



**OPENING REMARKS BY COMMISSIONER OF THE
SOUTH AFRICAN REVENUE SERVICE MR OUPA MAGASHULA
TO THE PARLIAMENTARY STANDING COMMITTEE ON FINANCE AND
SELECT COMMITTEE ON FINANCE ON THE
PRESENTATION OF THE SARS ANNUAL REPORT 2009/10
14 OCTOBER 2010**

Introduction

Minister Gordhan,

Chairperson of the Standing Committee on Finance Mr Mufamadi

Chairperson of the Select Committee on Finance Mr De Beer

Honourable members of the Committees

Members of the media and the public

Ladies and gentlemen

Thank you for this opportunity to brief you on the South African Revenue Service's Annual Report for 2009/10 financial year and what is my first annual report as Commissioner of SARS.

While I did appear before this Committee at the same time last year, I had only fairly recently been appointed Commissioner. Today, having been in the SARS "hot seat" for the entire period under review, I can no longer claim innocence or ignorance!

In my presentation today I will take you through a very high level overview of some of the key elements of the Annual Report for 2009/10 knowing that you already have a

copy of the Annual Report and in order to allow as much time as possible for your questions.

The presentation will cover the following areas:

- a. Our Executive team who are here with me today
- b. The economic context of the year in review and its impact on revenue collection
- c. The increase in the debt book
- d. The cost of collection
- e. Compliance improvements which we have managed to continue despite the difficult economic circumstances
- f. Ongoing service improvements as part of our Modernisation Programme
- g. Enhancements to Customs and Border Management
- h. Collaboration initiatives with other government departments
- i. Human Resource trends in SARS
- j. Our governance gains
- k. And finally some other key achievements

Let me turn firstly then to introducing the SARS leadership team who share the responsibility for leading our wonderful organisation. This executive team is the outcome of an on-going leadership journey and review of our operating model which began in July 2009 and culminated in a streamlined leadership structure for SARS introduced in May this year.

The first is Ivan Pillay who is Deputy Commissioner and also oversees our governance, enforcement and risk, and business enablement divisions.

Kosie Louw is our Chief Legal and Policy Officer.

Barry Hore is our Chief Operations Officer.

Elsie Pule is our Chief Human Resources Officer.

Gene Ravele is our Chief Officer of Customs and Border Management.

Trix Coetzer is our Chief Financial Officer.

One further chief officer position is provided for in our revised operating model namely the Chief Segmentation Officer who will oversee the development and implementation of a strategic segmentation model including differentiated service offerings for a variety of key taxpayer and trader segments including the Large Business Centre, small business, practitioners and others. Joseph Rock who heads up our Large Business Centre is currently acting in this position while we pursue a formal recruitment process.

Context of 2009/10

Honourable members, allow me to briefly reflect on some of the key achievements and challenges of the year under review in this Annual Report before availing ourselves to answer the questions you have.

2009/10 was without doubt one of the most challenging and demanding financial years in the history of the South African Revenue Service. The Minister has already reflected on the economic conditions prevalent during the year and given the nature of your work, this committee needs no reminding of the economic rollercoaster ride which South Africa and the world were – and continue to be - subjected to.

I also don't need to inform the honourable members here today of the inextricable link between revenue collection and economic conditions. Quite simply with economic growth and expansion comes revenue growth and with economic contraction comes revenue contraction.

In this regard, a clear indication of the prevailing economic downturn experienced during 2009/10 is reflected in the revenue performance reported in our Annual Report which showed a year-on-year decline in overall revenue of R26.4 billion – the first time in the 13 year history of SARS in which revenue collection declined in a 12 month period.

Only collections from Personal Income Tax – which was buffered by above inflationary wage increases – the fuel levy and excise duty showed year-on-year gains but these were not enough to off-set significant declines in Corporate Income Tax (R30.2 billion or 18% lower), VAT (R6.4 billion or 4% lower) and Customs duties (R3.2 billion or 14% lower).

In response to the challenging revenue collection target, coupled with the tough economic conditions, SARS identified a number of necessary special initiatives to enable achieving its target. These initiatives, along with the dedicated SARS workforce, were key factors in helping SARS exceed the revised target by R8.4 billion.

Increase in debt book

Honourable members, the economic conditions also took their toll on our debt book which grew 23% year-on-year to R85.8 billion in 2009/10. For the same period the Credit Book declined by 7.3% down from the R45.5bn in 2008/9 to R42.2bn in 2009/10. The Credit Book is a reflection of payments to SARS which have not yet been allocated.

This increase in debt was in part a reflection of the difficult economic circumstances in which taxpayers – both corporate and individual – found themselves in during 2009/10 which significantly affected their ability to pay on time and in some cases at all. Much publicity has been given to similar trends which have been experienced and reported on by financial institutions and tax authorities the world over.

At the same time, the economic conditions over the past 18 months have accentuated the challenges we face in both debt and account maintenance across multiple tax types, multiple periods and multiple systems.

SARS processes more than 2 million journal entries each year to update, rectify and adjust payments across the various tax types and payment periods and where these adjustments relate to prior payments, as they frequently do, this has a ripple effect on all payments thereafter as it can affect penalty and interest calculations. This makes it very difficult for both SARS and taxpayers – especially employers – to reconcile their annual payments.

A significant portion of debt listed each year is ultimately off-set against the credit book once unallocated payments are correctly identified and allocated against the taxpayer, tax type and period for which they were intended.

In a cash accounting system currently in use by SARS, this discrepancy has not materially impacted on revenue collection but as part of our preparation for a move to accrual accounting in 2012, we are working on significant improvements for the account, payment and debt processes as part of our Modernisation Programme.

Already significant gains have been made in providing individual taxpayers with a statement of account on demand, the redesign of the PAYE submission, reconciliation and payment process and the expanded use of eFiling which has provided taxpayers with far more control over their own tax payments than ever before.

Over the next two years, we plan to go even further towards a system in line with modern banking in which taxpayers are in control of their accounts, payments and transfers which should significantly reduce both the credit and debt books.

We believe this process will also necessitate a review of the current debt write-off policy to remove unrecoverable debt.

Cost of collection

The decline in revenue collection also resulted in a slight increase in the cost of collection which rose from the steady 1% level over the past three financial years to 1.2% in 2009/10. This ratio remains highly efficient and is equitable with many comparative revenue administrations globally. It is anticipated that as revenue collections rebound over the coming years and the efficiency gains of our Modernisation Programme are further realised, this ratio will return to the 1% range.

Compliance gains

Honourable members, while for obvious reasons times of recession are usually associated with a decline in compliance, one of the more positive gains achieved during the year was a marked improvement in compliance – especially in terms of returns submitted on time. By the end of Tax Season 2009, SARS had received

more than 3.1 million returns compared to 2.4 million a year earlier, reflecting a growth in the compliance ratio to 79% compared to 58% in 2008.

Equally encouraging is a growing trend by taxpayers to submit their returns earlier. It took just eight weeks in Tax Season 2009 to reach 1 million submissions. By the same point in 2008 only 427 000 returns had been submitted. This year we have seen this trend towards early filing continue. It took just 7 weeks to reach the 1 million mark this year and three months into Tax Season we have received over 2.2 million returns compared to 1.8 million by this stage last year – a 22% increase.

We believe that years of laying a strong foundation for tax morality – coupled with the introduction of an effective new penalty regime and the significant improvements in risk detection provided by third party data and other sources as part of the Modernisation Programme - is bearing fruit at exactly the time it is most needed to drive compliance.

During 2009/10, SARS issued more than 270 000 penalty notices to taxpayers with multiple outstanding returns resulting in the submission of over 80 000 late returns. This has been followed up in the past few weeks with the issuing of approximately 60 000 IT88 Agent Appointment notices to recover outstanding penalties from defaulting taxpayers' salaries.

We have also clamped down on fraudulent VAT claims through a focused effort to remove bogus VAT vendors and to tighten up on VAT registrations to ensure legitimate access to the VAT system. This saw some 16 000 VAT vendors suspended during the year.

The sophisticated risk engines, expanded use of third party data, and the reorganised compliance process also allowed SARS to expand its audit and verification coverage for tax returns which increased by over 50% from just over 70 000 audits to almost 160 000 audits last year resulting in additional revenue of approximately R1.3 billion.

Honourable members, a credible threat of detection and enforcement for those who fail to meet their obligations is an essential ingredient for a fair and equitable tax system and we plan to further expand the use of administrative penalties, third party data and risk detection for those who continue to skirt their obligations.

This has helped us on the enforcement side with far-better targeted interventions which had led to seizures of illicit and counterfeit goods including:

- a. 560 cloned cheques to the value of R7.8 million
- b. 67 million cigarettes to the value of R33 million
- c. Two warehouses of alcohol
- d. 340 000 DVDs worth R53 million
- e. 35 tons of textiles
- f. And 400 seizures of narcotics with a street value of R280 million

We have also contacted over 880 investors who are South African taxpayers in connection with Ponzi schemes. It should be remembered that Ponzi schemes are illegal and any earnings will be surrendered to the state.

Service Improvements

SARS continues to deliver against target and expectation on the modernisation programme embarked on in 2007. The key initiatives initially aimed at transforming the income tax process from a complex paper-based and labour-intensive process, to a simplified and automated process, has delivered great results. This endeavour has not only reduced cost for both SARS and taxpayers, but it has also gone a long way toward strengthening the compliance aspect.

Over the past three years, the number of registered e-Filing users increased from 500 000 at the end of 2006, to over 6 million users at the end of 2010 – a twelvefold increase. Usage of this channel has increased substantially, with the number of electronic returns submitted increasing from approximately 1.5 million per annum in 2006 to approximately 10.8 million at March 2010 – resulting in an increase of 720% across Income Tax, VAT, PAYE, SDL and UIF tax products.

Following the learning from the pre-populated employee IRP5 information initiative used in previous years, 2010 saw significant improvement in this process. As a result, reconciliations between SARS and employers have become less complicated, while at the same time it assists in tracing and collecting outstanding debts.

These improvements have helped significantly improve the turnaround times for the assessment of returns with almost 95% of returns processed within 24 hours during Tax Season 2009 compared to 62% a year earlier. In the vast majority of cases this resulted in refunds being paid within 48 hours of submission directly into taxpayers' bank accounts.

During the year, SARS refunded R14.8 billion compared to R11.2 billion a year earlier, providing significant and speedy relief to cash-strapped consumers.

During the past three years, SARS has also invested significantly in a Customer Service Programme. To date, considerable progress has been made in the programme. We have continually moved towards improved customer service resulting from integrated and virtual Contact Centres, improved transactional workflow, optimised infrastructure and facilities, enhanced staff learning and delivery of self-help service offerings.

Honourable members, in his final Budget Speech as Finance Minister in February last year, Minister Trevor Manuel highlighted the challenges we have had in providing an excellent service to taxpayers and traders through the SARS Call Centre noting that it was "dysfunctional".

I am pleased to report that we have taken the criticism to heart and worked tirelessly at improving our Call Centre performance over the past year. Our Annual Report notes an improvement of over 10% in calls answered within 20 seconds to 63% and I am pleased to report that during last week's deadline peak for manual income tax return submissions we answered over 80% of calls within 20 seconds.

These improvements are not going unnoticed. A year or two back we received 0 out of 5 in the weekly *FinWeek* call centre rating. In the September 30 edition of *FinWeek* two weeks ago we received 4 out of 5 and the call was answered within 30 seconds.

We are not there yet – and many improvements can and will still be made – but I think we can definitely say that the call centre is no longer dysfunctional.

There are many other modernisation initiatives – including improvements to the Customs process, VAT and Corporate Income tax which are described in more detail in the Annual Report document.

The modernisation of SARS is driving significant business benefits for all stakeholders, including taxpayers, traders and practitioners, clearing agents and others who represent them. As the modernisation journey continues, it aims not only to reduce the administrative burden through simplifying and automating the entire process and increasing the speed and accuracy of processing and service, but improving the ability to detect and deter non-compliance.

This is translating into fiscal rewards and a more even spread of the tax burden. SARS acknowledges that there is still some way to go on this journey, but it is confident that by pursuing its consistent, steady and results-orientated approach it adopted three years ago, many benefits are still to be extracted from future modernisation efforts.

Customs and Border Management

Honourable members, the Customs and Border Management side of our business saw a year of intensive background work in preparing for the Customs Modernisation programme which was launched by the Minister in October 2009. This programme will address five aspects of the supply chain as reflected on the slide namely the concept of the “trusted trader” in which preferential treatment will be provided to registered traders who have proven themselves to be compliant; secondly we will seek to enhance our risk detection through third party data and the use of risk engines to better target customs interventions and inspection;

Thirdly, as previously reported, SARS took the bold step of buying a local software development company to secure the intellectual property for an advanced integrated customs and border management system which is already in use in Luxembourg and

which we believe has the potential to provide the platform for our modernisation initiatives and for other Customs administration in the region and indeed globally. Already Lesotho and Swaziland have indicated a desire for the system.

The benefits of buying the company have been to significantly reduce risk and to provide SARS with internal competence in this highly specialised area. In addition, any future gains from the implementation of this system elsewhere will be used to off-set the purchase price and on-going cost of implementation and development.

This system we help us make significant enhancements to declaration processing and finally we will be leveraging SARS capabilities to provide a more comprehensive view of traders by combining both tax and customs information.

Collaboration with other government institutions

Honourable members, this collaborative approach was also evident in our work with other government departments in preparing for the 2010 FIFA World Cup, the highly successful hosting of which we are all familiar with.

This cooperation has culminated in the on-going work of a steering committee comprising all significant roleplayers in border management and protection which is pursuing the Border Management Agency initiative announced by the President last year.

In addition, there is an enhanced and continuously improving working relationship with a wide variety of state institutions as evidenced by:

- Collaboration in the Justice, Crime Prevention and Security (JCPS), International Cooperation, Trade and Security (ICTS) and Governance and Admin clusters.
- Participation of SARS in the Multi Agency Working Group on improving the state procurement capability and the reduction of fraud and waste.
- Shaping the founding of the Roundtable of Financial state institutions to enable improvement of the management of the whole financial system; and

- Joint investigations of various cases including some highly publicised pyramid schemes, illicit goods such as drugs and cigarettes, and work in the anti-poaching and smuggling of abalone and rhino horn.

HR improvements

Ladies and gentlemen, on the people front SARS's headcount reduced very marginally during 2009/10 compared to the previous financial year with a total of 14 738 permanent employees and 525 temporary employees. This was 44 less than the previous year.

Encouragingly, we continued with our upward trend of employment equity with increases in the number of black employees and women, including in supervisory and management positions.

Governance

Honourable members we are pleased to report that the Auditor-General has given SARS an unqualified audit report for 2009/10 – the sixth in a row which reflects our on-going dedication and commitment to good governance.

In the interest of full disclosure, let me highlight the one emphasis of matter which the Auditor-General noted which relates to the impairment of the loan to Clidet Pty LTD. Clidet is the name of the company wholly owned by SARS which was established as part of the acquisition of the TATIS customs software as reported on in last year's Annual Report. The loan was required to be impaired as Clidet will be supported by SARS for their cash flow as the customs and border management system is further developed and implemented as part of Customs Modernisation.

There remains potential for future marketing of this system internationally – as mentioned earlier Lesotho and Swaziland have already expressed an interest in utilising this system – but the company is unlikely to be self-funding in the near future.

Honourable members, for us an unqualified audit is much more than a mere governance requirement and a fulfilment of our financial responsibilities. The

accountability of public institutions and the faith the public has in them is a key ingredient in the social contract between taxpayers and the state and is a direct contributor to greater compliance.

For us, therefore, it is a mark of our values of integrity, honesty, fairness and trust.

Other key achievements

Honourable members, allow me finally to brag about a number of other key achievements during the year in review. The first of these is the launch of the African Tax Administration Forum (ATAF) in Uganda. SARS pioneered the ATAF and now chairs the forum, having already attracted over 30 African countries as members. This forms the basis for closer co-operation and engagement between revenue authorities on the African continent. South Africa will host the ATAF secretariat. In addition, SARS continued to play a key leading role in a number of international multilateral tax and customs forums including the OECD Forum for Tax Administration and the World Customs Organisation (WCO).

Secondly, SARS was awarded top honours in the inaugural Public Service Excellence Awards in October 2009, the Grand Prix Platinum Award for Best Reputation of all Government Departments and State-owned Entities. In addition, SARS received four Gold Awards for Overall Effectiveness, Service Orientation, Service Orientation in Rural Areas, as well as Best Reputation in the Financial Services category. The Minister of Public Service and Administration, Richard Baloyi, presented these awards to SARS.

SARS received another accolade in the form of the Lean Institute Africa Diamond Award for Excellence. This award recognised achievements in efficiency and productivity internationally in line with the “lean” production philosophy developed by Toyota.

Conclusion

In conclusion, Honourable Members, the prevailing conditions during the financial year 2009/10 presented SARS with its sternest test yet. The strong foundation laid and foresight of the leadership of this organisation over the past 10 years enabled

the organisation to navigate these conditions with relative stability, certainty and confidence.

Our work in meeting our mandate through improved compliance, enhanced service and fair and firm enforcement is by no means over. Nor will it ever be for there will always be room for improvement, always new goals and always higher performance expected of us by ourselves and others who wish for our country to succeed.

I remain confident that SARS has the people, the passion and the patriotism to meet these challenges.

I thank you.