Dear Sir

CALL FOR COMMENT: EMPLOYER-PROVIDED MOTOR VEHICLES

We refer to the workshop held on 24/25 June 2010.

In response to the request raised during this workshop we have prepared suggestions regarding the proposed increase in the fringe benefit on employer provided vehicles, specifically vehicles that are ordinarily referred to as dedicated pool vehicles or Tool of Trade vehicles.

Set out below please find the joint SAICA and LEF submission proposal’s.

Background
Paragraph 2(b) of the Seventh Schedule to the Income Tax Act, No. 58 of 1962 (“the Act”) includes the right of use of an asset for private or domestic purposes, free of charge or for payment which is less than the value of such use, by the employee, as a taxable fringe benefit. The value of the private use is determined by paragraph 7 of the Seventh Schedule to the Act. Currently, the difference between the fringe benefit value and any consideration paid by the employee would be included in his/her taxable remuneration.

The proposal aims to amend the calculation of the fringe benefit value by changing the definition of the determined value to include the Value Added Tax paid on the vehicle and the cost of the motor plan, to increase the rate charged on the determined value from 2,5% to 4% and also allow for certain deductions against the fringe benefit amount to be included in gross income and remuneration.

Excluded from paragraph 7 are vehicles that are available to employees in general, usually referred to as “pool vehicles”, and vehicles used by employees who are regularly required to use the vehicle outside normal office hours where any private use is incidental.
There is no further distinction made between a “Tool of Trade” vehicle and vehicles provided to employees as a benefit. By “Tool of Trade”, we mean that the vehicle is an essential tool allocated to a particular person, which enables that employee to perform his/her duties.

Examples would include:

- A delivery person who has the dedicated use of a small bakkie, van or delivery vehicle.
- Assessors – employees employed by short-term insurers or financial institutions in divisions such as home loans that are required to travel to specific properties to perform valuations for the purpose of determining the validity of an insurance claim or possibly extending a loan to an applicant.
- Client relationship officers – employees who are dedicated to resolving and maintaining external client relationships that include regular visits to their business premises.
- Artisans specialising in fixing heavy duty trucks and other capital equipment where these artisans have to travel to the truck/capital equipment in specially equipped bakkies.
- Sales representatives – employees who are responsible for selling the taxpayer’s products, and are required to visit clients, etc.

Some employers do, indeed, have benefit “schemes” whereby employees are provided with vehicles as a benefit, regardless of the nature of their duties. As demonstrated above, there are also employers that provide essential users with vehicles to fulfil a real business need.

This document aims to create a mechanism to distinguish between a Tool of Trade vehicle allocated to a specific employee and vehicles provided as a benefit and the fringe benefit treatment thereof.

**Distinguishing a Tool of Trade vehicle**

A Tool of Trade vehicle can be distinguished from a vehicle offered as a benefit and a general use vehicle (pool vehicle) based on the following criteria:

- Tool of Trade vehicle means a vehicle that is allocated to a specific employee, where the nature of his/her work requires the ongoing business use of a motor vehicle, and
- The employee travels mainly on business with that vehicle during any 3 month period.

**Recommendation**

We propose that the above “Tool of Trade” vehicle definition be included in paragraph 7(1) of the Seventh Schedule to the Act.

**Capped amount**

The average purchase price paid by an employer for a Tool of Trade vehicle for the current year was R165,000 and R157,000 for the prior tax year. It is submitted that, ordinarily, Tool of Trade vehicles are not exclusive / executive type vehicles.
The capped amount, however, would also have to take into account circumstances where the vehicle needs to be more rugged (hence more expensive). This would be applicable to instances where employees have to use more robust vehicles, such as light commercial vehicles, delivery vehicles and other multi-purpose vehicles. An example would be a service consultant who regularly has to visit clients on farms and would hence require a robust vehicle such as a bakkie or a delivery person who uses a multi-purpose vehicle, such as a Mercedes Vito delivery van, for business.

**Recommendation**

We would recommend a capped amount of R400 000 (excluding VAT) to cater for all requirements. Having said this, we also strongly recommend that the capped amount excludes the value of technical equipment that has no bearing on the function of the vehicle. This would apply for example in the case of the tool of trade car used by a field engineer working for one of the cell phone network providers to visit remote mast stations, where the vehicle might cost say R380k but the vehicle would also be equipped with instrumentation costing say R 250k.

**Taxation of private use**

The fringe benefit amount that is included in the taxable remuneration of an employee is currently calculated as the cash equivalent of the value of the private use, less any consideration given by the employee.

**Recommendation**

We propose that paragraph 7(4) of the Seventh Schedule to the Act that determines the cash equivalent of the private use be amended as follows:

1. The private use calculation of vehicles that do not meet the criteria of a Tool of Trade to be 4% of the determined value.
2. A new provision to be included for the private use calculation of vehicles that do meet the Tool of Trade requirements. It is proposed that the cash value of the private use of a Tool of Trade vehicle will be calculated at a final rate of 4% and with reference to the actual private/business mileage and total business mileage for every month.

The formula for the private use calculation is proposed as follows:

\[
\text{Fringe benefit} = \frac{\text{Private mileage} \times \text{determined value}}{\text{Total mileage}} \times 4\%
\]

Example: An employee has the use of a Tool of Trade vehicle with a determined value of R146,512 (excluding VAT) and has travelled a total of 25,000 kilometers for the year. It is estimated that the employee will travel 15,000 km on business and 10,000 km privately. The employee does not contribute towards the cost of the vehicle. The fringe benefit tax of the private use is demonstrated below:
1. The current monthly fringe benefit value included in the balance of remuneration will be:

$$R146,512 \times 2.5\% = R3,662.80$$

2. The proposal in the Draft Taxation Laws Amendment Bill will determine the taxable private use that is to be included in the monthly taxable remuneration to be:

$$R167,023 \times 3.2\% = R5,344.74$$

This would not be the final amount as the employee would submit an actual business travel claim against the fringe benefit. The final calculation of the correct private use of the motor vehicle, to be done on assessment, would be:

$$(R167,023 \times 4\% \times 12 \times 10,000/25,000 = R32,068.42 \text{ (R2,672.37 per month).}$$

The employee would consequently receive a refund of the tax overpaid on the difference between R5,344.74 and R2,672.37.

3. The above proposed monthly fringe benefit calculation of the private use, based on actual private mileage, presuming 725km private mileage and 2,022km mileage travelled in total:

$$R167,023 \times (725/2022) \times 4\% = R2,395.48$$

Even though the actual fringe benefit for the particular month might appear to be less than the Draft Bill proposal, over the tax year the benefit would be the same as the final and correct assessment of the private use in the individual’s tax return.

We believe that the 4% value applied against the determined use to establish the fringe benefit value of the private use is not in line with the benefit enjoyed. The actual cost of maintaining and running the vehicle, on a monthly basis, is less than 4%. For example, the monthly cost of running a vehicle with a cost price (VAT inclusive) of R200,000 (30% residual value financed over 54 months and travelling an average of 25,000 km per year) is approximately R7,186 calculated by using the Automobile Association’s rates for maintenance, fuel etc. and including any repayments and insurance arrangements. The current fringe benefit on that vehicle would be R8000, to be included monthly at 80% (R6400 would be included in the employee’s monthly employees’ tax calculations). The fringe benefit is clearly higher than the benefit received. Also, if a rate of 4% per month on the determined value of the vehicle is charged to the employee, the individual would have paid tax on the full value of the vehicle after 25 months. The rate of 4% should be revised to align it to the actual benefit enjoyed.

Admittedly, the fringe benefit charge does include the monthly operational costs of a vehicle. As an alternative to reducing the 4% private use value, the determined value should either be reduced on an annual basis, in line with the depreciation of the vehicle, or the 4% should only
be applied against the operational costs at a certain point in time. This, we submit, would be after the full determined value was included in the taxpayer’s taxable income.

Inclusion in the definition of remuneration / balance of remuneration
The current proposal is to include 3.2% of the monthly fringe benefit calculation for motor vehicles in the definition of remuneration for the purpose of calculating the balance of remuneration upon which the monthly employees’ tax withholding is calculated. This is based on the assumption that the employee would have incurred some business mileage and that he/she would claim the actual business vs. private use on this basis in their personal tax return.

Recommendation
It is proposed that the Tool of Trade vehicles be excluded from this provision and that the full 4% fringe benefit be charged in the balance of remuneration monthly through the payroll. As this amount is already apportioned for private and business use, no further concession should be granted as the employee would, in any case, have to refund SARS the balance of the 0.8% upon assessment.

Anti-avoidance measures
Recommendation
To prevent potential abuse of Tool of Trade vehicles, we propose the following anti-avoidance measures:

- If an employee, who has the use of a Tool of Trade vehicle, does not travel any business mileage in any particular month, the full fringe benefit will be charged at a rate 4%. This anti-avoidance measure would apply automatically as a result of the workings of the above formula.
- If the actual business mileage for any 3 month period does not exceed the required 50% of total mileage, the employee would be deemed not to have the use of a Tool of Trade vehicle and the fringe benefit will be recalculated at 4% of the determined value with effect from the first month. This adjustment will be made for all three months, in the third month.
- We also propose that, in the event that the employee has the use of a Tool of Trade vehicle, no deduction should be allowed against the fringe benefit charged on business mileage. This is due to the fact that the fringe benefit is already charged only on the private element of the use of the vehicle. If such a deduction is allowed, it could lead to abuse by employees whereby they could manage to claim a reduction in the fringe benefit charged.

It is possible that an employee might enjoy the use of a Tool of Trade vehicle for a portion of the year only. For example, the employee could be promoted, move to another position where he/she has the use of an employer provided vehicle as a benefit or be on leave for an extended period but retain the use of the Tool of Trade vehicle.
We would, therefore, propose that the fringe benefit amount be disclosed under separate fringe benefit codes on the annual employees’ tax certificate, the IRP5.

**Other practical considerations**

Essentially, the burden of proof of the use of a Tool of Trade vehicle will reside with the employer. We believe that employers would implement the above provisions by retaining sufficient proof that the nature of the employee’s work requires a vehicle and that he/she would travel sufficient business mileage in relation to the total mileage.

This would be best achieved by a signed undertaking that includes the following:
- Nature of the employees’ work,
- Business case for the need of an employer provided vehicle, and
- A best estimate of the anticipated total and business mileage.

On a monthly basis, the employee would have to maintain a logbook of actual business and private mileage travelled. This places the same administrative burden on a “tool of trade” driver as on a person receiving a car allowance. These totals would have to be submitted for approval to the line manager and uploaded onto the payroll to enable the correct fringe benefit calculation.

Due to practical payroll time lines, this submission would only occur monthly in arrears. For example, mileage travelled for March would be submitted and processed in the April payroll. If, for some reason, no private or business mileage is submitted in a particular month, the fringe benefit would be calculated upon the full determined value at the 4% rate i.e. no apportionment would occur. Also, as the car is identified as a Tool of Trade vehicle, the employee would not be able to claim a business travel deduction against the fringe benefit.

We trust that the above is of assistance.

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

Yours faithfully

Muneer Hassan CA (SA)

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