13 July 2012

Legal & Policy Division
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Dear Sir

**IT14SD FORM: COMMENTS**

We refer to the discussions held during the previous SARS National Stakeholders Meeting, Regional Stakeholder Meetings and SARS request for comments. Set out below please find the SAICA National Tax Committee’s submission comments regarding the IT14SD Form.

The following submission is in response to the IT14SD returns, but will also addresses the requests for supporting documents received by taxpayers and vendors alike. The intention of this submission is to request SARS as a matter of urgency to reconsider the use of these requests. It is submitted that the more appropriate way of dealing with this would be to follow the normal audit process. The first part of this submission deals with the reasons that support our request with regard to the normal audit process.

At the outset we wish to record the following:

We recognise that SARS may “require any person to make further or more detailed returns respecting any matter of which a return is required” (this is in terms of section 66(10)). The value-Added Tax legislation affords SARS with the same – refer to section 57A of that Act. We accepted that taxpayers in the main are aware that “the return of income to be made” by them in respect of any year of assessment must be a full and true return – section 66(13). Whilst the Income Tax Act in the context of returns states that the word income must be construed as including any aggregate capital gain or aggregate capital loss the purpose of these returns must be to enable SARS to determine taxable income. We accept that the purpose of the IT14SD and requests for supporting information is to enable SARS to determine the correctness of taxable income and, in the case of the requests relating to the VAT201’s, the vendor’s calculation of the tax payable.

Neither of the Acts prescribe the way in which the taxable income or the tax payable (VAT) must be presented other than to refer to the return itself. Taxpayers and vendors must
therefore complete these returns and would expect that the information requested is sufficient for SARS to make assessment. The current method of furnishing returns (not only the eFiling system) does not allow a taxpayer or a vendor to submit supporting documents when the return is filed. In fact, if supporting documents are submitted with the return, the experience is that it is separated from the relevant return and in most instances, if subsequently required by SARS, again requested. It is therefore also not possible to provide additional and explanatory information when a return is furnished.

It is only when the subsequent request is received that the taxpayer is afforded the opportunity to submit supporting documents. This can then be done by way of electronic submission of the response to SARS (which is an additional return) or manually (by post or delivery to a SARS branch).

It is accepted that these requests for supporting documents cannot expect of the taxpayer to submit all the information relevant to a tax year. It would just not be practical to do so and the limitations on the file sizes would also make that impossible to do. If SARS requires all the documents for inspection it would clearly be done by means of an audit.

We are also mindful of the duty of the taxpayer to retain all records relevant to a return for a period of 5 years – section 73A. The Value-Added Tax refers to “books of account, records and documents” and also refers to a period of 5 years (section 55(3)(a) of the Value-Added Tax Act and 73A of the Income Tax Act). The obligation to keep records (in the Income Tax Act) specifically also deals with the records required to determine a capital gain.

We now wish to record the experience of our members so far.

The IT14SD, the requests for information (relevant to personal income tax) and the requests for supporting documents (VAT) are all issued after an assessment has already been issued. The exact wording of the first request (in the IT14SD for example) is the following: “In the accompanying ITA34 Notice of Assessment you will find all the information which The South African Revenue Service (SARS) I captured from your return. Please carefully review this information against your relevant supporting documents. If you find any errors or are unsure as to what to do, you are required to complete and submit the supplementary declaration, IT14SD”.

The actual purpose of these requests is therefore to notify the taxpayer that the income tax return has been identified for verification as part of the income tax assessment verification process. It is therefore accepted that the response to these requests will alert SARS to issues which may require further investigation.

We have received numerous examples from our members where an IT14SD or request for information was send to a taxpayer or vendor and irrespective of the response from the taxpayer or vendor and shortly after the initial request an assessment is issued. These
assessments would as a rule disallow all the deductions or input tax deductions. Our members report that no further correspondence was received by the tax practitioner or taxpayer before the assessments were issued. The taxpayer (vendor) is therefore not given any opportunity to explain or engage with SARS in this regard. In our view this constitutes an “administrative action” as envisaged in the Promotion of Administrative Justice Act and our concern is that the process followed in these instances may not constitute proper administrative action.

The implication of this on the taxpayer or vendor is severe. Because of the fact that an (amended) assessment was issued to the taxpayer or vendor the only avenue open is to start the objection and appeal process. All of this may result in the following:

- Because an assessment was issued the taxpayer will have to deal with the subsequent request for payment of the amount which, in the examples where all expenses were added back, would not be the correct amount due – pay-now-argue-later.
- If the taxpayer is unable to make payment awaiting the response to the objection, the taxpayer may well find it impossible to obtain a tax clearance. This in turn will limit the taxpayer’s ability to conduct normal business operations.
- It is our experience that taxpayers engage professionals to assist them with the response to the IT14SD and other requests from SARS. This puts pressure on the staffing and planning of all the parties concerned.
- From the reports of our members the taxpayers generally have to wait a relatively long period before a response is received from SARS.

In the next part of our submission we deal with specific issues relating to the IT14SD. We are of the opinion that the IT14SD document will be useful to revise items which mismatch as well as indicate risk areas in business organisations but should NOT result in revised assessments being issued by SARS. Further the IT14SD should not be automatically required for every IT14 return submitted but only those notified by SARS where SARS is of the view that risks may prevail.

**General**

Taxpayers are alarmed and are unsure of the purpose of the IT14SD. The covering letter states that the income tax return has been identified for verification purposes as part of the income tax assessment process. The request further instructs the taxpayer to review the information disclosed in its income tax return and, if any errors are found the taxpayer is advise to submit a revised return. If they cannot identify the errors then they are required to complete and submit the IT14SD. What process is to be followed where discrepancies and errors are identified on the form is not clearly communicated.

**21 Day deadline**

The tax return is often completed by tax practitioners who do not always advise or assist the taxpayer with other taxes such as VAT, PAYE and customs, therefore it may be time consuming to reconcile and obtain information prepared by the various parties. Furthermore
the information requested in the IT14SD may not readily be available as the taxpayer’s accounting system may not be designed to generate the required reports and to extract the relevant information. Taxpayers should have been informed in advance about the reconciliation as their accounting systems need to be upgraded accordingly to enable them to generate the information required to be inputted into the form. The completion of the IT14SD could thus be costly as well as time consuming. The 21 calendar day deadline given by SARS does not take into account year end and interim audits that may be in progress by the entities. It does not take into account December year end leave and other leave taken by staff during the year. The information technology required to obtain the information required as discussed above has also not been taken into account. Thus the 21 calendar days given to complete the form is insufficient when taking into consideration the matters discussed above.

Disallowance of expenditure
The reconciliation is not a letter of findings, and presumably does not give notice of an intention to disallow any item of expenditure. It is a general inquiry designed to enable SARS to determine whether there is risk associated with the return. SARS cannot disallow all expenses and tax income in full on the basis that the reconciliation is not filed. The test for deductibility of expenses is mainly whether "the expense is actually incurred", Port Elizabeth Electric Tramway Co Ltd v CIR, 8 SATC 13 and section 11 of the Income Tax Act No. 58 of 1962 ("the Act").

The wholesale disallowance of expenditure claimed in a return without reasonable ground would be a contravention of principles of administrative justice and reviewable under Promotion of Administrative Justice Act No. 3 of 2000 - as unjustified administrative action. If such were the case it should be a simple matter to convince a court that the disallowance had been made without the assessor applying his/her mind to the expenditure in question and should result in the decision being overturned.

Specific industry understanding
During a conversation with a SARS auditor who enquired as to when the entity’s IT14SD was to be filed, stated that the reconciliation is simple - can be done from the financial statements. One has to understand the clients business in order to do the reconciliation, for example shipping industry clients have major complications with agency, etc. Construction industry clients have income received in advanced, work in progress adjustments, etc. Payroll cannot be from the Annual Financial Statements ("AFS") since there are numerous fringe benefits or deductions that are not in the AFS expenses. A serious concern is whether SARS has suitably skilled and adequate staff to review these reconciliations since as mentioned above, one must understand the clients business before understanding the reconciling items.

The R100 allowable reconciling difference basically requires the reconciliation to balance at 100% which is not practically possible especially for large business entities but possible for simple business entities. It should be noted that the performance of a manual reconciliation will require the skill and expertise of a senior accountant/s, and will be an extremely costly exercise.
We include below our specific comments on the IT14SD form.

**PAYE Reconciliation Schedule**
The form requires total PAYE as per the EMP201 and then below requires the total employment costs on which the liability was calculated. This is understood to be the total cost of employment on which the PAYE was calculated and in turn is an onerous calculation to perform. The total employment cost amount is not required on SARS forms which mean that the amount must be reconciled to the total cost to the company’s payroll system.

The salaries and wages expense in the IT14 return includes provisions for bonuses, leave pay, phantom shares etc, which are only taxed once the actual expense incurs.

Other employment costs may include expenses which are not taxable such as labour broker costs or expenses not considered as fringe benefits such as teambuilding costs.

Differences could be from manual adjustments which were performed for the current month but paid in the following month which falls under the next financial year.

The form should therefore pre-populate what is in the IT14 return. This will assist the taxpayer in understanding what is required to reconcile the PAYE.

**Income Tax Reconciliation Schedule**
The income tax section of the reconciliation seems superfluous as it really does not achieve much in terms of reconciling between two different documents and does nothing to identify risk of understatement of income tax.

Items on the IT14 form submitted by the taxpayer can be pre-populated on the IT14SD to assist the taxpayer in seeing which items are not reconciling.

**VAT Reconciliation Schedule**
If the VAT period is a bi-monthly period and the period does not end on the same month as the company yearend it becomes a difficult task to reconcile. The changing of vat periods to coincide with the financial year end should be considered. Companies do not provide a direct reconciliation link between the calculation for direct tax based on financial statements, and indirect tax claim as done on the VAT201.

When completing the VAT201 an automatic VAT run is performed on the accounting system. This is a system based tool used to clear the month’s inputs and outputs to the Vat control account. This tool cannot be used to do the necessary reconciliation due to the way the system is setup as well the numerous differences in the way the VAT report pulls the details from the system.
Taxpayers that operate independent branches or divisions and that have separately registered each branch or division for VAT will not be able to reconcile their accounting records to the VAT 201 declarations submitted by each branch or division. This is because each inter-branch transaction is considered to be a supply for VAT purposes and has an impact on both output tax and input tax, whereas such transactions are ignored from an accounting perspective. For a reconciliation to be possible, the accounting systems must be set up to distinguish between internal supplies/acquisitions and external supplies/acquisitions for VAT purposes.

**VAT output:**
Total output VAT as per VAT201 field 13, calculated back to exclusive amount will not balance back to the income statement sales figure, as field 13 contains amounts such as Capital Goods, discounts received & bad debts recovered.

Currently the IT14SD form compares the total VAT supplies per the VAT201 returns to the total sales per the IT14. Other types of income that are subject to VAT (e.g. rental income, insurance proceeds, etc) are usually reflected on the AFS and the IT14 separately (i.e. not included in sales / turnover). The IT14SD form does not take these items into account, which will always result in a reconciling difference, which then has to be explained. The reconciliation is between total vat supplies per VAT201 and sales per IT14. The problem here is that the VAT201 includes exempt and non-supplies which includes dividend income and interest income which are not shown in the IT14 as turnover. Other vatable supplies included in the IT14 as separate line items such as administration fees and commission are not taken into account.

Companies are faced with trying to reconcile the VAT run to revenue but also reconciling the revenue per the general ledger to the Vat run. The problem here is that not all entries in the Vat run go to revenue and vice versa which creates numerous differences, for example not all entries included in revenue are included in the turnover side of the Vat run. Recoveries are allocated to accounts based on the nature of the recovery.

We recommend that a field is added onto the IT14SD form to include other vatable income per the IT14. The sum of the sales per IT14 and other income per IT14 should then be compared to the total VAT supplies per the VAT 201s. Companies may use different systems to account for revenue and output vat which will make it difficult to reconcile to the total sales per the IT14.

**VAT input:**
Currently the IT14SD form compares the total cost of sales (excl inventory adjustments) per the IT14 to the total acquisitions per the VAT 201s. Total input VAT as per VAT201 , field 19, calculated back to exclusive amount will not balance back to Cost of Sales, as field 19 contains amounts such as Capital purchases & other expenditure not shown under Cost of Sales but expenditure such as Accounting fees, Bank Charges, Telephone, Electricity etc.
VAT input claimed grossed up by dividing by 0,14 and reconcile to the cost of sale as per the IT 14. The problem here is that input is not only claimed on cost of sales.

The cost of sales as presented in the Financial Statements at year end, consist of a consolidation of various cost tables, such as:

a) Purchase of local stock  
b) Purchase of imported stock (SAD500)  
c) Transport costs on local stock  
d) Transport costs on imported stock  
e) Destination charges  
f) Destroy stock calculation  
g) Damaged stock calculation  
h) Duty on imported stock (SAD500)  
i) Storage cost on stock  
j) MIDP calculation of stock  
k) Obsolete stock calculation

The cost components that are consolidated into one group cost of sales will vary from industry to industry, and will make reconciliation impossible, unless the cost of sales concept is broken down into more specific layers, or the Industry adopts a purchase plus approach.

Financial systems do not distinguish between goods or services acquired from vendors and from non-vendors, whereas only VAT paid in respect of goods or services acquired from vendors is reflected as input tax on the VAT 201 declarations. In order to reconcile expenses with the form VAT 201 declarations taxpayers will be required to carry out a manual exercise of each and every expense per supplier to determine which suppliers were vendors and levied VAT. This will be a substantial and extremely costly exercise for large corporations with voluminous expenditure.

All entertainment related expenses are generally reflected as a single expense item for accounting purposes, whereas only VAT on entertainment expenses relating to employee subsistence cost is reflected on the VAT 201 declarations as input tax. Taxpayers will be required to manually work through each and every entertainment related invoice to determine whether it relates to employee subsistence cost or not in order to carry out the reconciliation. Similarly, operating expenses such as consulting fees, legal fees, advisory fees, insurance etc. will all be reflected as a single expense item for accounting purposes, but such expenses may include supplies by foreign suppliers who are not registered for VAT and on which supplies no VAT was charged, or expenses on which VAT was charged but which is not deductible as input tax as they relate to non-taxable activities. It would comprise a major exercise to work through each expense item manually on an invoice by invoice basis to establish which expenses were subject to VAT, and if so whether the VAT was included as input tax on the VAT returns. Such an exercise will be further complicated if the taxpayer makes both taxable
and exempt supplies and applies different apportionment methods for different operating divisions.

Where a supplier did not provide the taxpayer with valid tax invoice, the expense will be reflected in the financial records of the taxpayer, but no input tax deduction will be claimed until a valid tax invoice is obtained. In addition, the basis of accounting for VAT on certain expenses such as instalment credit agreements and leases are different for VAT purposes and for accounting purposes. Substantial timing differences will complicate the reconciliation process.

Journal entries and provisions will affect the accounting records but not the VAT claims. Similarly, pre-paid expenses will not be reflected in the accounting records as expenses but a taxpayer is entitled to claim the VAT thereon as input tax.

The IT14SD does not take into account other vatable expenses such as administration and operating expenditure and fixed assets acquired that have been capitalised in the balance sheet.

We recommend that additional fields are added onto the IT14SD form to include other vatable expenses per IT14, and fixed assets acquired per AFS.

The sum of the total cost of sales, other vatable expenses and fixed assets acquired should then be compared to the total acquisitions per the VAT 201’s.

**Customs Reconciliation Schedule**

For imports and exports, there are no differences shown which makes it difficult to verify what needs to be reconciled.

*Imported goods:*
The IT14SD form compares the total value of imported goods as per customs declarations to total imported goods included in cost of sales as per IT14 to total goods imported as per VAT 201s.

The VAT paid on imports is a minimum of 15.4% of the customs value of the goods imported, whereas the actual cost of the goods, including customs duty where applicable is reflected in the financial records as expenses. To distinguish between locally acquired goods and imported goods is a major exercise.

The first issue we have is that the value of imported goods as per customs declarations is a “notional amount” calculated by Customs on which Customs Duty and Customs VAT is payable. This is not the price actually paid by the taxpayer. Therefore there will always be a difference between the value of imported goods and the actual cost of goods processed in the general ledger.
The second issue is that for most taxpayers, separate general ledger accounts for imported purchases and local purchases are not maintained, making it difficult to now calculate how much of cost of sales per the IT14 relates to imported goods.

Thirdly, imported goods could be included in other accounts in the general ledger other than Cost of sales, for example fixed assets such as machinery could be imported and capitalised to the balance sheet. This will result in a reconciling difference. We recommend that an additional field be included on the IT14SD to include fixed assets imported.

Lastly, preparing the Customs reconciliation for imported goods is practically impossible. For those taxpayers who import goods and assets on a large scale, to collate the information for the purposes of this reconciliation is time consuming and an administrative burden.

**Exported goods:**
For most taxpayers, separate general ledger accounts for exported sales and local sales are not maintained, making it difficult to now calculate how much of sales per the IT14 relate to exported goods.

Also, preparing the Customs reconciliation for exported goods is practically impossible. For those taxpayers who export goods and assets on a large scale, to collate the information for the purposes of this reconciliation is time consuming and an administrative burden.

The following is suggested:
Create a “Purchase Plus” model per industry, that can reconcile back to the VAT201 as well as the Financial Statements with little effort and reconciliation table.

Find a unique identifier that will work with this “Purchase Plus” model, throughout the supply chain link, that can roll up to the VAT201 and SAD500 data fields.

Ensure that SARS can assist the industry in this “Purchase Plus” reconciliation, as all the data fields are visible to SARS, as shown in **Diagram A**, below.

**Diagram A: Visibility of Data**
Reconciling Items
The form provides space for the taxpayer to explain why there are differences under the relevant tax types. However, a maximum of four lines are provided, and the form does not allow you to insert additional lines. Four lines is not sufficient as there can be numerous reasons why items are not reconciling and the form not allowing the input of negative numbers makes it more difficult for the taxpayer to reconcile items and substantiate the reconciling items. This means that the taxpayer is forced to reconcile items in away to accommodate the form which may not be necessary the correct way, which in turn defeats the risk purpose of the form.

The form should have a wizard which allows the taxpayer to insert additional lines where necessary. It should also allow for negative numbers to be inputted or allow away for the taxpayer to show reconciling items in away similar to a general ledger account where you have debits and credits.

Conclusion
We propose that the information in the forms such as the IT14, EMP501, and VAT 201 be pre-populated into the IT14SD and where items do not reconcile be highlighted.

Corrections should be made on the forms pre-populated into the IT14SD and when these corrections are made SARS should be able to see that the form was changed and where.

We recommend that should SARS decide to proceed with the implementation of the form IT14SD, that it only be implemented from a future date to allow taxpayers sufficient time to make the required adjustments to their accounting systems.

As the IT14SD does not cater for organisations in the various industries SARS needs to engage with the relevant professional bodies in those industries do discuss on how to make the form more user friendly and applicable to those industries through the creation of data field and reconciliation tables that relate to specific industries. These engagements could
enhance the audit results and assist both SARS and business in tightening the reconciliation process.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

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