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Provisional tax understatement penalties:

first-time provisional taxpayers

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Many taxpayers become provisional taxpayers unintentionally.
For individual taxpayers this is often triggered by additional income received over and above their normal salary income.

Such income includes rental income, foreign employment income, investment income or consulting income. Once this additional income is declared, the taxpayer may automatically fall into the provisional tax system and could face an underestimation penalty if their provisional tax payments were insufficient.

This is an area where compliance risk is often underestimated, particularly for individuals with increasingly complex income streams.

When does the provisional tax underestimation penalty apply?

The provisional tax underestimation penalty applies when your second provisional tax estimate is significantly lower than your actual taxable income. In such cases, a 20% penalty is imposed on the shortfall. This penalty is calculated automatically using a prescribed formula and is not influenced by taxpayer intent. It differs from understatement penalties under the Tax Administration Act, as it arises specifically under the Income Tax Act and is applied mechanically.

If a provisional tax return is not submitted, it is regarded as a nil estimate. This means SARS treats the taxpayer as having estimated zero taxable income, which will trigger an underestimation penalty if taxable income was in fact earned.

The first-time provisional taxpayer problem

In many cases, a taxpayer may not have been a provisional taxpayer in previous years and may therefore not fully understand that they are required to estimate their income.

There may also be no reliable prior-year amounts to use as a reference, and their income may fluctuate due to factors such as side consulting income, expatriate assignment income, foreign bonuses or once-off receipts. These circumstances can easily result in an underestimation of taxable income.

Can the provisional tax underestimation penalty be remitted?

SARS may only remit the provisional tax underestimation penalty if the taxpayer can show that the estimate was properly calculated based on the information available at the time and was not deliberately or carelessly understated. In other words, the taxpayer must demonstrate that there were reasonable grounds for the estimate, that the income was uncertain or variable, that professional advice was relied on, or that unexpected income arose after the return was submitted. The focus should be on explaining the facts and the calculation, rather than making an emotional appeal.

If the underestimation occurred simply because you were unaware that you were required to submit provisional tax, or because you did not attempt to make a proper estimate, remission is unlikely. Where a taxpayer is newly registered, is unaware that they have become a provisional taxpayer, and fails to submit a return (which is treated as a nil estimate), SARS generally views this as non compliance rather than a case of making a reasonable estimate.

While being a first time provisional taxpayer is not, on its own, a basis for remission, certain factors may strengthen the argument that the estimate was reasonable at the time. These include the absence of a prior year basic amount, fluctuating income, or a mid year change in circumstances.

However, if you became a provisional taxpayer during the year, made an efforttried to calculate an estimate based on limited or uncertain information, and your income later changed unexpectedly, you may have grounds to request remission. In such cases, your motivation must clearly explain how the estimate was calculated and why it was reasonable given the information available at the time.

In summary, being new to the provisional tax system is not a ground for remission on its own. The key consideration remains whether the estimate submitted was reasonable based on the information available at the time.

Practical example

A salaried employee becomes tax resident again mid-year and starts earning foreign income. Based on the information available at the time, they submit their second provisional tax return using their expected earnings. In February, however, they receive an unexpected foreign bonus.

The final taxable income now exceeds the estimate, triggering a provisional tax underestimation penalty.

In short, being new to provisional tax is not in itself a ground for remission. The decisive question is whether the estimate was reasonable based on the information available at the time.

If you are currently engaging with SARS or anticipating a dispute, early structuring of your response can materially affect the outcome.

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