South African Institute of Taxation

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30 November 2022

To: The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS,
299 Bronkhorst Street
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Via email: **National Treasury** (2023AnnexCProp@treasury.gov.za); and
SARS (acollins@sars.gov.za)

RE: ANNEXURE C PROPOSALS: SAIT PERSONAL & EMPLOYMENT TAXES TECHNICAL WORK GROUP

We attach the Annexure C proposals from the SAIT Personal & Employment Taxes Technical Work Group (the WG), as it pertains to technical proposals for possible inclusion in Annexure C of the 2023 Budget Review.

We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate. Please do not hesitate to contact us should you need further information.

Yours sincerely

SAIT Personal & Employment Taxes Technical Work Group

Unless otherwise indicated, all references to sections of the Income Tax Act, No. 58 of 1962 (the ITA)

1. EMPLOYEES' TAX ISSUES REGARDING THE RECRUITMENT OF NON-RESIDENT EMPLOYEES AND INDEPENDENT CONTRACTORS

[Applicable provisions: Fourth Schedule]

1.1. Background

1.1.1. South African employers are increasingly seeking to offer employment to individuals who are tax resident outside South Africa. As opposed to pre-COVID times, many employers now allow employees to work remotely from their home country. The benefit is that whilst the company attracts the necessary talent, it does not incur the additional cost of relocating an individual and their family.

1.1.2. In the typical scenario that we encounter, the employee resides outside South Africa, does not relocate to South Africa, and renders their services to the South African employer exclusively from that foreign country.

1.2. The legal nature of the problem

1.2.1. In terms of the definition of "gross income" in section 1 of the ITA, non-residents are only subject to tax in South Africa on income, which is from a source within South Africa. Therefore, if the employee does not render any services to the South African employer whilst physically present in South Africa, the remuneration of the employee would not constitute South African sourced income and would therefore not be subject to income tax in South Africa.

1.2.2. In addition, where there is an applicable double taxation agreement (DTA) between South Africa and the country where the employee is tax resident, the income from employment article typically provide that salaries, wages and other remuneration derived by a resident of one contracting state in respect of employment shall be taxable only in that state unless the employment is exercised in the other contracting state. Furthermore, if the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other state.

1.2.3. The result is that under such a DTA provision, South Africa would only have taxing rights in respect of the remuneration of a non-resident individual who is tax resident in a treaty country to the extent such employment is exercised in South Africa. If the employment is not exercised in South Africa, South Africa has no taxing rights in terms of the double taxation agreement.

1.2.4. Despite the analysis above, there has been some interpretation of the legislation which suggests an employer in the scenario sketched above will have an employees' tax obligation. The argument flows from paragraph 2(1) of the Fourth Schedule, every employer who is a resident, who pays or becomes liable to pay any amount by way of remuneration to any employee, shall, unless SARS has granted authority to the contrary, deduct or withhold from that amount by way of employees' tax an amount which shall be determined as provided in the Fourth Schedule in respect of the liability for normal tax of that employee.

1.2.5. However, it is important to note that the definition of "remuneration" means any amount of income, which is paid or is payable to any person by way of any salary, leave pay etc. "Income" is specifically definition in section 1(1) as the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II. Since the definition of gross income, as mentioned above, in the case of non-residents only includes income of a South African source, there can be no income and therefore no remuneration, since the definitions build on one another.

1.2.6. However, we note some SARS officials hold the view that there would still be an amount of remuneration and, the South African employer would be obliged to deduct employees' tax from the employee's remuneration despite the fact that the employee has no normal tax liability in South Africa. Despite the above, SARS in practice requires employers to deduct employees' tax in these circumstances.

1.2.7. It is submitted that the Fourth Schedule should not apply to an individual who has no South African normal tax liability. In our view, enforcing any withholding tax obligation at this point would only result in administrative cost on the side of SARS and the taxpayer and employer.

1.2.8. A similar issue arises for non-resident independent contractors (including non-executive directors) who work exclusively outside South Africa, because they would not qualify for the exclusion from the definition of "remuneration" in the Fourth Schedule since the exclusion only applies to resident independent contractors.

1.3. A detailed factual description

1.3.1. A South African employer (Bike Traders) employ an individual (Alitia) that resides and is tax resident in Fiji. Alitia only provides their services in Fiji and does not travel to South Africa.

1.3.2. Despite Alitia not being liable for normal South African tax, SARS would require Bike Traders to deduct employees' tax from Alitia's remuneration.

1.3.3. The only available remedy for Alitia at that point to avoid the deduction of employees' tax would be to obtain a hardship directive from SARS which directs that no employees' tax be deducted from their remuneration in these circumstances.

1.3.4. In order to apply for a hardship directive, Alitia (the non-resident employee) would have to register as a taxpayer with SARS (despite not being legally required to do) and apply for the directive on eFiling.

1.3.5. In the absence of a hardship directive, Alitia (the non-resident employee) would receive an IRP5 tax certificate from Bike Traders and would have to claim a refund from SARS at the end of the year of assessment for the employees' tax that has effectively been overpaid. (From a practical perspective, there is also no specific IRP5 code which applies to non-taxable remuneration paid to non-residents for services rendered outside South Africa. The IRP5 codes for foreign services only apply to South African residents who work abroad for purposes of claiming the foreign earnings exemption.)

1.3.6. The result is that the Alitia (the non-resident employee) would have to register as a taxpayer in South Africa (despite the fact that Alitia has no South African income tax liability) and submit annual income tax returns in order to claim a refund of the employees' tax deducted by Bike Trader (the employer).

1.4. The nature of the business / persons impacted

1.4.1. Non-resident individuals employed by a South African employer but who renders services abroad.

1.5. Proposal

1.5.1. We propose that the Fourth Schedule be clarified to confirm that employers need not to deduct employees' tax in circumstances where they employ a non-resident individual who works exclusively outside South Africa on the basis that the relevant employee/contractor does not earn any South African sourced income, i.e., if there is certainty that the employee does not earn any SA sourced income, and additionally, is a non-resident. From our point of view, the proviso/exclusion could be subject to the employer obtaining confirmation from the individual that they are tax resident in a foreign country e.g., a certificate of tax residence or similar for countries where no such document is obtainable.

1.5.2. In the event that the proposal above is accepted, we request that consideration be given to also provide a similar exclusion from the skills development levy (SDL) and unemployment insurance fund (UIF) contributions in the relevant legislation. However, it is understood that any amendment processes pertaining to SDL and UIF would not necessarily run concurrently with the tax legislative cycle.

2. PROVISION OF SECURITY TO KEY EMPLOYEES

[Applicable provisions: Paragraphs 2(e) and 10(2)(c) of the Seventh Schedule]

2.1. Background

2.1.1. Employers regard the ongoing contribution, and therefore the security of key individuals within the organisation as a critical element of the success and continuance of the operations of the organisation.

2.1.2. Due to the continued rise in kidnappings in South Africa, employers have been forced to implement security policies, which include personal focused security guards for key individuals. These services are not limited to the place of work and extend to certain routes and venues outside the organisation.

2.1.3. Employers mainly engage the security service for key personnel such as Executives and Managing Directors. Under certain circumstances, the risk analyses of the employer may also indicate that certain legal representatives of the organisation, or personnel involved in investigations or disputes, are at high risk.

2.2. The legal nature of the problem

2.2.1. Paragraph 2(e) of the Seventh Schedule:

> *2. For the purposes of this Schedule and of paragraph (i) of the definition of "gross income" in section 1 of this Act, a taxable benefit shall be deemed to have been granted by an employer to his employee in respect of the employee's employment with the employer, if as a benefit or advantage of or by virtue of such employment or as a reward for services rendered or to be rendered by the employee to the employer—*
>
> *(e) any service (other than a service to which the provisions of subparagraph (j) or (k) or paragraph 9 (4) (a) apply) has at the expense of the employer been rendered to the employee (whether by the employer or by some other person), where that service has been utilized by the employee for his or her private or domestic purposes and no consideration has been given by the employee to the employer in respect of that service or, if any consideration has been given, the amount thereof is less than the amount of the lowest fare referred to in item (a) of subparagraph (1) of paragraph 10, or the cost referred to in item (b) of that subparagraph, as the case may be; or*

2.2.2. The Seventh Schedule does recognise certain circumstances where 'no value' provisions are appropriate. Under these circumstances, although there is a fringe benefit, the legislation deems the value of the fringe benefit to be zero for the purposes of that particular transaction.

2.2.3. 'No value' services are listed throughout the Seventh Schedule. The characteristics that these 'no value' fringe benefits have in common, are that they are provided solely or predominantly for the benefit of the employer either to protect the employer's assets or in order to enable the employee to better perform their duties, and the 'benefit' for the individual is incidental to the main purpose in providing the goods or services.

2.2.4. Currently, the provision of security in respect of an employee's physical person, is viewed as a taxable benefit. However, in our view the benefit is not enjoyed by the employee for their private purposes. The employer is undertaking the security of the employee for the sole purpose of ensuring business continuity and keeping its 'human capital' asset safe. Although security provided at the place of work would be a 'no value' fringe benefit, employees are often more vulnerable when away from their place of work.

2.3. A detailed factual description

2.3.1. Example 1: An employer does a risk assessment on the potential assassination or kidnapping of its CEO due to threats that have been made against her. The risk is calculated as very high. The employer contracts with a security firm to physically protect the employee 24 hours of every day. The risk assessment is reviewed every three months and once the threat has passed, the security detail is withdrawn.

2.3.2. Example 2: Employee A, is employed manage high-level disputes and grievances between the employer and its employees. Based on past experience, and after assessing the risk, the employer contracts security to guard the employee's physical person 24 hours of every day. It is determined that the risk remains constant and as such the security detail is attached to that position in the organisation.

2.4. The nature of the business / persons impacted

2.4.1. All employees that are at risk due to their employment and is the subject of security detail on their physical person funded or provided by their employer.

2.5. Proposal

2.5.1. We request consideration of adding a 'no value' fringe benefit to paragraph 10(2)(c) to include security services for key personnel specifically included in the organisations security policy, following a risk analysis which puts the employees at particular risk for assassination and/or kidnapping.

3. PERSONAL SERVICE PROVIDERS

[Applicable provision(s): Definition of "personal service provider" in paragraph 1 to the Fourth Schedule to the ITA]

> *"**personal service provider**" means any company or trust, where any service rendered on behalf of such company or trust to a client of such company or trust is rendered personally by any person who is a connected person in relation to such company or trust, and—*
> *(a) such person would be regarded as an employee of such client if such service was rendered by such person directly to such client, other than on behalf of such company or trust; or*
> *(b) where those duties must be performed mainly at the premises of the client, such person or such company or trust is subject to the control or supervision of such client as to the manner in which the duties are performed or are to be performed in rendering such service; or*
> *(c) where more than 80 per cent of the income of such company or trust during the year of assessment, from services rendered, consists of or is likely to consist of amounts received directly or indirectly from any one client of such company or trust, or any associated institution as defined in the Seventh Schedule to this Act, in relation to such client,*
> *except where such company or trust throughout the year of assessment employs three or more full-time employees who are on a full-time basis engaged in the business of such company or trust of rendering any such service, other than any employee who is a holder of a share in the company or settlor or beneficiary of the trust or is a connected person in relation to such person;*

3.1. Background

3.1.1. Employee remuneration is subject to a specific policy framework, which includes a limitation on deductions, as well as a withholding tax obligation on the payor. As per the Fourth Schedule, the withholding tax is a monthly obligation that is based on the monthly "remuneration" paid or payable by the "employer" to the "employee" (all defined terms).

3.1.2. In contrast to an employee, a third party (independent contractor, company etc.) rendering services to the same entity (the employer) would be liable to declare provisional tax on the income that it earns from the entity. Whereas an employees' tax deduction has a monthly impact on the taxpayer's cashflow, the impact in the case of a provisional taxpayer is more staggered.

3.1.3. There are also direct reporting obligations applicable to employers which, in the case of employees, makes the possibility of avoiding tax much more difficult. Additionally, the tax deductions that may be claimed against "remuneration" is severely limited through the application of section 23(m).

3.1.4. As a result of the reasons stated above, schemes emerged over the years aimed at artificially disguising the employer-employee relationship. In response, the legislature implemented anti-avoidance rules in the form of so-called 'deemed employees'. When an entity (typically a company or trust) falls within the definition of a "personal service provider" (PSP), all legislative consequences of earning ordinary remuneration follows.

3.1.5. In order to ensure that the anti-avoidance provision does not unduly affect legitimate businesses, the legislature provided for an exclusion where such company or trust throughout the year of assessment employs three or more full-time employees, who are engaged on a full-time basis in the business of such company or trust.

3.1.6. It is understood that the proviso is a proxy created by the legislature to glean the legitimate businesses from the artificial businesses, thereby addressing the avoidance tactics.

3.2. The legal nature of the problem

3.2.1. The proxy of using the employment of (1) "three or more full-time employees", (2) who are engaged on a full-time basis in the business (3) throughout the year of assessment, as a gage to determine legitimacy is in our view not appropriate in the case of start-up entities.

3.2.2. Most start-up entities would initially build a client base to financially support the appointment of employees. During this period the start-up is particularly vulnerable to cashflow constraints, and a monthly withholding tax as opposed to a provisional tax obligation is severely limiting.

3.2.3. Whilst it is Government's policy to support small businesses, which in turn will have a positive impact on the unemployment levels in South Africa, the constraint disc used above does not assist and encourage new business developments. In particular, when it is considered that as soon as the business makes sufficient profit to employ more individuals, the business would be out of the employees' tax net entirely.

3.3. A detailed factual description

3.3.1. Ms X registers a company (Fish Co.) with the CIPC and SARS. Initially, during the first year she gets a big contract, and the company receives 80% of its income during the first year of assessment, from services rendered to its big client. At that point in time, Fish Co. does not yet employ three or more full-time employees who are on a full-time basis engaged in the business of such company.

3.3.2. However, year 1 Fish Co builds up cash-flow and capacity, and in year 2, Fish Co starts employing 3 people to render the services to its big client, and subsequent clients that it acquired.

3.4. The nature of the business / persons impacted

3.4.1. All taxpayers except natural persons, i.e., companies, closed corporations, and trusts.

3.5. Proposal

3.5.1. In order to accommodate start-up businesses, we propose that a more relaxed approach be applied to this anti-avoidance provision and its proviso. Specifically, that approach be considered to allow a start-up to build an employee base gradually over the first 12-month period.

3.5.2. We are mindful that an unlimited time period would nullify the anti-avoidance rule, and in the same vein as the initial proxy, we propose a 12-month period of grace prior to the application of the anti-avoidance measure.

End.