31 October 2008

The South African Revenue Service
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PRETORIA
0001

BY E-MAIL: tsnyckers@sars.gov.za

Dear Madam

CALL FOR COMMENT: PROVISIONAL TAX PROCESS

We refer to the call for comment on the provisional tax process. Set out below please find the SAICA National Tax Committee’s submission.

1. Background:

Paragraph 19(1)(b) of the Fourth Schedule requires a provisional taxpayer which is a company to submit an estimate of the total taxable income that will be derived in a particular year of assessment. Paragraph 19(1)(c) of the Fourth Schedule in return requires such an estimate to be equal to at least the “basic amount”, as defined in paragraph 19(1)(d) of the Fourth Schedule. The Commissioner may, however, agree to an estimate lower than the basic amount should the circumstances warrant it.

Based on the wording of the legislation, it has in the past been the practice amongst taxpayers not to estimate the taxable income in relation to each year as required by paragraph 19(1)(b), but to rely on the basic amount and the third provisional top-up as this ensured that SARS could not levy interest and penalties on the amount of provisional tax underpaid. Provisional tax payment was therefore based on the basic amount irrespective of whether the basic amount bore any resemblance to the estimated taxable income for the year of assessment.

SARS condoned this practice by hardly ever invoking paragraph 19(3), which allows the Commissioner to call upon the taxpayer to justify the estimate, or to furnish particulars of income and expenditure or any other particulars that may be required for that year of assessment in respect of which the provisional tax payment is being made and also allows the Commission, if he is not satisfied with the estimate, to increase it to an amount that he considers reasonable.
SARS then began deviating from past practice at least as far as listed company groups are concerned. SARS now invokes paragraph 19(3) whenever information becomes available that supports an increase in the estimate provided. As public companies have to publish financial information, the information to support an increase is easily available to SARS and frequently relied upon to invoke paragraph 19(3).

It appears as if SARS is applying paragraph 19(3) mainly to listed companies as the financial information of listed companies is readily available. One could argue that this is unfair as all the other taxpayers continue with the practice of paying provisional tax based on the basic amount.

SARS has issued Interpretation Note 1, dealing specifically with revised estimates in terms of paragraph 19(3). The interpretation note states that the Commissioner may exercise his discretion to increase the estimate whenever enough information is available to substantiate the increase, for example in the case of:

• An increase in taxable income resulting from events like legislative changes, mergers, or acquisitions;
• The availability of financial results that support an increase in taxable income;
• The estimate submitted by the taxpayer is based on a basic amount that is more than two years old; or
• It is the taxpayer’s first year of assessment.

2. Comments:

In terms of the Income Tax Act, each company has to provide a bona fide estimate its taxable income for the relevant year of assessment for purposes of making both the first and the second provisional tax payment. It cannot merely rely on the basic amount. The legislation as it currently stands therefore creates the opportunity for taxpayers to rely on the basic amount by invoking interest and penalties only if the provisional tax paid is less than the tax due in relation to the basic amount. Taxpayers relying on this safe harbour, are then criticised for doing so.

SARS’ practice of applying paragraph 19(3) as set out in interpretation note 1 is inherently prejudicial to listed groups because:

• generally listed groups have to finalise their financial statements within 3 months compared to 6 months for privately owned companies, which means that listed companies’ financial information will generally be available earlier, and;
• listed groups publish preliminary results even earlier, which privately owned companies do not have to do.

Currently as far as the application of paragraph 19(3) is concerned, taxpayers are not all treated equally. SARS also seem to be of the view that accounting profit and taxable income is more or less the same amount, which it clearly is not.
In addition, the legislation requires taxpayers to do half-year tax computations. This is often administratively burdensome and sometimes even impossible, especially in uncertain trading conditions. Taxpayers are loath to overpay tax as the repayment of overpaid tax is a time consuming and frustrating process.

3. **The practical difficulties in estimating a taxpayer's taxable income**

Average exchange rates are only determinable after year end, which is particularly relevant for large corporates and multi national enterprises.

The provisions of section 24I have to be carefully considered and calculations in this regard are generally performed manually, which is time consuming as this necessarily requires a second process of review in order to ensure the accuracy of the calculations.

Large corporates and multi national enterprises are required to make IFRS adjustments to their financial information, which in itself is a lengthy process. Thereafter, the tax effects thereof have to be considered, which is also a time consuming manual process.

Large corporates, such as Banks, have multiple divisions which are consolidated in order to provide entity financial information. The tax effects of single transactions and individual line items of income expenses within these multiple divisions have to be reviewed before the entity's taxable income can be accurately estimated. The sheer volume of financial information involved in this process results in a delay in ascertaining an accurate estimate.

4. **The unfair manner in which interest is treated in this regard**

The current system of provisional tax of allowing interest on an overpayment by a taxpayer is only effective 6 months after the taxpayer's financial year end. By withdrawing the 'safe-harbour' of the basic amount, it is inevitable that taxpayers will rather make an overpayment of provisional tax, than an underpayment and risk incurring a 20% penalty.

These taxpayers will not be entitled to interest on this overpayment for the first 6 months. In addition, the rate at which this interest accrues differs to the rate which taxpayers are charged on underpayments (i.e. it is lower), and interest incurred on underpayments of provisional tax is not deductible! This is a somewhat inequitable situation for taxpayers.

In order to address this untenable result pertaining to interest, it is proposed that -

- The current section 89quat interest free period should be revisited, i.e. interest should accrue on overpayments from the date of the payment;
- The rates at which interest is calculated on over and underpayments should be equalised; and
- Interest incurred on underpayments should be deductible

In addition, in order to address the practical difficulties in estimating a taxpayer's taxable income, the following process of four provisional tax payments is proposed -
that taxpayers are allowed to make a third top up payment within 3 months after its financial year end if it notices/suspects that the estimate upon which its second payment was made is below 80% of its actual tax payable; and

that taxpayers are allowed to make a 'top up' payment within 6 months of a company's financial year end.

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

Yours faithfully

M Hassan CA(SA)

PROJECT DIRECTOR: TAX

The South African Institute of Chartered Accountants