia 2003, Rosetta Stone (http://encarta.msn.com)).

However, what is not generally known (and it was certainly never taught at school), is that the Rosetta Stone is partly a tax-oriented document. Its main purpose was to sing the praises of the boy King Ptolemy V and establish the cult of the King. To establish this cult, the stone describes, in addition to a general amnesty for political rebels and tax debtors, a tax immunity for the priests, their temples, crops and vineyards. A translated sentence of the Stone reads: “And of the revenues and taxes levied in Egypt, some he has wholly remitted and others has lightened, in order that the people and all the others might be in prosperity during his reign; and whereas he has remitted the debts to the crown being many in number which they in Egypt and the rest of the Kingdom owed” (A translation of the writing on the stone is to be found at: www.mysteries-in-stone.co.uk/rosetta.htm).

The priests apparently placed replicas of the Rosetta Stone at the doorway to their temples to keep out the over-zealous tax man from trespassing in their temples. Should a tax man have happened to put a foot past the doorway, the priests would immediately have referred him to the immunity outlined on the Rosetta Stone, and have legally evicted him (Adams 1999:2-3).

Just as the priests of the temples of Egypt in 196 BC had the Rosetta Stone to bolster their right to exclude the unlawful entry of the tax man into their temples, so those who live in South Africa today have the Constitution of the Republic of South Africa Act, 108 of 1996 (the “Constitution”) to protect them from the unlawful entry of state officials (including the revenue authorities) into their homes and property (section 14 of the Constitution and Wehmeyer v Lane NO and Others, (1994(4) SA 441(C)) and Mandela and Others v Minister of Safety and Security and Others, (1995(2) SACR 397(W)).

Similar to the immunity from taxes that the Rosetta Stone provided for the temples of Egypt and their crops and vineyards, section 25(1) of the South African Constitution 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.

2 Ironically, the English eventually seized the stone from the French and it is now on display in the British Museum in London.
The imposition of income tax is inherently the expropriation of a taxpayer’s assets and it is, ostensibly, 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 . . .

In view of this limitation clause, the Income Tax Act, No. 58 of 1962, (the “Act”), is prima facie constitutional, because the imposition of taxes is considered reasonable and justifiable in an open and democratic society. Refer also to sections 43, 44 and 213 of the Constitution in this regard. However, this does not mean that every section of the Act is constitutional. Each section should be tested individually against the provisions of the Constitution to establish its constitutionality. The sections that do not meet the requirements of the Constitution should be removed.

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

Fortunately, South Africa appears to be in the first stage only. 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)) estimates the tax gap or leakage in 1994 to be some R3 billion per annum for Value-Added Tax (“VAT”) alone (14,6% of potential VAT revenue). The gap in respect of income tax is not quantified in the Katz Report, but is estimated to be as high as 30% of the potential revenue from that source. Extrapolating these figures, the amounts involved are probably double the original values at today’s Rand equivalent.

W Feather has cynically expressed the universal distaste for paying taxes by stating that “the reward for energy, enterprise, and thrift – is taxes” (Quotes Galore). Desco Electronic Software, c 1985). Arthur Godfrey humorously expressed his sentiments by saying “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” (Quotes Galore). But perhaps the most appropriate adage was coined by Ralph Waldo Emerson at some date between 1830 and 1840, and is as pertinent today as it was then, namely: “Of all debts men are least willing to pay [are] the taxes” (Emerson 1830–1840).

Virtually every taxpayer will commit a tax offence in terms of the Act at some time during his taxpaying days. On the one hand it could be merely the late submission of an income tax return or a careless omission in filling in the tax return or, on the other hand, it could be blatant tax fraud on the fiscus. All tax offences, even minor offences, are potentially punishable and the Act even provides for a period of imprisonment for certain offences (sections 75 and 104).
Section 76(1) of the Act specifies various tax offences, ranging from the mere late submission of a tax return to an incorrect statement made on the return, which may or may not involve the intention by the taxpayer to evade taxes. The maximum penalty that may be imposed in such circumstances is an amount equal to 200% of the tax properly chargeable.

Although section 76(1) refers to additional tax (rather than to a penalty), the judiciary, in hearing appeals against the imposition of additional tax, generally refer to such additional tax as “in essence a penalty” (CIR v McNeil, (22 SATC 374 at 382) and CIR v Da Costa, (47 SATC 87)). For the purposes of this article, the words “additional tax” and “penalties” are used interchangeably, as appropriate.

However, section 76(2)(a) of the Act, as well as the common law, recognise that any penalty or sanction that ought to be imposed for a taxation offence may be remitted where “extenuating circumstances” exist.

In an earlier article in this research journal, the author examined the general meaning of the term “extenuating circumstances” as it relates to taxation matters (Goldswain 2001a:123–135). It is not the intention of this article to re-examine the general concept. It was concluded in that article (without discussion in detail) that it is a very broad concept and that a number of “extenuating circumstances” have influenced the level of the penalties or sanctions imposed by our courts in taxation matters (pp.133–134). One of the more commonly pleaded defences or explanations given by taxpayers as a reason for having fallen foul of section 76(1) of the Act is that they had relied on their tax advisor, bookkeeper, accountant or a member of staff.

The author analysed this defence or plea comprehensively in a paper published in this journal (Goldswain 2001b:137–154). It was concluded that the judiciary are fairly consistent in regarding the reliance on advisors and members of staff as either a complete defence to the imposition of penalties or as an “extenuating circumstance” for the purpose of remitting penalties in terms of section 76(2)(a) of the Act.

In addition, the conduct of the taxpayer, including his motives, character, attitude and behaviour before, during and after committing an offence, and whether these factors could constitute “extenuating circumstances” for the purposes of section 76(2)(a) of the Act, was analysed in another paper that the author published in this journal (Goldswain 2002:71–85). He concluded that the conduct and the factors associated with the conduct of the taxpayer could, in the appropriate circumstances, be regarded as “extenuating”.

2 The objective of this article

The objective of this article is to examine those special or unusual defences or “extenuating circumstances”, of which many are based on the provisions of the Constitution and which are not commonly pleaded or which may never have been pleaded in tax cases in South Africa in the past. These defences include ignorance
of the law, *bona fide* belief or mistake of fact, oversight, following the wrong advice, destruction of records, prevalence of crime, impropriety committed by investigating officers, entrapment, loss of interest to the *fiscus*, permissible deductions, *de minimis non curat lex*, physical impossibility of complying with the law and necessity. The question that arises is whether all or only some of these defences or pleas fit the judicial definition of “extenuating circumstances” for the purposes of remission of penalties in terms of section 76(2)(a) of the Act.

The adverse personal circumstances of the taxpayer, such as intelligence (or rather the lack thereof) and naiveté; financial means; ability to pay; loss of employment; hardship; insolvency; dependants reliance on the taxpayer; 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, can also be regarded as “extenuating” in the appropriate circumstances (Goldswain 2001a:123–135). A detailed analysis of these defences or pleas are, however, considered to be beyond the scope of this article.

3 Research method

The research method adopted comprises a literature review, analysis of the relevant provisions of the Act and the common law together with court decisions, both local and foreign, which relate, directly and indirectly, to the objective. As far as local court decisions are concerned, a comprehensive search was done on the Butterworths Intranet Resource for Students and Lecturers, Commercial Resources, South African Tax Cases Reports (http/livepublish@butterworths.co.za). The appropriate cases in relation to special or unusual defences or pleas by taxpayers in penalty situations were selected. The keywords used in the search were:

- Section 76 of the Income Tax Act.
- Penalties.
- Extenuating circumstances.
- Mitigating circumstances.
- “Versagende omstandighede”.

4 Approach of the courts

4.1 *Ignorance of the law, bona fide belief or mistake of fact, oversight and following wrong advice*

In Gardiner and Lansdown’s *South African Criminal Law and Procedure* (1957:60), it is stated that:

> 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*, (1909 T.S. 890 at 905), Innes CJ aptly states 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*, (1977(3) SA 513(AD)), 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 to be a complete defence (because there can be no intention or *mens rea* by the taxpayer to commit a tax offence). This tendency applies in particular to cases in which mistakes arise out of advice given by qualified professionals.

In *ITC 1306*, (42 SATC 139), the taxpayer followed the advice of his auditor in regard to the deregistration of his company. He was taxed on the dividends received upon 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, as a result of which the wrong course of action was followed, as constituting a complete defence and did not impose a penalty.

In *ITC 1576*, (56 SATC 1), the court reduced from 125% to 50% the penalty imposed by the Commissioner despite 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 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*, (64 SATC 223), which went even further. 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 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 that was not justified, had committed a section 76 offence and accordingly imposed a penalty of 100% in addition to a section 89 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 that had been claimed in the years of assessment concerned. However, with regard to the imposition of penalties, the court was of the opinion that, although it found against the taxpayer in respect of his claim, the fact that the taxpayer had claimed the deduction on the basis of professional advice that had been 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 essence, been at the very root of legitimate tax planning. Therefore there was no justification for imposing a penalty in terms of section 76(1)(b) of the Act.

In ITC 1377, (45 SATC 221), the taxpayer, a garage owner who also owned and raced horses from time to time, was investigated by the revenue authorities and found not to have declared in his return an amount of some R27 000, which he received from winning a totaliser jackpot. The Commissioner imposed a small penalty of approximately R600 in terms of section 76 of the Act.

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 in order 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. He therefore contended that the win was fortuitous and therefore of a capital nature.

The court held that, because he was a professional punter (he had also placed other bets of approximately R900 per month with bookmakers), all his earnings from horse racing activities, including any totaliser wins, were taxable. 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 did not derive from an intention to avoid tax, but from the appellant’s bona fide belief that such winnings are 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, (53 SATC 442), was treated rather leniently by the Zimbabwean Court. The taxpayer, an unmarried 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 and made 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 that the appellant entered into the transaction, and throughout the period until she sold the vehicle, her motive was to resell it in Zimbabwe in order to generate a profit and therefore the profit was taxable. He therefore raised an assessment. 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 advanced reasons why the profit made on the disposal of the vehicle should be considered to be capital in nature, the court held otherwise. The 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 article.

However, as far as the penalty is concerned, the taxpayer admitted that she had not declared the income from the sale of the car in her return for the particular 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 upon the sale of her car was an amount that she was obliged to reflect in her income tax return. The penalty was accordingly remitted in toto.

4.2 Destruction of records

In appropriate and compelling circumstances, the loss or destruction of a taxpayer’s records could 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. Should the taxpayer honestly attempt to reconstruct the records, which are later found to be inaccurate, and a penalty is imposed, such penalty should, it is submitted, be remitted by the Special Court.

The defence or plea of destruction of records has, to the knowledge of the author, only been raised in ITC 1612, (59 SATC 180). The taxpayer, a professional man, had over a number of years failed to disclose in his tax returns certain income accruing to him from his professional body. 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 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 commented 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. In fact, those cheques had never been entered in the books. 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 matter was also dealt with in passing by the judge in *Kahn v CIR*, (1 SATC 170), in which it was held that the fact that the taxpayer had destroyed his records did not prevent the Commissioner from raising an estimated assessment.

### 4.3 Prevalence of crime

The prevalence of tax evasion in the community, or the absence thereof, is a factor which is not normally referred to when a taxpayer is penalised in terms of section 76 of the Act. What is inherent in such punishment is that a particular offender is punished in order to make him or her an example for others who may commit similar offences. The fact that the tax affairs of a taxpayer are subject to the secrecy provisions of section 4 of the Act means that in imposing a penalty on a taxpayer in terms of section 76 of the Act, the Commissioner should, it is submitted, not take into account the prevalence of tax offences in the community in general in determining the penalty to be imposed. It is only in very limited circumstances that the Commissioner may divulge to a third party information relating to the taxpayer. 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 that a penalty of 100% was imposed.

Should the Commissioner impose a large penalty on a taxpayer in terms of section 76 of the Act and give as justification for the imposition of such a large penalty that he wants to make an example of the taxpayer to deter other potential tax offenders from committing similar tax offences, it is submitted that this aspect of the penalty amounts to unreasonable conduct on the part of the Commissioner. It is therefore unconstitutional and would be altered on appeal. Support for this view was given in *ITC 1430*, (50 SATC 51). The judge in the Special Court remarked that in cases in which the remission of penalties is hardly likely to come to the attention of many other taxpayers, the principle of deterrence was not applicable in deciding upon a correct, fair and just penalty.

In all cases of punishment, the overriding question in punishing a particular taxpayer should be: What penalty should this offender receive for this offence?
Naturally, the potential deterrent effect of imposing a fine in terms of sections 75 or 104 of the Act and the possible resultant publicity, may be considered. These offences are statutory offences and punishment can only be effected after a conviction has been obtained in a court of law. Such proceedings are not secret.

The other option available to the Commissioner is to lay a complaint with the Attorney-General and to prosecute the offender for common law fraud in addition to imposing section 76 penalties, as was done in the case of Van der Walt v S, (52 SATC 186). This case and its implications are discussed comprehensively in one of the author’s previous articles in this research journal (Goldswain 2002:71–85).

The prosecution of the taxpayer for common law fraud received tremendous publicity as did the pre-emptive strikes by the revenue authorities and subsequent press statements in the local and national newspapers regarding the tax fraud that businessman Dave King and soccer supremo Irvin Khoza had allegedly committed. However, these pre-emptive strikes by the revenue authorities may have adverse repercussions for the revenue authorities. It appears, *prima facie*, as if several of the taxpayers’ constitutional rights may have been violated (for example the freezing of the bank account of a taxpayer is a violation of the right of a person not to have his property expropriated (section 25), demanding information from a taxpayer constitutes a violation of his right to remain silent and not to incriminate himself (section 35)). The revenue authorities may already have gone too far in their zeal to punish these alleged tax evaders, but any further comment on these constitutional issues is considered to be beyond the scope of this article.

Gubbay JA in *COT v CW (Pvt) Ltd*, (52 SATC 77 at 86), summarized as follows the situation regarding arbitrary administrative action taken by revenue authorities:

> 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.

It is submitted that the component part of any penalty imposed (if it can be identified as such) by the revenue authorities on an errant taxpayer in terms of section 76 of the Act, purportedly to deter the community at large from committing similar offences, is arbitrary action and it should not be tolerated by our courts. It is sufficient warning to the taxpaying community at large that they be made aware of the potential penalties that may be imposed on them if it is done through a medium which is publicised generally rather than being imposed on a taxpayer in which case the details may not be divulged to the community at large.

### 4.4 Impropriety by investigating officers and entrapment

The defence of impropriety by investigating officers is fundamentally a constitutional issue. Constitutional issues are considered to be beyond the scope of this article. 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, taxpayers and the courts have frequently raised questions regarding the approach to the pursuit and punishment of tax offenders. 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)3 of the Act to enter a taxpayer’s premises at any time of day, search the premises, seize any documentation found on the premises and retain such seized documents. The authority of a judge or magistrate was not required 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)4, which permitted 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, (59 SATC 399), (search and seizure under the old section 74(3) of the Act) and Podlas v Cohen and Bryden NNO and Others, (1994(4) SA 662(T)) (interrogation in terms of section 152 of the Insolvency Act, 24 of 1936) are instructive. In these cases the right of administrative officials to search and seize relevant documentation and interrogate under oath was upheld. The actions of the administrative officials concerned in these 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 Commissioner occurred only a matter of days before the Constitution became law in 1993.

However, different decisions (in conflict with the two cases mentioned above) were reached in Wehmeyer v Lane NO and Others, (1994(4) SA 441(C)) (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, (1995(2) SACR 397(W), in which the actions of the administrative officials also took place just prior to the introduction of the Constitution.

In the Mandela case, the court granted an interdict in favour of the former Deputy Minister of Arts and Culture, in circumstances in which her right to privacy was invaded and the police had seized documents from her home in connection with criminal charges to be brought against her. The police were obliged to return all the documents seized in the raid, even the documents which allegedly incriminated her, because no evidence was placed before the magistrate that the companies referred

3 Now repealed and replaced by section 74D, which ostensibly is in line with the Constitution in that the fundamental rights of the individual, that are granted in terms of the Constitution, are limited in terms of section 36. However, although the section is prima facie constitutional, the conduct of the revenue officials is still subject to all the Bill of Rights clauses, namely sections 7 to 39 of the Constitution.
4 Now repealed and replaced by section 74C. The same comments mentioned in footnote 3 above, in relation to the conduct of the revenue officials, are applicable for this section.
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.

Recognising that the powers granted in terms of the previous section 74 of the Act were now unconstitutional in terms of the Constitution and that the actions of the revenue authorities in the *Rudolph* case would have been severely criticised by the judiciary if a similar raid had taken place after the promulgation of the Constitution, section 74 was substantially amended in 1997, purportedly to comply with the Constitution.

Even with the amendment of 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. The authorities behaviour could be considered unconstitutional if cases of unreasonable behaviour, when they do not follow the correct procedures and even when their application for a search warrant is vague regarding either the offence committed or the tax documents they wish to seize.

It is furthermore submitted that the *Mandela* case has succeeded in extending South African law, by way of the Constitution, to embrace a precept that is well established in the United States, namely 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 the defence of impropriety is concerned for the purposes of section 76 of the Act, the onus is on the taxpayer to convince the court that the conduct of the Commissioner was such that his or her rights in terms of the Constitution were violated.

The defence of entrapment is also based on the Constitution in that the conduct of the revenue authorities or their agents is unreasonable.

Burchell and Hunt (1976:322) states that:

> 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 in addition “the criminal design must have originated with the official” (at p.322).

Prior to the introduction of the new Constitution, this defence was hardly likely to succeed, because the offence was committed voluntarily and not as a result of compulsion or necessity. Nevertheless, entrapment may be treated as an “extenuating circumstance” or even be regarded as a complete defence to the imposition of penalties if it can be shown that there had been some impropriety by government officials.

For example, should a revenue official, during a secret investigation of a taxpayer, pose as an ordinary citizen and encourage the taxpayer not to charge VAT
on goods purchased in return for paying cash and thereafter use such evidence as a basis to establish possible other tax violations, such evidence is tainted evidence in terms of our Constitution and could provide a complete defence against penalties being imposed.

4.5 Loss of interest to the fiscus

This is not really a defence, but a plea by the taxpayer that if any penalties should be raised, the penalties so raised should be limited to the interest lost to the fiscus. This plea is especially effective in situations in which there was no intention on the part of the taxpayer to evade tax.

A reading of the relevant cases and decisions on penalties that have been 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 an additional 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, (43 SATC 76 at 87), the court was of the opinion 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, (50 SATC 51), 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, (51 SATC 165), however, the court refused to impose a penalty in circumstances in which the Commissioner had originally imposed penalties after an investigation into a deceased estate. The Commissioner’s representative had argued, in 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 is a penalty and that the court would not countenance the imposition of a penalty against a representative taxpayer.

Similarly, in ITC 1489, (53 SATC 99), 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, (56 SATC 225), the Commissioner raised interest in terms of section 89 quat in addition to a penalty. The court was of the opinion 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.
Special or unusual defences or “extenuating circumstances” that may be pleaded

In *KBI v Mabotsa*, (55 SATC 98), 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.

The court furthermore held that it is only right and proper that a taxpayer should at least pay the loss of interest that was suffered by the State as otherwise he or she could be better off with a fine than had the proper tax been paid in time. Accordingly, the fine of R4,000 that was imposed by the court *a quo* was not appropriate, the fine imposed by the Commissioner of 100% of the additional tax payable was excessively punitive and that a reasonable and appropriate fine in the circumstances was R20,000.

In *ITC 1725*, (64 SATC 223), no penalty was imposed, but a section 89quat interest charge was imposed as there had been an exploitation of what was perceived to be a tax planning gap in the Act.

### 4.6 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, because other permissible deductions could be claimed, such as wear and tear allowances, cleaning expenses or casual labour costs.

In such a case, the question of permissible deductions tends to indicate that there was no intention on the part of the taxpayer to evade taxes. This is typically the case in a hobby situation.

In *ITC 1377*, (45 SATC 221), the court referred 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 that had been won by a professional gambler and that was not declared as income. The court remitted, in *toto*, the penalty that had originally been imposed by the Commissioner.

### 4.7 The de minimus non curat lex principle

If a taxation offence is committed that is of a trifling nature, the community is not materially affected and would not be prejudiced if no penalties were 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.

The offence is of a trifling nature and the Commissioner should not impose a penalty if it were the first time that the taxpayer was late in submitting a return.
However, the penalty is usually computer generated and a fairly substantial penalty is imposed, depending on the taxes assessed rather than on the amount of tax outstanding. The question that arises is whether it is reasonable that the late submission of a return by someone who is assessed to pay taxes of R100 000, and who may have already settled such tax liability (by paying provisional tax), is penalised with R10 000 or 10% of the assessed taxes, whereas someone who is assessed to pay taxes of R10 000, and who has not yet settled his liability, should be penalised with only R1 000 or 10% of the assessed taxes?

This is a situation in which 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 that are generated by computers should be reviewed by a natural person for reasonableness before being distributed. This measure would prevent unnecessary administrative irritations for both the revenue authorities and the taxpayer and would promote an efficient administration in accordance with section 33 of the Constitution.

4.8 Physical impossibility of complying with the law and necessity

The principle of lex non cogit ad impossibilia, or that 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 also succeed in taxation matters in the appropriate circumstances. Burchell and Hunt (1976:294), are of the opinion that

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 should be absolute. For example, 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, (1941 SR 211), the taxpayer was poor, in addition to being in prison. The Southern Rhodesian Supreme Court (as it was then known) 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 to be “extenuating”.

The following are some excuses that have succeeded abroad in value-added tax matters (Webb 2002:29):

- 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 (p.29):

- A managing director said he could not sign cheques, because he was depressed.
Special or unusual defences or “extenuating circumstances” that may be pleaded

☐ 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.

Burchell and Hunt (1976:285) set out the requirements for the defence of necessity as follows:

(a) A legal interest of the accused should have been endangered
(b) by a threat that had commenced or that was imminent, but which was
(c) not caused by the accused’s fault: and, in addition, it should have been
(d) necessary for the accused to avert the danger; and
(e) the means used for this purpose should have been reasonable in the circumstances.

The danger of death or serious bodily harm should 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.

In *R v Canestra*, (1951(2) SA 317(AD)), 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 virtually present a full defence or, at the very least, a substantial reduction in the penalties that are imposed under section 76 of the Act.

A good example for the illustration of this defence would be to alter the facts slightly from that which took place in *ITC 1423*, (49 SATC 85). In that case, the taxpayer 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 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.

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 and had been able to prove it, then such a threat would have constituted a complete defence (the defence of necessity) against the imposition of penalties.

Marital coercion, it is submitted, would also fall within this category of defence or plea.

5 Corporate tax evasion

This is not a defence, but is mentioned for the sake of the completeness of this article. Penalties are more usually imposed on an identifiable natural person than on a person that is not a natural person. The judge in CIR v Richmond Estates (Pty) Ltd, (20 SATC 355 at 361), referred to a company as,

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” could 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 (Ruby 1994:312–313):

- The size and character of the corporation and its position in the marketplace. 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 officers and guiding personalities are relatively anonymous.

- The relative wealth of the corporation as well as its relative poverty, in cases in which this is a factor.

- The fact that the corporate character and ownership may change over a period of time. 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 on 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 should properly supervise their employees in the performance of their
duties. See the similar sentiments expressed by the court in *ITC 1486*, (53 SATC 39), regarding the duty of management to supervise employees properly.

Corporate offenders view a fine in the same light as any other business expenses.

Reliance upon professional advice may provide a complete defence or may constitute a “mitigating” factor.

A difficulty arises as to how to apportion blame, and accordingly punishment, between the individual as opposed to the corporation. The court in *R v Oriental Bowl et al.*, ((1983) 83 DTC 5342 (Sask. Prov. Ct.) at 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.

In *ITC 1486*, (53 SATC 39), the Commissioner imposed the maximum penalty on the taxpayer, a company, in terms of section 19(3) of the now repealed Sales Tax Act, 103 of 1978, 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 to the taxpayer the intent of the employees to evade taxes, acting contrary to the instructions of the taxpayer. In regard to determining the penalty to be imposed, the court held that consideration should be given to the blameworthiness of the appellant. In this case it comprised 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 reduced the penalty of some R600 000, that had originally been 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 when the corporate offender is a medium to large company and the tax offence committed is perpetrated by employees of the corporation who acted on their own accord and 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. The taxpayer who sets out on a deliberate and systematic path that leads to tax evasion usually can expect harsher penalties being imposed than a “spur of the moment” decision to evade taxes (*ITC 1658*, 61 SATC 231), because such conduct is regarded as an aggravating factor. Any personal “extenuating circumstances” pleaded should then be balanced against the aggravating factors.
6 Conclusion

The special or unusual defences or “extenuating circumstances” that are not commonly pleaded for remission of penalties in tax matters are analysed in this article. It may be concluded that, in the appropriate circumstances, ignorance of the law, a bona fide belief, following the wrong advice, (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)), destruction of financial records (ITC 1612, (59 SATC 180)), the de minimus non curat lex principle or arguing that the income was not disclosed because the income was covered by permissible deductions (ITC 1377, (45 SATC 221)), and necessity or physical impossibility of complying with the law can either be regarded as a complete defence or, at the very least, can constitute “extenuating circumstances”.

A plea of provocation of the taxpayer or impropriety by the investigating officers (constitutional defences) should, it is submitted, be seen in the same light and also be treated as “extenuating”.

The aspect of corporate tax evasion and the way in which it is dealt with by the judiciary have also been examined and it can be concluded that the same or similar defences and plea of “extenuating circumstances” that are available to individual taxpayers also extend to the corporate tax offender.

Nevertheless, in determining the level of the penalty to be imposed on both the individual and the corporate taxpayer when a complete defence is not available, it appears as if the starting point for the judiciary is the loss of interest to the fiscus (ITC 1331, (43 SATC 76); ITC 1430, (50 SATC 51); ITC 1461, (51 SATC 165); ITC 1489, (53 SATC 99); ITC 1576, (56 SATC 225); KBI v Mabotsa, (55 SATC 98); ITC 1725, (64 SATC 223)).

Thereafter the judiciary considers all the “extenuating circumstances” that are present in a case and decide upon an appropriate penalty.

Mercy is an aspect of punishment which, it is submitted, should always be taken into account. Holmes JA in S v V, (1972(3) SA 611(A) at page 614), referred to mercy as “an element of justice itself”. In S v Harrison, (1970(3) SA 684(AD) at page 686), the judge expressed similar sentiments: “Justice must be done, but mercy, not a sledgehammer, is its concomitant.”

The maximum penalty of 200%, as provided for in section 76(1) of the Act, should only be imposed for the worst offences. Gardiner and Lansdown (1957:498) comment as follows:

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.

Perhaps, in imposing a penalty for a tax offence, the Commissioner and his representatives should follow the sentiments of the judiciary in regard to mercy. Napoleon’s adage to the effect that mercy is not mercy if deserved, is apt.
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