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To: The South African Revenue Service
Lehae La SARS
299 Bronkhorst Street
PRETORIA
0181

Via email: SARS: policycomments@sars.gov.za

SAIT RESPONSE TO CALL FOR COMMENT ON THE DRAFT INTERPRETAION NOTE PERTAINING TO THE CONSEQUENCES OF AN EMPLOYER'S FAILURE TO DEDUCT OR WITHHOLD EMPLOYEE'S TAX

Dear Colleagues,

We thank you for the invitation and opportunity to comment on the draft Interpretation note (**draft IN**) that provides guidance on the consequences of an employer's failure to deduct or withhold employees tax that was released for comment on 16 February 2024.

All references to legislation are pertaining to the Income Tax Act, No.58 of 1962 (the Act), together with relevant Schedules to the Act.

We have set out below commentary regarding specific aspects of the draft IN.

Yours Sincerely,

SAIT Tax Technical and select members of the SAIT Personal and Employment Tax Technical Workgroup

1. The application of paragraph 5(5) of the Fourth Schedule to the Act in the case where the employer releases an employee of a debt.

1.1. Comment

Paragraph 4.4.3 and 5 of the draft IN states at that, in terms of paragraph 5(5), where an employer does not recover an amount of employees' tax paid by the employer from the employee, that amount so paid will be deemed to be a penalty for purposes of section 23(d) of the Act and the employer would be prohibited from claiming the amount paid as a deduction from its own taxable income The provisions of paragraph 5(5) of the Fourth Schedule is the crucial deterrent for employers not to fall foul of their statutory obligations.

However, the IN is silent on the nature of the taxes paid in the case where the employer takes on the liability of the under-deducted PAYE and releases the employee of its obligation to pay the debt owed to the employer and a gross-up is performed as per Examples 4, 5 and 6.

1.2. Submission

It is our understanding that to the extent that there is a gross up of the tax paid by an employer on behalf of an employee an additional fringe benefit arises under paragraph 2(h) of the Seventh Schedule (as stated in the draft IN under paragraph 4.4.2.).

Where the gross-up is performed, the nature of the PAYE liability changes and the full grossed-up amount becomes 'remuneration' paid by the employer to the employee and such amount should be allowed as a deduction in the hands of the employer.

We propose that the draft interpretation note be amended to clarify that the gross up amount is 'remuneration' and an allowable deduction in the hands of the employer.

1.3. Additional commentary

As mentioned above, the provisions of paragraph 5(5) of the Fourth Schedule are a measure to ensure that employers fulfil their statutory obligations. We agree with the severity of this sanction and the effect of paragraph 5(5). Although it is our view that the amount the general deduction provisions of section 11(a) of the Act should in itself prohibit the deduction of this deemed penalty amount (i.e. the requirements of in the production of income and furtherance of trade could be argued), any doubt is removed by the specific inclusion under section 23(d) of the Act.

Arguably the forgiveness by the employer of the debt due by the employee is similar to a donation or similar disposition. Whether there is a '*disposal of property made wholly or to an appreciable extent gratuitously out of the liberality or generosity of the disposer*' - such act is dependent on the circumstances, e.g. where an employer chooses not to pursue to recovery of the debt. If so, a donor is prohibited from claiming a tax deduction for the donations made other than to qualifying institutions and therefore the provisions of the para 5(5) penalty give the same tax effect.

2. Timing of inclusion of additional taxable benefit in the case of a gross-up

2.1. Comment

Further to the above, is the timing of the inclusion of the additional taxable benefit in the case that an employee is released of a debt and a gross-up is performed. In practice SARS includes the gross-up in the tax year in which the under-deduction of employees' tax occurred although the employer only releases the employee of the debt at the time that the grossed-up liability is paid to SARS.

Although it may be a practical approach, this practice is not correct in terms of the legislation. The benefit in respect of the grossed-up tax liability should be included in the hands of the employee at the time that the employee is released from the debt and the employer should be able to claim a corporate tax deduction at the same time. The current treatment brings about an anomaly with regard to the incurral of interest on under-deducted employees' tax, late payment penalties and understatement penalties (where applicable), as interest is effectively charged on the under-deduction of employees' tax prior to the benefit being enjoyed.

2.2. Submission

Because of the anomaly discussed above, we propose that SARS consider only including the grossed-up benefit and the tax thereon in the year that the additional taxable benefit arises, i.e. when the employee is released of the debt. This will align the timing of the inclusion of the taxable benefit in the hands of the employee and the claiming of the corporate tax deduction and will ensure that the employer is not subject to excessive interest.

3. Application of paragraph 5(2) – Absolving employer of its personal liability in respect of employees' tax

3.1. Comment

Footnote 22 of the draft IN specifically excludes the application of the requirements for granting absolution in terms of paragraph 5(2), from the scope of the draft IN.

3.2. Submission

We recommend that the application of paragraph 5(2) should be included in the scope of the draft IN, as it bears relevance to the subject of this draft IN. Paragraph 5(2) is worded in very broad terms and its application is the cause of much confusion amongst employers. We propose that the draft IN be amended to discuss the requirements of absolution and when employers would be able to rely on the provisions of paragraph 5(2), in order to provide clarity.

4. Consequences for the employee (Paragraph 4.4.2)

4.1. Comment

This paragraph contains the statement that *"[t]he employer's right to recover from the employee, and the employee's debt due to the employer arise automatically by operation*

of law when the employer incurs personal liability. The tax amount is thus a debt owing by the employee to the employer."

4.2. Submission

We are of the view that the above statement is incorrect in law, on the basis that an employee does not incur any debt owing to the employer at the same time that the employer may incur personal liability. It is only at the point that the employer takes the decision not to recover tax paid on behalf of an employee that a debt may (i.e. not necessarily) arise in the hands of the employee.

If an employer takes the decision not to recover the tax paid on behalf of the employee (which may occur for various legitimate business reasons), the employer may elect to gross up the tax and thus no fringe benefit in respect of a loan would arise that is subject to tax in the hands of the employee (as discussed above). The draft IN should therefore be clarified to address the above, and to expressly state and that where an employer grosses up the tax paid on behalf of an employee, SARS will not institute collection proceedings against the employee to settle the tax already paid.

5. Is there double taxation? (Paragraph 4.4.3)

5.1. Comment

Upon our reading of this paragraph, this paragraph appears to conflate the employer's liability to withhold tax with the employee's liability to actually pay the tax in respect of their income.

5.2. Submission

We therefore recommend that this paragraph be reconsidered and/ or redrafted having regard to this important distinction.

5.3. Comment

The discussion at paragraph 4.4.3 of the draft IN regarding double taxation should be reconsidered having regard to the comments at 4 and 5.1 and 5.2 above. We respectfully submit that it is improper for SARS to recover the same amount of tax from the employer and employee.

5.4. Submission

We recommend that the draft IN clarify that SARS will not proceed against an employer and an employee for the same amount, and clarify SARS' policy in regard to collection of the tax debt in circumstances where an employer has either:

(i) withheld but not paid the tax to SARS, or

(ii) (ii) not withheld and not paid the tax to SARS, i.e. whether SARS will first pursue collection against the employer under the provisions of paragraph 4 of the Fourth Schedule to the Act and/or section 157 of the Tax Administration Act, No. 28 of 2011 ("**TAA**"), or whether SARS will first pursue collection against the employee.

We further propose that for the deletion of Example 7 on the basis that there would be no expenditure actually incurred by the employer which could qualify for a tax deduction in the context of the facts stated in the example.

6. Miscellaneous

The draft IN makes no mention of paragraph 4 of the Fourth Schedule, which provides that *"[a]ny amount required to be deducted or withheld in terms of paragraph 2 shall be a debt due to the State and the employer concerned shall save as otherwise provided be absolutely liable for the due payment thereof to the Commissioner."* (own emphasis)

The draft IN also does not address the interaction between paragraph 4 of the Fourth Schedule and section 157 of the TAA (the latter being the only provision that the draft IN appears to consider).

We recommend that the draft IN include SARS' guidance regarding practical remedies available to an employee where an employer withholds employees' tax but does not pay the amount to SARS and thus the employee's personal tax affairs are not compliant as a result of the actions of the employer.

On a more substantive basis, we propose that in order to address the conflict between section 157(2) of the TAA which provides that the payment by the employer in discharge of its personal liability is a payment on behalf of the employee for the employee's liability for income tax, and paragraph 5(4) and paragraphs 28(1) and (2), we recommend that the wording to section 157(2) of the TAA be amended or removed in its entirety.

We value the opportunity to provide commentary regarding this draft IN and would welcome further engagement where appropriate.

End.