THE PROVISIONAL TAX STATUS PROBLEM FOR INDIVIDUALS

Introduction

Provisional tax procedures have been running successfully for many years, even with understatement penalties in place. Based on SARS statistics it is a very successful tax collection process.

During the 2021 tax year something material changed for individual taxpayers - SARS related the submission extension date of individuals tax returns to their provisional tax status;-

- Non provisional taxpayers had to submit returns by the end of 23rd November 2021 (for 2022 – 24th October 2022)
- Provisional taxpayers by the end of January 2022 (for 2022 - 23 January 2023)

Between the two taxpayer types above there is a gap of approximately 3 months in time on filing of the tax returns.

So what did SARS do;-

- where an individual taxpayer did not meet the minimum provisional tax payment requirement according to them for making a provisional tax payment on assessment SARS deactivated the taxpayers provisional tax status unilaterally.
- SARS also deactivated provisional tax status before the assessment incorrectly.
- and if the taxpayer was not unknowingly a provisional taxpayer and filed a return after 24th October 2021 SARS imposed an admin penalty on assessment which recurs every month.
- it appears the same will happen in 2023 for 2022 tax returns.

What could possibly be the reason?

- is it because SARS believe that individual provisional taxpayers are taking advantage of their provisional tax status to delay tax returns by 3 months.
- or because they can drop the provisional tax status and collect administration penalties for late returns.
- or is SARS taking advantage of a situation like the pandemic and lockdown because the whole industry is behind and it creates admin penalties and thus a windfall for SARS.

Is SARS correct in doing this? This paper is an attempt to reverse this situation!

Owing to the onerous more complicated tax returns many individual taxpayers do not know if their provisional tax status should be de-activated at least until they do the tax return which by that time

will be well beyond the first extension date and already be in a penalty situation. Is this fair, ethical and constitutional!

Many of these taxpayers if they are linked to companies and CC's use Tax Practitioners (TP's) who are working around the clock to keep their tax clients up to date and compliant. In many cases it's impossible because of the increase in work load and it's impossible to plan for extension deadlines in advance not knowing the provisional tax status because at the time of doing provisional tax one does not know what the tax return is going to look like and to do the tax return when the P2 payment is done is impossible.

In fact I submit that in many cases it is impossible to make the provisional tax status determination until the tax return is done. We have reached a point where this situation is unworkable and something has broken. This situation is a major conundrum for the profession causing increased labour for TP's and aggrieved taxpayers who object to the deactivation and the penalties.

Provisional Tax Status

Originally there was a rule that if an individual was a ***director of a company or a member*** **of a** ***CC*** or over income thresholds then one had to go through the registration process for provisional tax and e-filing of an IRP6. Directors and members of a company or CC now do not have to pay provisional tax if they have covered their tax by PAYE and don't have other material income or a capital gain.

All that's happened is that from a cash flow point of view many directors and members of CC's have opted into the PAYE system for cash flow reasons in order to make sure that they pay their taxes as their income is earned, avoiding lump sum payments on provisional tax, but nevertheless still regard themselves as provisional taxpayers so that they can go through that final check for understatement at the provisional tax P2 stage. Many of these directors cover their trade income by paying PAYE.

It is accepted that the provisional tax registration law has changed and according to Interpretation Note 1 (IN1) that there is no longer a registration or deregistration for provisional tax other than registering a tax type on e-filing to be a provisional taxpayer. This is a simple matter of retrieving an IRP6 form.

Why should it suddenly be different as provisional tax payment is based on an estimate for something that's is going to happen in the future and not where all the facts are known by the P2 payment date. In fact in many instances this is impossible! It's an estimate at a particular point in time where

the actual figures are not known and owing to economic reality incomes are fluctuating and SARS are imposing penalties on taxpayers that should never have been imposed because of something that has nothing to do with provisional tax.

Provisional Tax Is an Act of Pure Compliance

There is no question that provisional tax makes taxpayers more compliant as in order to process a provisional tax payment the TP has to collect all the necessary information and if understated is subject to severe penalties.

Owing to the pressure that the new tax extension system creates there is no time for TP's or taxpayers to make proper decisions about provisional tax status or for taxpayer clients to provide all the necessary information at the P2 time especially if they have income from a trade.

What is onerous is who is a provisional taxpayer in terms of the minimum requirements or not at the time of doing provisional tax and planning the firms tax return submission dates. Provisional tax legislation gives taxpayers a margin of error in making the income determination for payment which is used to the best advantage based on information available, so why can't the determination of provisional tax status use the same status metric.

So what is the compliance issue in this regard if there are a whole lot of taxpayers who view themselves as provisional taxpayers and always have and submit their tax returns by the end of January as they have paid provisional or completed a nil return. Why not if they consider themselves provisional taxpayers in order to make sure that they are not exposed to an understatement penalty and they are sure that they are safely within the difference parameters of provisional tax. Clearly the provisional tax process is the most compliant act that a taxpayer can carry out, so why punish the taxpayer for doing their best at being compliant.

If in effect the full provisional tax on the income to be declared has been paid then SARS are not out of pocket by material amounts as most of the tax has been paid. So the only issue is the potential admin penalty that can be imposed because according to SARS the tax return is late because the taxpayer is suddenly not a provisional taxpayer.

The risk element of an understatement penalty for the taxpayer is huge where a taxpayer who does not consider themselves to be a provisional taxpayer has trade income or a large capital gain out of the blue, so why should the taxpayer take the risk, owing to the fluctuations of economic reality.

It is my view that the change in the SARS rules on provisional tax status is based on SARS standard internal operating procedures which were not announced fairly to the tax community. The tax community found out by the change in admin penalty rules by a government gazette notice and when the penalties started to flow in January 2022 and it seems to be happening again in 2023.

Practice Generally Prevailing

Despite all the laws and the situation that has transpired I submit that the way we have handled provisional tax status up and until now is a **practice generally prevailing** which needs to be taken into account in this situation and puts paid to the admin penalty based on provisional tax status deactivation at a point in time simply because a taxpayer does not fit in with whether they are a provisional taxpayer right now but could change in the future. Once a taxpayer, has registered the tax type, paid provisional tax or submitted a nil return for all intents and purposes they are accepted by all and sundry as a provisional taxpayer and they continue to complete IRP6 forms from that point onwards even if it is a nil payment. If they don't then there could be the possibility of a P2 understatement penalty.

The **practice generally prevailing** is known and should be accepted by SARS, all TP's and taxpayers throughout the country and has been the system in place for many years. Please refer to **Annexure A** for a ruling on what a **practice generally prevailing** is.

The TAA does not deal with the current situation that has arisen but does deal with a **practice generally prevailing**, s 5 of the TAA which specifies that a practice generally prevailing must be communicated in an interpretation note or a SARS policy. This current policy on provisional tax status was not communicated properly and is very weak and only found out by the advent of admin penalties as is indicated on an assessment.

IN1 does not deal at all with the provisional tax status other then who is liable to pay provisional tax and who is a provisional taxpayer.

Interpretation Note 1 (Issue 3)

Provisional tax is not a separate tax but a payment method in order to pay income tax. IN1 says that provisional tax payments are based on an estimate and the returns can be obtained from SARS and e-filing and ***"must be submitted even if the amount of the provisional tax payment is nil."*** There are rules for this calculation and if the estimate is materially inaccurate penalties and interest will be imposed.

The IN1 also deals with "who is liable to pay provisional tax" and the then defines a provisional taxpayer in terms of the law.

To summarise any individual whose income ***is not remuneration*** (not covered by PAYE) is a provisional taxpayer. There are some exclusions from being a provisional taxpayer one of which is;-

Excluded from the exclusions is any natural person who **does not derive income from the carrying on of any business.** This means that where an individual derives income from carrying on any business irrespective of the income they earn is a provisional taxpayer even if there is a loss.

For all other taxpayers if that persons taxable income does not exceed the annual tax threshold or, by setting the minimum payment due from all sources where the taxable income (rental, remuneration from an unregistered employer) is less then R30,000 is not a provisional taxpayer. This is the legal positions and anything contrary to this is unlawful.

So where is the published policy changed, therefore the practice generally prevailing has not been changed by SARS in terms of the TAA or rules and especially not changed when no one has been told and the only method of communication is an admin penalty after an assessment. The first indication is when the assessment says provisional taxpayer "**No"** nearly a year after the P2 provisional tax form was filed.

If one of the deactivated provisional taxpayers fails to pay the correct provisional tax they would no doubt be penalised with an understatement penalty so SARS has it both ways.

So in affect this is SARS changing a practice generally prevailing which are not in terms of the rules, before any taxpayer knew or could do anything about it or without the tax community even knowing about it – this is wrong and should be rectified.

This can be likened to a soccer match that's ended and the rules are changed retrospectively as a goal is disallowed and the winner becomes the loser after the match is over.

A bigger issue is the method of granting tax return extensions based on provisional tax status which is totally unworkable as already mentioned and the position for larger firms who will never meet their deadlines which is just going to fuel penalties and requests for remission on an ongoing basis.

I submit that based on this paper SARS must stop provisional tax status deactivation and find a more favourable method of extensions for submitting tax returns.

ANNEXURE A

2054. Additional assessments; practice prevailing
April 2012 – Issue 151

The judgment of the Tax Court (Western Cape), in Cases No 12760, 12828 and 12756 (decided on 14 September 2011 not yet reported) is relevant for a number of reasons. One of the issues considered by the Court was whether SARS was precluded from issuing additional assessments pursuant to proviso (iii) to section 79(1) of the Income Tax Act, No 58 of 1962 (the Act). This section provides that SARS is not entitled to raise an assessment if the amount which should have been assessed to tax was (in accordance with the practice generally prevailing at the date of the assessment), not assessed to tax.

In CIR v SA Mutual Unit Trust Management Co Ltd [1990] (52 SATC 205), it was indicated that a practice generally prevailing is one that is applied generally in the different offices of SARS in the assessment of taxpayers. It is not sufficient merely to show that the practice was applied in one or two offices. The concept of "practice" has been interpreted to be "a habitual way or mode of acting". It is therefore not sufficient to show that a certain attitude had been adopted by assessors concerned only in some instances. Ultimately, a practice generally prevailing is one known to the Commissioner and authorised by him for application, and duly applied by the various assessment offices throughout the country. It was also indicated that a taxpayer must show that the failure originally to assess in a particular manner was attributable to the practice generally prevailing.