Dear Sirs,

PROPOSED SOLUTIONS TO THE PROVISIONAL TAX LEGISLATION IN THE DRAFT TAXATION LAWS AMENDMENT BILL 2009

We refer to the meeting held on 3rd July 2009.

We thank the National Treasury and SARS representatives for meeting with us to discuss the specific concerns that were previously raised through our written submissions and to consider possible solutions. Set out below please find proposed solutions as was requested during this meeting.

This submission has been prepared jointly by the following bodies:

South African Institute of Chartered Accountants (SAICA)
South African Institute of Professional Accountants (SAIPA);
South African Institute of Tax Practitioners (SAIT);
The Banking Association of South Africa, and
The Law Society of South Africa

PROVISIONAL TAX – PROPOSALS

PRINCIPLES

The principles guiding these proposals are as follows:
As far as practicable, the system should collect tax due for a particular tax within that tax year or within a short interval thereafter.

Cognisance should be taken of:
- the difficulty businesses have in accurately estimating taxable income at the end of a financial year.
- the difficulty small and medium-sized businesses have of obtaining external accounting and tax resources if deadlines are congested.
- The effectiveness of PAYE for most employees, and the consequent lesser relevance of the provisional tax system for this category.

Consequently, a “one size fits all” system is inappropriate. Some degree of customisation is thus necessary, and a two-tier system is accordingly proposed.

DEFINITIONS AND CONCEPTS

Basic Amount
Where the term “Basic Amount” is used below, it refers to the latest assessed taxable income (as currently defined). Where this assessment is more than 24 months old, this amount must be escalated (this could be a fixed percentage (e.g. 10% p.a.) or an inflation-index-related percentage published by SARS). Assuming the fixed percentage (e.g. 10% p.a.) is applied, where this amount is more that 36 months old, the escalation is 20%, and so on.

We emphasise that taxpayers who do not submit their tax returns timeously are subject to penalties under section 75B and that there is therefore every motivation for taxpayers to ensure that their assessments are relatively up to date. Automatic increases in basic amounts should therefore be the exception rather than the rule.

For taxpayers that do not yet have a basic amount, it is suggested that they be deemed to fall into tier 2.

Current Taxable Income (i.e. Actual Taxable Income for the Current Year)
For the purposes of the rules set out below, this term refers to the taxable income as determined in an “Initial Assessment”, as defined below. Subsequent assessments based on potential disputes are not taken into account.

Initial Assessment
This refers to the initial issue of a tax assessment in respect of current taxable income. It also includes any subsequent assessment issued merely to correct mutually agreed errors.

Interest
It is recommended that the interest system should as far as possible be a neutral means of compensating for the use of money, rather than as a penalty system. A separate penalty system should exist to apply in appropriate circumstances, as discussed below.
Interest neutrality would be best achieved by applying interest to all provisional payments, by setting an identical rate for overpayments and underpayments, by adjusting the rate regularly to reflect changes in the repo rate, to reflect as closely as possible a market rate for a creditworthy borrower, and finally, by ensuring that the tax consequences on credit and debit interest are identical. This last-mentioned point should be achieved by ensuring that interest receivable by a taxpayer in relation to provisional and assessed tax is inherently taxable, and interest paid is inherently deductible.

Subsequent to initial assessment, if any subsequent tax dispute should be resolved to indicate that any further amount of tax relating to the tax year in question is either due by the taxpayer, or refundable by the tax authorities, the same interest regime should apply, dating back to the Initial Assessment.

**Penalties**
There should be two categories of penalties, namely:

a)  **Provisional tax penalties:**
These are dealt with in detail in the proposed systems below. These penalties will constitute additional tax, and will not constitute tax-deductible expenses. SARS will have discretion to alleviate penalties where there are valid factors that adversely affected the taxpayer’s ability to make an accurate estimate. These penalties no longer apply after payment settlement due under Initial Assessment.

b)  **Subsequent penalties:**
Although the provisional tax penalties will not apply after payment settlement due under Initial Assessment, any subsequent tax dispute will continue to be subject to potential penalties under section 75 and section 76 of the Income Tax Act.

**Top up payments**
At any stage after the first provisional payment a taxpayer has the right to make additional provisional tax payments. These will affect interest calculations, but will not inherently affect penalty provisions. However, such payments may be taken into account by SARS in exercising discretionary powers to alleviate penalties.

**Two-tier system**
The R1 million limit should distinguish between the two tiers of provisional taxpayers. It is suggested that the basic amount be used rather than current taxable income, as taxpayers just above or just below this limit will otherwise not be able to determine their tier status with certainty. It is suggested that this monetary limit should initially be R1 million, with this limit being revised on an annual basis.

The R1 million threshold is based on statistical information provided by SARS at the meeting held on 3rd July 2009.
PROPOSED SYSTEMS

System A – Tier 1 Taxpayers
Applicable to all taxpayers (individuals, corporate entities and other taxpayers) with a basic amount exceeding R1 million.

a) 1st Provisional payment:

Timing: 6 months after commencement of tax year.
Payment rule: Based on estimate of current taxable income (for the full tax year). Required payment is based on 50% of this estimate.
Safe haven: None, as there are no penalties. However, if an estimate is less than the basic amount, SARS may request justification, with the right to revise this estimate.
Interest: Applies if cumulative payment is above or below 50% of liability based on current taxable income (i.e. the period for interest on under or over-payment is from the beginning of the 7th month to the end of the year of assessment and this is based on 50% of the actual taxable income for the year).
Penalties: None.

b) 2nd Provisional payment:

Timing: Last day of tax year.
Payment rule: Based on estimate of current taxable income (for the full tax year). Required payment is based on 100% of this estimate.
Safe haven: Lower of basic amount or 80% of current taxable income (see penalties below).
Interest: Applies if cumulative payment is above or below 100% of liability based on current taxable income (i.e. interest on under or over-payments should run from the end of the year of assessment to 6 months after the end of the year of assessment and be based on 100% of the underestimate).
Penalties: Apply if estimate is less than safe haven. Amounts to 10% of the difference between the actual payment and the safe haven payment.

c) 3rd Provisional payment:

Timing: 6 months after end of tax year.
Payment rule: Based on estimate of current taxable income (for the full tax year). Required payment is based on 100% of this estimate.
Safe haven: 90% of current taxable income (see penalties below).
Interest: Applies if cumulative payment is above or below 100% of liability based on current taxable income (i.e. the interest on under or over-payments should run from 6 months after the end of the year of assessment as is currently the case under section 89quat).
Penalties: Apply if estimate is less than safe haven. Amounts to 20% of the difference between the actual payment and the safe haven payment.

System B – Tier 2 Taxpayers

Applicable to: All taxpayers (individuals, corporate entities and other taxpayers) with a basic amount lower than or equal to R1 million.

Note: The distinctions from System A are underlined.

a) 1st Provisional payment:

Timing: 6 months after commencement of tax year.
Payment rule: Based on estimate of current taxable income (for the full tax year). Required payment is based on 50% of this estimate.
Safe haven: None, as there are no penalties. However, if an estimate is less than the basic amount, SARS may request justification, with the right to revise this estimate.
Interest: Applies if cumulative payment is above or below 50% of liability based on current taxable income (i.e. the period for interest on under or over-payment is from the beginning of the 7th month to the end of the year of assessment and this is based on 50% of the actual taxable income for the year).
Penalties: None.

b) 2nd Provisional payment:

Timing: Last day of tax year.
Payment rule: Based on estimate of current taxable income (for the full tax year). Required payment is based on 100% of this estimate.
Safe haven: Lower of basic amount or 60% of current taxable income (see penalties below).
Interest: Applies if cumulative payment is above or below 100% of liability based on current taxable income (i.e. interest on under or over-payments should run from the end of the year of assessment to 6 months after the end of the year of assessment and be based on 100% of the underestimate).
Penalties: Apply if estimate is less than safe haven. Amounts to 10% of the difference between the actual payment and the safe haven payment.

c) 3rd Provisional payment:

Timing: 6 months after end of tax year.
Payment rule: Based on estimate of current taxable income (for the full tax year). Required payment is based on 100% of this estimate.
Safe haven: Lower of basic amount or 80% of current taxable income (see penalties below).
Interest: Applies if cumulative payment is above or below 100% of liability based on current taxable income (i.e. the interest on under or over-payments should run from 6 months after the end of the year of assessment as is currently the case under section 89quat).

Penalties: Apply if estimate is less than safe haven. Amounts to 20% of the difference between the actual payment and the safe haven payment.

ALTERNATIVE PROPOSAL

Whilst we acknowledge the merits of the previous proposal, we understand that our request is for a fundamental change to the provisional tax system. Should this not be achievable in the short term we propose the following:

Accept the principle of a two-tier solution.

For tier 1 taxpayers i.e. all taxpayers (individuals, corporate entities and other taxpayers) with a basic amount over R1 million:
(1) Keep the current 80% requirement;
(2) Remove the 20% penalty and apply a discretionary penalty instead with clear guidelines drafted in the legislation of how and when these penalties will apply or;
remove the 20% penalty and provide for a 10% penalty instead if any shortfall is not topped up within 3 months of the year-end.
(3) Interest is payable or receivable based on the actual taxable income from the year-end.;

For tier 2 taxpayers i.e. all taxpayers (individuals, corporate entities and other taxpayers) with a basic amount lower than or equal to R1 million:
Re-instate the basic amount, with exactly the same rules as before (i.e. lower of 90% or basic; 20% penalty, etc.), the only difference would be that the basic safe harbour should include an automatic annual uplift percentage. This could be a fixed percentage (e.g. 10% p.a.) or an inflation-index-related percentage published by SARS.

Please do not hesitate to contact me should you wish to discuss the above.

Yours faithfully

M Hassan CA(SA)

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