ministry of finance

Department:
The National Treasury
REPUBLIC OF SOUTH AFRICA

**INTRODUCTORY SPEECH BY TREVOR A MANUEL, MP,
MINISTER OF FINANCE**

SMALL BUSINESS TAX AMNESTY AND AMENDMENT OF TAXATION LAWS BILL, 2006

13 June 2006

Introduction

Madame Speaker, it gives me great pleasure to introduce the "Small Business Tax Amnesty and Amendment of Taxation Laws Bill, 2006." The purpose of this Bill is to begin fulfilling the tax promises televised to the public in my annual February 2006 Budget Address to the nation (with the remainder to follow later in the year). The Bill is designed:

- To enact the full range of changes to rates, brackets and monetary thresholds, all of which provide substantial tax relief for middle and lower income taxpayers;
- To introduce a comprehensive tax amnesty for small businesses within both the informal and formal sectors; and
- To simplify municipal tax administration.

The most notable aspect of the Bill involves the small business tax amnesty but before turning to the amnesty in detail, it bears repeating that 2005 economic growth and enhanced SARS administration have once again exceeded expectations. The net result is additional revenue, allowing for continued across-the-board tax cuts, infrastructure development, and social upliftment programmes.

Rate changes and monetary thresholds

In accordance with the February 2006 announcements, the Bill enacts the promised tax cuts, including:

- Upward adjustment of the six personal income tax brackets for the benefit of individuals at every level. For instance, the bottom 18% bracket now ends at R100 000 (from the previous R80 000), and the top 40% now begins at R400 000 (from the previous R300 000).
- Upward adjustment of the primary and secondary rebates. Individuals under 65 can now generate up to R40 000 tax-free (as opposed to the previous R35 000), and individuals 65 and older can generate up to R65 000 tax-free (as opposed to the previous R60 000).

In terms of savings, taxpayers strongly benefited. The Tax on Retirement Funds is reduced from 18% to 9%. The individual exemption for investment interest increases to R16 500 for those under 65 (and to R24 500 for those 65 and older). The annual Capital Gains Tax exclusion increases from R10 000 to R12 500 for the sale of passive investments, such as JSE listed shares.

Home ownership – another form of middle-class savings – also enjoys substantial relief. The Bill drastically increases the Transfer Duty brackets. For instance, individuals can now purchase a home with a value of up to R500 000 wholly free from Transfer Duty (as opposed to the previous R190 000 tax-free threshold). Meanwhile, the Capital Gains Tax exclusion for the sale of a primary residence also increases from R1 million to R1.5 million.

Small Business Amnesty

1. Objectives

While the proposed Small Business Tax Amnesty contains many of the basic features outlined in the February Budget Review, we significantly expanded the scope of the amnesty after public consultation. This aspect of the Bill strongly benefited from the informal hearing process undertaken by the Portfolio Committee on Finance. It provides yet another example of how the Executive Branch and Parliament can best work together. The public consultation also gained from visits to small businesses, izimbizo with small business owners, and other interactions with small business associations organized by SARS.

The net result is an amnesty that is fully expected to enhance the small business tax register and to provide piece of mind for both unregistered and registered small business owners living in fear of past non-compliance. Restated in more formal terms, the amnesty is expected to –

- Broaden the tax base;
- Facilitate the normalisation of small business's tax affairs;
- Enhance the tax compliance culture; and
- Facilitate participation in the taxi recapitalisation.

It should be noted that the initial amnesty was designed as a two-phase process – an initial pilot phase concentrating solely on the taxi industry (to facilitate the taxi recapitalisation), followed by a general small business amnesty. This two-phase system was ultimately dropped after it was determined that the two-phase process actually complicated (rather than simplified) applications process and their administration.

Before turning to the details, it would do well to remember that amnesty was provided for wealthy owners of foreign assets in 2003. It is only fitting that comparable relief is afforded to those of lesser means, especially given their critical role in generating further economic growth. As with the 2003 amnesty, the Bill contains provisions for a full accounting to Parliament so that the amnesty's success is fully measured,

2. Who can apply

The amnesty covers the full spectrum of small businesses, including sole proprietors, partnerships, unlisted companies and trusts. The key limit is size. A business will be viewed as small only if gross business income does not exceed R10 million. The only other restriction pertains to unlisted companies and trusts – where ownership or interests must be limited wholly to individuals. This requirement is designed to exclude complex entity structures (such as consolidated financial groups), all of which typically involve sophisticated businesses falling outside the typical small business sector.

3. When to apply

Applicants must act quickly to enjoy this once-off opportunity. Specifically, applicants must submit their applications to SARS from 1 August to 31 May 2007.

4. What to submit

To qualify for amnesty, applicants must submit the following three items –

- The Amnesty Application (including disclosure of all net business income for the 2006 tax year);
- The 2006 Income Tax Return; and
- A 2006 Statement of Assets and Liabilities.

In other words, applicants are eligible for amnesty simply by coming forward with an honest declaration of their business tax affairs for a single year. They need not recreate books and records for prior years, all of which Government recognises are beyond the capacity of typical small businesses. Moreover, even if the records for the 2006 tax year are deficient, "reasonable" estimates will suffice. This reliance on "reasonable" estimates will be critical for informal businesses, many of whom lack proper books and records.

5. What to pay

The amnesty comes at minimal cost. The amnesty levy is tiered based on taxable business income, with the levy never exceeding 5%. In particular:

- Applicants pay nothing if their 2006 taxable business income ranges from 0 to R35 000;
- Applicants pay 2% on their 2006 taxable business income from R35 000 to R100 000;
- Applicants pay 3% on their 2006 taxable business income from R100 000 to R250 000;
- Applicants pay 4% on their 2006 taxable business income from R250 000 to R500 000; and
- Applicants pay the top 5% on their income exceeding R500 0000.

6. Coverage

Successful applicants obtain relief for all violations relating to the full range of direct national taxes falling on business as well as the Value-added Tax. This relief specifically includes:

- Income Taxes and STC arising before the 2006 tax year;
- VAT, PAYE, UIF and Skills Development Levy for tax periods ending before 1 March 2006; and

- Withholding Tax on Royalties for payments to non-residents before 1 March 2006.

The amnesty not only covers successful applicants, but also their authorised representatives (e.g. public officers). This amnesty further includes relief from all interest, penalties, and additional taxes as well as freedom from criminal prosecution in terms of tax offences.

However, it should be noted that the amnesty cannot be used to undermine the tax system. Hence, taxpayers cannot utilise the amnesty as a means for obtaining refunds nor can they claim assessed losses arising from amnesty years as an offset against future income.

7. Approval process

The approval process for the Small Business Amnesty will operate in comparable fashion to the previous amnesty for foreign assets. As with the previous amnesty, SARS will review applications with a view toward assisting applicants – not as a means of "victimisation."

The amnesty process will again be fully transparent. SARS will deliver notice of approval or denial. Any denial will include the reasons therefore, and all denials will be subject to the full range of objection and appeal procedures.

That said, the amnesty process is not a blank cheque. Applicants must apply in good faith. Applicants will accordingly lose the benefit of the amnesty for core violations – failure to pay the levy, failure to make full disclosure or the provision of materially incorrect estimates.

8. Organised Crime

The amnesty contains measures to ensure no relief is afforded for organised crime. Whilst regulations will be issued to ensure that the Financial Intelligence Centre Act does not bar advisors from offering amnesty tax advice despite the possible criminal nature of these violations, this prohibition does not extend to knowledge of other criminal offences. Hence, tax advisors cannot freely offer advice to parties engaged in drug dealing, smuggling and other aspects of organised crime.

The amnesty also does not apply to fictitious schemes that deliberately use the VAT refund system as a method of stealing cash from the fiscus. The amnesty accordingly does not apply to schemes involving the submission of wholly fictitious invoices for artificial VAT refund claims nor does the amnesty apply to schemes involving fictitious claims of zero-rated exports for items that actually involve fictitious exports or standard-rated local sales.

9. Waiver of Penalties and Interest

One difficult issue is the treatment of parties who have already come forward to disclose their non-compliance before the amnesty or are already liable for tax as a result of SARS audit, investigation or other enforcement. This group of taxpayers typically falls outside the amnesty process because the amnesty acts as a "quid-pro-quo" for coming forward. In other words, parties are rewarded for disclosing their tax non-compliance during the amnesty window period before being detected by SARS – i.e. they have come forward before being found out.

That said, those parties with outstanding debts following their voluntary disclosure of their non-compliance or SARS enforcement action undoubtedly feel unfairly treated given the complete amnesty of others engaged in similar violations. Given these concerns, the amnesty will be extended by regulation to cover this set of taxpayers. Although they will not receive full amnesty, the regulations will allow for relief from interest, penalties and other additional charges while maintaining SARS claims against underlying capital. This aspect of the amnesty is being set aside for regulations due to the unique issues involved (but will be tabled for Parliamentary review).

Municipalities

The final significant aspect of the Bill concerns municipalities. Firstly, the Bill sets in motion the removal of the Regional Services Council Levy with effect from 1 July 2006. This removal will provide significant relief for businesses in terms of tax and administration. This removal is especially helpful for small businesses (who disproportionately bore the compliance burden). As was announced in February, all revenues lost by the municipalities will be replaced (mostly via national transfer payments).

Secondly, the VAT treatment of property rates will be shifted from "out of scope" to a zero-rating. This shift will mean that all VAT bearing municipal costs relating to these rates will now be fully claimable by municipalities as creditable VAT inputs. This new level of claimable VAT input credits will indirectly shift substantial revenues to the municipalities as a further means of compensation for the loss of the Regional Services Council Levy.

The final set of changes again relates to VAT. Due to the historical treatment of property rates and municipal supplies, much of the municipal VAT calculation has turned out to be far more complicated than necessary. Many of these issues relate to whether municipal charges fall within or outside of the VAT net. The Bill accordingly brings the charges into the VAT system. This clarifies much of the confusion, simplifies compliance, and generates further VAT input credits for municipalities.

Again, I would like to thank the Chairman Nhlanhla Nene for his leadership, and the members of the Portfolio Committee for their constructive role in the process. I can proudly say that the end product will take South Africa one-step forward in terms of further growth. Madame Speaker, I hereby table the "Small Business Tax Amnesty and the Amendment of Taxation Laws Bill, 2006" as well as its companion, the "Second Small Business Tax Amnesty and Amendment of Taxation Laws Bill, 2006."