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**THE CHAIRPERSON OF THE
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(PCOF)**

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**RESPONSES TO WRITTEN REPRESENTATIONS BY ORGANISATIONS
TO THE PORTFOLIO COMMITTEE ON FINANCE ON THE DRAFT SMALL
BUSINESS TAX AMNESTY AND AMENDMENT OF TAXATION LAWS
BILL, 2006 (the Bill)**

1 Introduction

As indicated to you during the hearings on the above-mentioned Bill on 2 and 6 June 2006, National Treasury and SARS wish to respond as follows to the various points raised by commentators in their submissions on the Bill.

Abbreviations used in this document:

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|-------|---|
| ABASA | Association for the Advancement of Black Accountants of Southern Africa |
| BASA | Banking Association South Africa |
| BUSA | Business Unity South Africa |
| DR | Deneys Reitz |
| PWC | PricewaterhouseCoopers |
| SAICA | South African Institute of Chartered Accountants |
| SAIPA | South African Institute of Professional Accountants |

2 Consultation

SARS and the National Treasury placed two batches of draft legislation as well as explanatory notes on their websites on 28 February and 4 May 2006. The draft Bill and explanatory memorandum were submitted to your committee on 12 May 2006 and again placed on the SARS and National Treasury websites. This, therefore, occurred more than 10 working days before the informal briefing on the draft Bill on 31 May 2006.

3 Responses to specific issues raised in representations by commentators to the PCOF on the draft legislation for comment

3.1 Small Business Tax Amnesty

3.1.1 Clause 5 - Application of Chapter

The definition of "person" varies in the different taxing Acts covered by the amnesty. The Income Tax Act excludes a partnership as a person whereas the VAT Act defines a person to include "any body of persons (corporate or un-incorporate)", which includes a partnership. It is suggested that the amnesty should apply to partnerships as well as to partners in a partnership.

(SAICA)

This proposal is accepted in part. A definition of person was introduced in the Bill, which is similar to the definition of person in the Income Tax Act. This has the effect that it would be beneficial for the partners of a business partnership to individually apply for amnesty if the partner's gross income from the partnership for the 2006 tax year is not more than R10 million.

If the R5 million limit will apply to the gross income of each individual partner, this may discourage partnerships from applying for the amnesty where some partners qualify for amnesty and others do not, depending on the percentage interest held.

(SAICA)

Applying the gross income ceiling per partnership as suggested by SAICA would be more restrictive than the current approach. Under the current proposal, it is true that partners of a partnership would have to weigh the benefits of the amnesty against the risk for other partners when applying for amnesty.

The turnover limit of R5 million does not coincide with any other definitions of small business in the various taxing Acts. It should be

made clear whether it is intended that the amount of R5 million is inclusive or exclusive of the previously undisclosed amounts.

(SAICA)

It is believed that the threshold of R5 million turnover might limit the number of taxpayers that will be able to come forward. ABASA would like to propose that National Treasury and the Ministry consider increasing this limit to R14 million in line with the Small Business Corporation definition.

(ABASA)

A small business should be consistent with the income tax recognition of a small business, i.e. a business where the annual gross income does not exceed R14 million.

(DR)

The proposals are accepted in part. The gross income ceiling has been increased to R10 million. The R14 million gross income ceiling for Small Business Corporations relates to the 2007 tax year and is not relevant to all the types of persons who may apply for amnesty.

If the business has a financial year of less or more than 12 months, there should be a pro-rating of the R14 million.

(DR)

This proposal is accepted and the R10 million ceiling will be pro-rated.

In the case where a taxpayer should have charged VAT but did not do so, the amount invoiced is deemed to have been inclusive of VAT. It should be clarified whether the amount to be taken into account for the purposes of determining the turnover limit includes VAT in these circumstances.

(SAICA)

As it is now proposed that amnesty relief for VAT will be available for tax periods ending on or before 28 February 2006, applicants will generally not be required to adjust their gross incomes for the 2006 tax year for VAT deemed to be included in amounts invoiced.

It should be clarified that a person who ceased carrying on an undeclared business before March 2005 and who now desires to legalize the assets and liabilities accumulated from the business should be permitted to apply for the amnesty.

(SAICA)

This circumstance has already been covered in the draft legislation. Any person whose business turnover for the 2006 tax year is less than R10 million (even zero) may apply for tax amnesty for small business tax contraventions.

It is suggested that the amnesty should be available to a group of companies (as defined in section 1 of the Income Tax Act) if the

aggregate gross income of all companies in the group does not exceed R5 million, and each company in the group is eligible for amnesty. It is also possible that certain individuals may own the shares in a company, which may or may not trade, and that company has a wholly-owned subsidiary which does trade and where the understatement took place.

(SAICA)

In the case of unlisted companies, the qualifying criteria should be that all the shares or members' interests are held directly or indirectly by individuals or trusts. This is to cater for businesses run through a chain of companies where the ultimate owners are individuals and as the amnesty is extended to trusts there appears no reason why companies who are held by trusts should not also be able to apply for amnesty.

(DR)

These proposals are not accepted. Groups of companies do not fall within the target market for which the tax amnesty has been designed. The structures as described are sophisticated and do not as a general rule correspond with small business activities. The exclusion also prevents multiplication in income splitting.

It is also somewhat illogical and limiting, that a company all of whose shares are held by a trust is precluded from the amnesty, e.g. family trusts. It is suggested the wording be amended to include a company, some or all of whose shares are held by a trust.

(SAICA)

As noted above, the tax amnesty is not intended to assist group structures. However, the point that trusts and companies should be treated on a similar basis is acknowledged. Trusts should only qualify as applicants where only individuals are vested or contingent beneficiaries.

3.1.2 Clause 7 - Information required in application

It is required that an applicant declare all "taxable income ..." It is suggested that this be changed to require the applicant to declare all gross income to avoid any issue of what is "taxable income" as taxable income is a defined term derived after deducting allowable expenses.

(SAICA)

This proposal is not accepted. The requirement has, however, been simplified as it is no longer necessary to declare taxable income which has not previously been disclosed. Taxable income in respect of all amounts received by or accrued to (or deemed to be received by or accrued to) the applicant from carrying on a business must be disclosed for the 2006 tax year. This taxable income will tie back to the income tax return that must be submitted with the application.

For income tax purposes information is to be disclosed of amounts “received by or accrued or deemed to have been received by or accrued” to the taxpayer. The VAT requirement should similarly refer to both taxable supplies and deemed taxable supplies.
(SAICA)

This proposal is no longer relevant as the information reporting requirement relating to VAT has been removed.

The wording allows for an applicant to apply for amnesty where employees’ tax has previously been declared to SARS but had not been paid to SARS.
(SAICA; SAIPA)

The provision has been corrected to exclude amounts declared but not paid over.

It is not clear whether the employees’ tax relief also applies where the applicant is a “deemed employer”, for example in the case of personal service companies and trusts.
(SAICA)

In terms of the definition of “employer” in the Fourth Schedule to the Income Tax Act, any person who pays or is liable to pay any amount by way of remuneration would automatically be an employer. As personal service companies and trusts are “employees” for PAYE purposes the employer paying remuneration to them is obliged to deduct or withhold employees’ tax from their remuneration. Therefore, a small business paying remuneration to a personal service company or trust will also be able to apply for amnesty for PAYE.

If the taxable income in an income tax return was understated in a return for 2005 that was submitted (albeit incorrectly) before 15 February 2006? Must another tax return be submitted or will there be a special return to submit?
(SAICA)

It is no longer a requirement that an income tax return be submitted for the 2005 tax year in order to benefit from the tax amnesty.

There may be instances where assets were acquired at no cost (e.g. by way of a donation), in which case the implication is that a nil value will be submitted for that asset, or details of that asset will not be shown at all. Guidance is needed as to how such assets must be reflected.
(SAICA)

As the asset was acquired at no cost, the statement of assets and liabilities should show the asset at a zero cost.

The term “reasonable” used in the context of reasonable estimates which will be accepted, is very subjective and some guidelines should be given as to what SARS will regard as reasonable.

(DR)

What is reasonable depends on the facts and circumstances of each individual applicant.

3.1.3 Clause 8 - Evaluation and approval

The term “delivered” in relation to a notice of an audit, investigation or other enforcement action could have a wide interpretation, with onerous consequences that may result in many applications being rejected in cases where the Commissioner has sent a notice of audit or investigation to the person’s last know address. If the taxpayer can prove to the Commissioner that he or she did not receive the notice prior to the cut-off date or had notified SARS of a change of address, the Commissioner should take such factors into account.

(SAICA)

These are factors to be considered when SARS receives requests for withdrawal of a notice.

SARS is urged to temporarily halt carrying out any new investigations of categories of taxpayers who would qualify for amnesty, during the duration of the amnesty so as not to prejudice these taxpayers from qualifying for the amnesty.

(SAICA)

This proposal is not accepted. Freezing audits for over a year is not acceptable. SARS is, however, prepared to consider withdrawing notices of audit and investigation issued from 15 February 2006 until the amnesty window opens.

It is suggested that it should be specified which specific other enforcement action would prevent the applicant from benefiting from the amnesty. For example, will a reminder that some of the applicant’s returns are outstanding, that has been issued by the Commissioner prior to a cut-off date be regarded as an enforcement action? Does “other enforcement action” mean when litigation commences or merely a query?

(SAICA)

The term “other enforcement action” should be clarified, as it is possible for taxpayers to receive standard type questionnaires which are not necessarily indicative of an investigation.

(DR)

These proposals are accepted. A provision has been inserted to provide for publication in the *Gazette* of the type of enforcement action that would prevent amnesty being granted.

It is suggested that the exclusion from amnesty should only apply to the specific tax or levy that is being or is to be queried or audited by SARS so that these taxpayers may also take advantage of the amnesty process to regularise their tax affairs is so far as other non compliance. We can understand, although we do not agree with the merits, why SARS wants to exclude those matters which are already under investigation but cannot see the logic for excluding those taxes, levies or duties that are not under investigation.

(SAICA)

This proposal is not accepted. An investigation may, by its nature, be extended past its initial focus.

We would support SARS in imposing the maximum penalty and interest and possible criminal sanction on those persons who do not take advantage of the amnesty when they are subsequently detected by SARS.

(SAICA)

This statement is noted.

Clarification is required as to what approval processes the applications will be subjected to. It is not recommended that the applicants be subjected to a full audit of all their affairs. Applications should be accepted at face value.

(DR)

Amnesty applications will be reviewed to ensure completeness, as well as to identify arithmetic and other obvious inaccuracies, in order to assist applicants who may not have a high level of sophistication in financial matters. Once amnesty has been granted an applicant may be selected for audit, based on the normal risk based or random selection procedure applicable to any other taxpayer. A fundamental principle of the amnesty process is that applicants will not be "victimised" in any way.

3.1.4 Clause 9 - Imposition of tax amnesty levy

What happens if the taxable income was fully declared by 15 February 2006, but there was under- or non-disclosure of other taxes, for example, PAYE, STC or SDL? Will the mere disclosure of these shortfalls and a comprehensive application be sufficient to provide amnesty even though no levy is payable?

(SAICA)

How is the amnesty levy calculated where a small business has declared its income tax liabilities but has not registered for VAT purposes or has not accounted for VAT on all its taxable supplies?

(PWC)

The tax amnesty levy is calculated on the taxable income for the 2006 tax year of the applicant which is attributable to the carrying on of a business. The levy is payable by an applicant whether or not the applicant was fully compliant for income tax purposes during the 2006 tax year.

There is some confusion as to the amount of taxable income on which the levy would be calculated and we suggest that the Explanatory Memorandum should contain an example to clarify this.

(SAICA)

This proposal is accepted and an example has been included in the Explanatory Memorandum.

Because the amnesty does not extend beyond the applicant itself, such as a company, CC or trust, the shareholders or members or beneficiaries may be loath to put forward their company, CC or trust for amnesty as it could lead to problems for themselves personally. For example, if the taxable income is understated because cash sales were not disclosed or fictitious expenses were listed, clearly it is the shareholders or trustees who will have taken that money. This could be seen as income in their hands, which has not been declared. Accordingly, either the amnesty should extend to shareholders and members or the amounts paid to them should be deemed to be a dividend for STC purposes (and for which the company will claim amnesty) so that the receipt would be exempt in their hands. In the case of a trust it would have to be deemed that the amounts paid to the beneficiaries were paid out of income deemed to have already been taxed in the trust's hands, and that section 7 of the Income Tax Act and Part X of the Eighth Schedule to the Act will not apply.

(SAICA)

These proposals are not accepted, as the amnesty is directed at small business income. However, to the extent that small business income is understated and appropriated to the shareholders these amounts are treated as a dividend declared to shareholders for STC purposes under current law. Therefore, the issue raised does not arise in the case of companies.

As taxable income of businesses with a turnover of R5 million or less will be small consider dispensing with the levy. As an alternative a basic fee of R10 000 could be accommodated. If a levy is to be imposed, it should be set aside as an education or assistance fund for small businesses.

(BASA)

The incentive to induce small business to regularise their tax affairs must be pure and simple to which no penalty is attached. The imposition of the levy should be reconsidered.

(BUSA)

These proposals are not accepted. In comparison to the tax waived under the amnesty, the amnesty levy is a nominal amount in consideration for the waiver of the much larger amounts of tax and prosecution for tax contraventions. No earmarking of the tax amnesty levy collections is envisaged.

It is recommended that a firm date be set for payment of the levy and that interest be charged on any outstanding balance until full payment is made.

(DR)

This proposal is not accepted. Amnesty is void if the levy is not paid within the reasonable period of 12 months from the date of delivery of the notice of approval (or a longer period allowed by the Commissioner under special circumstances). No interest is charged on the unpaid levies.

3.1.5 Clause 11 - Relief from payment of tax, contributions or levies

Amnesty is only provided for income derived from carrying on any business. It may well be that the same entity has other, non-business income such as interest and rentals. It is accepted that it is not intended that the amnesty be extended to investment companies. However, it is suggested that as long as an applicant does have business income to which the amnesty can relate, all other income and capital gains of that applicant should also qualify for amnesty.
(SAICA)

This proposal is accepted in part. A definition of carrying on a business has been introduced which specifically includes the earning of investment income incidental to the carrying on of a business.

What is the position if the applicant has a taxable loss for the 2005 year of assessment? Can amnesty still be applied for? What if the applicant did not trade in the 2005 year of assessment but traded in prior years? The levy should be based on the last year of trading.
(DR)

An applicant who has an assessed loss for the 2006 tax year may apply for amnesty and no tax amnesty levy is payable. An applicant who did not carry on a business in 2006 will fall below the R10 million business income ceiling and will be able to apply for amnesty for small business tax contraventions. The levy is determined on the taxable income for the 2006 tax year which is easier to determine than the business income for a prior year for which records may not be readily available.

It is not clear whether the amnesty applies to remuneration, as it was originally stated that remuneration would be excluded from the amnesty, but there is no specific exclusion in the draft Bill.

(SAICA)

This proposal is not accepted. Remuneration is not specifically excluded as to do so would exclude certain branches of carrying on of a business which are included under the meaning of the definition of "remuneration" in the Fourth Schedule to the Income Tax Act. However, salaries, wages and similar income do not constitute income from the carrying on of a business and would be excluded from the amnesty.

Amnesty is granted for amounts received during the qualifying period from the carrying on of a business. It is necessary to clarify the possible overlap that exists between the carrying on of a business and the remuneration received by a labour broker or contractor.

(BUSA)

Although an entity is deemed to be a labour broker, it would not impact on the fundamental question of whether the entity is carrying on a business or not.

The list of taxes covered by the amnesty does not include Regional Service Council Levies (or Joint Service Board Levies), which seems to be an oversight. RSC/ JSB levies are a form of an indirect tax and should be included in the scope of the amnesty, especially considering the fact that they are in the process of being phased out.

(SAICA)

The proposal is not accepted. The levies are instruments for which local authorities are responsible. However, it should be noted that the law provides for a 2-year prescription for the collection of these levies.

The amnesty relief relates to periods up to and including taxes payable for the 2005 year. This, therefore, excludes periods ending after 31 March 2005 for companies or the February 2006 year for individuals and trusts. This poses a substantial cash flow problem when it comes to employees' tax and UIF for the period from, say, 1 March 2005 to 28 February 2006, insofar as such amounts may not have been deducted from employees' remuneration. In order to make the amnesty attractive, it should surely apply to periods up to and including February 2006 as far as these two taxes are concerned.

(SAICA)

It appears that the monthly obligations for employees' tax, VAT, UI contributions and skills development levies for the period 1 May 2003 to the current date will not be amnestied, which raises the spectre of interest and penalties. This may be substantial for a small business and be a fatal blow to its cashflow. The qualifying period should be extended to include 15 February 2006.

(DR)

These proposals are accepted. It is proposed that an applicant will be granted amnesty for the payment of VAT, PAYE, unemployment insurance contributions and skills development levies relating to tax periods or months which end on or before 28 February 2006.

An employer may have withheld employees' tax, never paid it to SARS and not issued IRP5 certificates. Can IRP5 certificates be issued while the non-payment of the tax to SARS will be covered by the amnesty?

(SAIPA)

SARS allows an employee a credit if the employee can prove that the tax was deducted from the remuneration of the employee, e.g. according to pay slips. However, no refunds of excess credits will be made.

It is recommended that the amnesty be extended to include estate duty, donations tax and customs and excise contraventions.

(DR)

This proposal is not accepted. Wealth taxes are not taxes on business operations. Customs and excise duties have consistently been excluded from previous tax amnesties. An amnesty for customs and excise would impact on international trade and smuggling.

3.1.6 Clause 12 - Relief from payment of additional tax, penalties and interest

The relief afforded by the amnesty should also extend to shareholders, members, beneficiaries and trustees as well.

(SAICA)

This proposal is not accepted as the amnesty is directed at persons carrying on a business.

3.1.7 Clause 13 - No prosecution for related offences

It is not only taxable entities themselves that can be liable for prosecution. It is also directors, public officer, trustees and representative taxpayers. They, too, should be given indemnity against prosecution.

(SAICA)

The proposal is accepted in part. Representative taxpayers will also be deemed not to have committed an offence to the extent that the represented person has been granted tax amnesty.

3.1.8 Clause 15 - Disallowance of deductions, allowances and losses

It is not entirely clear what the expression “any deduction, allowance” means. For example, if a fixed asset was purchased in the 2004 year and an allowance claimed under section 11(e), does this mean that allowances under this section in future years cannot be claimed?

(SAICA)

The expression has been deleted. The limitation has now been restricted to the utilization of assessed losses and assessed capital losses arising during the period for which amnesty is granted. With respect to the example, an allowance may be claimed on the asset in future years limited to its remaining useful life after the period for which amnesty is granted.

In the case of allowances that are normally granted in one year and added back to taxable income in the subsequent year, will these be taken into account in subsequent years of assessment where an amnesty has been granted? For example, section 24C or section 11(j) allowances that were taken into account in the 2005 year of assessment?

(SAICA)

The fact that a debtor arose before the 2006 year would not limit the taxpayer from claiming a doubtful debt allowance in subsequent years.

While we can certainly understand that, to the extent that amnesty is received on undeclared income, any assessed loss should be reduced, it is nevertheless unfair to eliminate it altogether. For example, assume that the undeclared income in 2005 amounted to R100 at a time when the entity had an assessed loss carried forward from 2004 of R400. Certainly the assessed loss should be reduced to R300, but for the taxpayer to have to forfeit the entire assessed loss is unfair and, in fact, effectively costs the taxpayer more than 10%.

(SAICA)

The comment is not accepted. It is likely that the assessed loss arose because not all income was declared and it will not be possible to determine the make up of the actual results of the business activities for the period for which amnesty is granted.

3.1.9 Clause 16 - Circumstances where approval is void

Guidelines need to be proved as to what constitutes “material” and whether this applies regardless of whether the incorrectness of the estimates is intentional or not.

(SAICA)

It is recommended that a percentage accuracy be stipulated.

(DR)

A fixed measure of materiality would be open to abuse as sophisticated taxpayers may obtain a “discount” on their tax payable, while financially illiterate persons who slightly exceed the fixed deviation could be penalized. What is material depends on the facts and circumstances of each individual applicant. Further information will be required by SARS when investigating approvals which may be void. Revoking an amnesty will require the approval of SARS head office.

3.1.10 Clause 17 - Objection against decision of the Commissioner

It is suggested that it would probably be better to object and/or appeal against the Commissioner’s decision to deny approval in respect of the specific Act in respect of the application. Where there are no such provisions in the specific Act, the provisions of the Income Tax Act would then be applied.

(SAICA)

This proposal is not accepted. An amnesty application should follow a single dispute resolution process to maintain simplicity in the process.

3.1.11 General

The secrecy provisions in the various Acts, particularly the Income Tax Act and Value-Added Tax Act, should apply to this amnesty as well.

(SAICA)

This proposal is accepted. The relevant provisions of the Income Tax Act have been made applicable to the small business amnesty with the necessary changes the context requires.

Admittedly there cannot be total ring-fencing of the information of unsuccessful applicant as there is no separate amnesty unit as in the case of the Exchange Control Amnesty. At the same time, if the applicant does not qualify on a technicality, this should not permit the SARS to use the information it has to impose full penalties and interest or prosecute.

(SAICA)

If an application is not successful, will the information and documentation submitted be used against the taxpayer for raising assessments or prosecution or will the application be destroyed/locked?

(SAIPA)

These proposals are not accepted. Approval for amnesty is not discretionary and is based on a number of clear requirements.

No mention is made about granting advisors exemption under the Financial Intelligence Centre Act (FICA) where they advise applicants on their rights and obligations and compile the amnesty applications.

We reiterate what we stated in our submission to the Portfolio Committee on Finance on the 2006 Budget:

"Another concern that must be addressed in the amnesty legislation is the implications in terms of the Financial Intelligence Centre Act (FICA). Since tax offences are reportable in terms of section 29(1)(b)(iv) of FICA, any client coming forward and disclosing any irregularities in the course of applying for amnesty will have to be reported. We suggest that a specific exemption from the FICA be granted. "

(SAICA)

This matter has been referred to the Financial Intelligence Centre.

A staggered approach of amnesty for the taxi industry and other small businesses should not delay or affect taxpayers with small business activities that are not involved in the taxi industry.

(SAIPA)

Confirmation is required that the amnesty will be available to all businesses from day 1 and not just the taxi industry as a first phase.

(DR)

The draft Bill does not distinguish between small business in general and the taxi industry.

A determined education programme designed to strengthen record keeping skills by small business must be undertaken by SARS.

(BUSA)

It is proposed that SARS provide small business with simplified manuals that can provide with education on tax matters. A simplified guide that will ensure a better understanding of tax affairs is recommended.

(ABASA)

The amnesty process should be accompanied by a significant publicity campaign by SARS.

(BASA)

SARS is urged to reconsider the frequency within which small businesses have to render income tax (IT), employees tax (PAYE), value-added tax (VAT), withholding tax on royalties, secondary tax on companies (STC) and unemployment insurance fund (UIF) returns and to also consider designing forms that specifically cater for small businesses.

(ABASA)

Further consideration should be given to the simplification of tax procedures. If not, the compliance burden on small business will continue to influence the decision whether to apply for amnesty.

(BUSA)

SARS is well aware of the need to improve the education and service offering to small business. A wide ranging programme of taxpayer awareness is planned around the amnesty. SARS has already launched a series of Izimbizo for small businesses and discussions with local business bodies to raise awareness of the amnesty. This

programme will be intensified once the final amnesty legislation is available. The simplification of SARS forms and procedures is an ongoing process that will receive specific attention in the small business area. SARS has also provided pre-printed books for record keeping for tracking sales and stock for the purposes of the small retailers VAT package. SARS will review this initiative and the possibility of extending assistance with record keeping in other areas.

SARS should evaluate and endorse an acceptable accounting package.

(BASA)

SARS to design simplified and standardised tax schedules which could be integrated into the approved accounting packages.

(BASA)

These proposals are not accepted. The endorsement of a particular accounting package would create an unfair competitive advantage to the product.

Successful applicants should receive incentives to acquire packages, e.g. a double deduction of cost. Audit / bookkeeping fees charged by registered accountants should be subject to double deduction by successful applicants for 5 years.

(BASA)

These proposals are outside the scope of the Bill.

4 Amendments to the Income Tax Act, 1962

4.1 Clauses 27 and 34 – Certain amounts to be included in taxable income (section 8(1)(a)) and the definition of “remuneration” in the Fourth Schedule

We do not agree with amendment of section 8 and paragraph 1 of the Fourth Schedule to the Act as we do not believe that the assertion that this creates an unfair bias to higher income earners is correct. Whilst we agree that the section has been subject to elements of abuse, there is a need to recognize the role this section of taxpayers has contributed to the fiscal and in most cases have been the most diligent taxpayers.

The purpose for which this section was being utilised for is still considered genuine and valid and will need to be revisited. We would therefore propose that private kilometres remain at 16,000 and advance payments be taxed at 50% and not 60% as being proposed. Alternatively consideration needs to be given to lower the marginal tax rate as this is now beginning to create an unfair bias in favour of the lower income earners.

(ABASA)

These proposals are not accepted. The increase in the deemed private kilometres from 16 000 to 18 000 was announced in the 2005 and 2006 Budgets. Where an employee keeps a log book of business travel the deemed kilometres will not be applied. It should also be borne in mind that higher income taxpayers benefited from the significant increase (R300 000 to R400 000) of the taxable income at which the top marginal tax rate applies.

As far as the increase from 50 to 60 per cent of the monthly traveling allowance is concerned, the increase was proposed to ensure that the correct amount of income tax is collected through the PAYE system during the tax year. Where the actual business travel is higher than catered for by the PAYE system a refund will be made on assessment.

4.2 Clause 32 – Gains and losses on foreign exchange transactions (section 24I)

There is a shortcoming in the interplay of section 24I(7A) with section 24I(10) of the Income Tax Act. The provisions of section 24I(7A) of the Act apply to loans or advances obtained or granted during any year of assessment ending before 8 November 2005. Due to the fact that the whole section is “subject to section 24I(10)” and that section applies to “exchange differences determined on the translation of an exchange item to which that and any company are parties, where that company is (i) a connected party in relation to that resident”, all translations occurring in years of assessment ending on or after 8 November 2005 which would previously have fallen into section 24I(7A), fall into s24I(10), including existing capital connected party loans. This also renders the reference to 8 November 2005 in section 24I(7A), which demonstrates SARS’ intention, redundant. It is recommended that the words “Subject to subsection 10.....” should be deleted from the provisions of section 24I(7A) of the Act.

(SAICA)

This proposal is accepted and the relevant provisions have been amended.

5 Amendments to the Value-Added Tax Act, 1991

5.1 Denial of change in use adjustments (sections 18(4) and (5)) and the denial of an input tax deduction in terms of section 16(3)(h)

The Bill denies municipalities the right to make change of use adjustments. The denial of the right to make adjustments provided for in section 16(3)(h) and section 18(4) and (5) is unfair. An example was given of a bulldozer bought for R1 140 000 on which no input tax was available under the current system. If the bulldozer is sold after 1 July 2006 at the same price the municipality will receive R1 million after declaring R140 000 output VAT, resulting in a loss of R140 000. It is proposed that input tax is allowed when a pre-July 2006 asset is disposed of post 1-July 2006.

(PWC)

By zero-rating municipal property rates substantial relief is granted to municipalities. It should be noted that public entities were treated in a similar manner to the proposed treatment of municipalities. The potential loss aspect identified by the commentator is minor compared to the substantial administrative and cash flow gains to municipalities.

As regards the example mentioned above, what appears to have been overlooked is that if the municipality acquired a bulldozer to replace the bulldozer it sold at the same cost, its net cost would be R1 million as the input tax of R140 000 would be allowed as a credit.

5.2 Change from payments to invoice basis for local authorities which are not municipalities

The requirement that the Regional Electricity Distributor 2 will have to use the invoice basis to account for the transfer of debtors from the municipality will have a negative cash flow impact.

(PWC)

The tax status of Regional Electricity Distributors still needs to be finalised and will be dealt with in the October Bill

5.3 Municipal entities will be designated entities and the Minister may notify certain municipal entities that they are not conducting enterprises

It appears that the proviso should contain the following closing words: "that municipal entity shall not be a designated entity".

(PWC)

This proposal is accepted and the relevant provisions have been amended.

5.4 Fines and penalties charged by municipalities

The treatment of fines and penalties, e.g. for library books or hired material not returned in time, building plans submitted late or not at all and parking fees where meter time exceeded should be clarified by SARS.

(PWC)

This statement is noted. The issue will be dealt with in an Interpretation Note that is currently being prepared.

5.5 Definition of “municipality”

Only a few District Municipalities will fall within the definition of “municipality”, because only District Municipalities who have a district management area within its territories will have the power to levy a municipal rate on property. It is suggested that the concept “municipality” refers to section 155(1) of the Constitution of the Republic of South Africa to define a “municipality”.

(PWC)

This statement is not accepted. The proposed wording of the definition was carefully chosen to include all District Municipalities. District Municipalities all have the power to levy rates, even though they may not be levying rates because they do not have a district management area in their present municipal area.

5.6 Certain entities (such as Regional Electricity Distributors (REDs) and Water Boards) currently qualify as a “local authority”, but will not be a “municipality” as from 1 July 2006

Furthermore, grants received were treated by the REDs and Water Boards (and budgeted for) as zero-rated, but should have been standard rated.

(PWC)

As explained above the tax status of REDs will be dealt with in the October Bill. With respect to Water Boards the incongruity will be clarified from 1 July 2006. They will then cease to be municipalities and clearly be designated entities in terms of the Public Finance Management Act and their grants standard rated from 1 July 2006.

5.7 Definition of “municipal rate”

The proposed definition would result in confusion with regards to the “single charge” and it is suggested to reword the definition.

(PWC)

This proposal is accepted. The relevant provisions have been amended to clarify the position.

5.8 Definition of “person”

Will all current local authorities still be ‘persons’ after 1 July 2006? For example, the Water Boards will be neither ‘municipalities’ nor ‘public authorities’. Will a Water Board fall within the definition of person?
(PWC)

Yes. A Water Board would constitute a ‘person’ as defined in the Interpretation Act, 1957. In addition the definition of a person in the VAT Act includes “any body of persons (corporate or unincorporate)”.

5.9 The term ‘acquired’

It is suggested that the term ‘acquired’ should be clarified as to whether the provision is intended to apply only to acquisition where the time of supply occurred prior to 1 July 2006.
(PWC)

This is an interpretation issue and will be dealt with in an Interpretation Note, as well as regulations that will deal with the transitional issues.

5.10 Transfer payments paid to local authorities – proposed section 40B

Unfair discrimination if only some municipalities enjoy relief. It is proposed that refunds should be allowed.
(PWC)

There were two solutions to the problem. The first solution being that SARS could insist on payment being made. This would have led to a circular flow of funds when municipalities approach National Treasury for additional funds. The second solution was to introduce a provision which effectively drew a line through the outstanding tax which prevents the circular flow of funds. The second solution is proposed and it was also applied in the case of public entities that had the same problem in 2005.

5.11 6-month tax period for small farmers

Request that the annual turnover limit be increased to at least R2 million instead of the amount of R1,2 million announced in the 2006 Budget to reflect the effect of inflation on the real value thereof.
(PWC)

Noted for consideration during the 2007 Budget process.

Prepared by SARS and the National Treasury