29 April 2014

South African Revenue Service
Private Bag X923
PRETORIA
0001

BY E-MAIL: policycomments@sars.gov.za

SUBMISSION: COMMENTS ON THE DRAFT INTERPRETATION NOTE ON TAX DEDUCTIONS FOR AMOUNTS REFUNDED TO EMPLOYERS

Dear Sir/Madam,

The South African Revenue Service’s Draft Interpretation Note on Tax Deductions for Amounts Refunded to Employers (the draft Note) issued in March 2014 refers.

Please find SAICA National Tax Committee’s response to the request for comments on the draft Interpretation Note.


General

Comments regarding paragraph 1 - Purpose

It is clear that the intention is to issue this as an Interpretation Note. As such it will set out SARS’s practice with regard to the application of a tax Act (the Income tax Act in this regard). It is stated that the purpose of this note “provides guidance and clarity on the tax implications”

The draft Note provides very limited information about the application of the Act.
Comments regarding paragraph 2 - Background

It is not clear what the “… uncertainty regarding the amount (which has been subject to the withholding or deduction of employees’ tax (PAYE)) that has to be refunded, and the related tax implications…”

We accept that some taxpayers may have been wondering if the repayment, particularly in the same year of assessment, could be used to adjust to employees’ tax deducted earlier. The draft Note deals with this. We are not sure what uncertainties there were relating to the “tax implications” unless they refer to the situation before the court case was heard.

The information covered in paragraph 4.1 relating to the introduction of section 11(nA) and the position prior to its introduction in our view should be dealt with under paragraph 2 as it is background information at best.

Comments regarding paragraph 4.1 - Section 11(nA) deduction

General comments

Our comment above relating to the fact that the information regarding the introduction of section 11(nA) is better suited under the paragraph dealing with background information is relevant here as well.

ITC 1823 was very fact specific and dealt with a restraint of trade (section 11(nB) more relevant), but again we submit should only be referred to as background information. The reason for the introduction of section 11(nA) (and (nB) for that matter) was that section 23(m) prohibited an employee from making a deduction, that could otherwise be available. Section 11(nA) then (and (nB)) was then introduced as a specific deduction and the prohibition removed.

The purpose of the introduction of these provisions was well summarised in the Explanatory Memorandum where it is stated that the “…overall result violates basic tax principles because the employee is being taxed even though no net enrichment arises.”
The deduction

The draft Note states that the “section permits a person…” We agree that the deduction would be available to all persons, not only individuals, but it is also available to a personal service provider. In the case of a personal service provider section 23(k) is then also relevant.

This paragraph does not deal with section 23(m). We submit that it is relevant to section 11(nA) and should be mentioned in this part.

We submit that the issues that may require an explanation of the Act are the phrase “amount, including any voluntary award … was included in taxable income…” and then also “… refunded by that person…”

Comments regarding “…amount, including any voluntary award … was included in taxable income…”

The draft Note states that “the amount that would have been used to determine that person’s taxable income on receipt thereof would have been the gross remuneration, and not the net amount received from the employer (namely, the amount after tax).”

It is possible that the employee may only refund a “net amount”. As section 11(nA) uses the words “so much of” it is clear that the deduction is available in respect of the amount actually refunded. In a sense the deduction is limited to the amount that accrued and must now be refunded. We suggest that the issue is clarified in the Draft Note (or Interpretation Note).

We agree that the practice of using the gross amount is correct and therefore that Example 1 is correct application of the law.

Comments regarding “… refunded by that person…”

The meaning word “refund” is not defined in the legislation and it must take its ordinary meaning of “to pay back…” The draft Note and examples provided in the draft Note only deal with cash items although non-cash items such as assets and shares also form part of taxable income and can also be “refunded”.

It is submitted that the word “refunded” as used in section 11(nA) is wider than the term “repaid.” It would also include the return of an asset. For example, if an employee receives a share award of an unrestricted share but has to return the share due to breach of his
agreement, such amount would have constituted remuneration and been included in taxable income in terms of section 8C of the Act. It is submitted that the amount refunded would qualify for deduction under section 11(nA).

The draft Interpretation Note should clarify what the word “refunded” means in the context of section 11(nA). It is submitted that the provision applies to both cash and non-cash amounts returned to the employer and which were included in taxable income.

Refund of amounts owed to third parties

The draft Interpretation Note does not envisage the situation where the refund relates to amounts owing to third parties. The amounts relating to medical aids and/or retirement funds refunded are amounts owed to third parties, whereby the employer merely facilitates the payments to such third parties.

There is uncertainty regarding what the employer is required to do with the refunded amounts in this situation, as the employee already enjoyed the cover and/or benefit as per the contractual agreement. It is for this reason that in most instances the gross amount is not required to be refunded.

It is proposed that SARS provide more adequate and detailed guidelines for employers when such refunding occurs within practice including guidance as to how to deal with this issue from an administrative perspective.

Reference to and discussion relating to paragraph 2 of the Fourth Schedule

From the heading to this sub-paragraph it is clear that the intention is to deal with the application of section 11(nA). The paragraph dealing with paragraph 2 of the Fourth Schedule is therefore misplaced. It does not relate to the application of the law relevant to section 11(nA).

We propose that this paragraph is dealt with under a separate heading.

It is clear that the principle made in this part is to address the employees’ tax considerations of the refund by the employee for both the employer and the employee.
We agree that the Fourth Schedule does not allow the employer to subsequently revisit the employees’ tax withheld when the initial amount was included in taxable income. Paragraph 11B(5) will not apply in these circumstances.

From the 2008 EM “This overall result violates basic tax principles because the employee is being taxed even though no net enrichment arises.”

**Payroll adjustments to account for refunds due by employees**

The draft Interpretation Note does not note and/or comment on the scenario, where an employer may make an adjustment in the payroll for an amount owed by the employee to the employer of a currently employed employee. For example, the employer may decide to allow the employee to refund the amount owed via a reduction in that employee’s remuneration for a certain number of months in order to alleviate any hardship which an employee may encounter as a result of making the refund. This situation is common in practice as the total refund may be higher than the employee’s remuneration on a monthly basis.

The guide deals only with the scenario where the employee has had to repay an amount to the employer with no consideration of the possibility, if the person is currently still employed, of an adjustment which the employer could make to the payroll of an amount which becomes refundable to the employer.

We respectfully request that SARS consider this scenario and include commentary in the interpretation note on the above situation.

**Reference to and discussion of the Seventh Schedule**

The same comment made above applies in this respect. It is suggested that this be dealt with under a separate heading.

**Taxable benefit where refund is not for the full amount that must be repaid**

The draft Note states that “a taxable benefit will arise if the employee is only required to refund the net amount paid, or to refund a lesser amount of what is contractually owed.”

It should be made clear that this scenario will only arise where the employee is contractually obliged to refund the gross amount and is subsequently partially relieved of that obligation. It
will not arise where the contractual obligation is to refund only a portion of the amount, e.g. the after tax amount.

Furthermore, the Seventh Schedule is only applicable where the release of the obligation is directly causally connected to employment by reason of the words in the preamble to paragraph 2 “if as a benefit or advantage of or by virtue of such employment”. If this causal connection is absent or is merely a *sine qua non* of the release of the obligation, no taxable benefit can arise.

*Administrative issues where the full amount owed was not refunded*

When a taxable benefit has arisen (as per examples in the draft Note), in most cases the employment relationship has ended. The question then arises as to how the employer will be able to deduct the employees’ tax (PAYE) relating to the taxable benefit when such employee is no longer on the payroll, and the employee is not in receipt of any remuneration.

The employers will be administratively burdened and be exposed to risk should they be required to resubmit IRP5 certificates and subsequently resubmit employer declarations as a result.

*Disclosing the deduction in the return of income*

We again submit that the part that part (The deduction of the amount paid back to the employer must be reflected in the field of the ITR12 annual income tax return dealing with deductions.) and what follows should logically be dealt with under a new heading.

*Comments regarding paragraph 4.2 - Documentation required to prove that an amount was refunded*

The employee bears the onus to prove (in terms of section 102(b) of the tax Administration Act) that an amount is deductible. We therefore disagree with the view expressed that “The employer is the only person who can confirm that the amount was actually repaid.” We also submit that it not the duty of the employer to “provide the employee with some kind of evidence that the amount was previously included in income and was subsequently repaid.”
In most instances the refund would follow from an agreement reached between the parties. A copy of the agreement or minutes of a meeting should be sufficient prove. The fact that the person repaid the amount would be further proof.

It is therefore not acceptable to require of the employer to “provide the employee with some kind of evidence that the amount was previously included in income and was subsequently repaid” as indicated in this paragraph. The letter (as per Annexure A of the draft Note) will only be necessary of no other documentary evidence is available.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

Piet Nel CA(SA)
PROJECT DIRECTOR: TAX

The South African Institute of Chartered Accountants