Dear Sir

SAICA PAYE SUB-COMMITTEE SUBMISSION

The SAICA PAYE Sub-Committee (a sub-committee of SAICA’s National Tax Committee) has identified a number of issues that require the attention of SARS and/or National Treasury. We seek clarity / guidance in certain areas and possibly an amendment to existing legislation. These issues are:

1. The penalty regime applicable to the late submission of PAYE reconciliations;

2. The practical application of paragraphs 6(4)(bA) and 10(2)(bA) of the Seventh Schedule to the Income Tax Act No 58 of 1962 (“the Act”);

3. Pension income of non-residents;

4. Tax directives;

5. The treatment of back-dated remuneration; and

6. PAYE liabilities in relation to non-executive directors and nominees.

1. **The penalty regime applicable to the late submission of PAYE reconciliations:**

   1.1. Penalties on the late payment of employees’ tax due are levied monthly. The percentage penalty approach is also unfair towards the degree of lateness i.e. 1 day late vs. 6 months late. It is also unfair towards larger payrolls. This penalty should rather be replaced with a fixed fine to be charged on a monthly basis. Such a fine could increase incrementally with time.
1.2. The proposed administrative penalties to be levied in terms of the draft regulations published for section 75B of the Act would charge a 10% penalty on both the non-submission of the return and the non-payment of the amount of employees’ tax. Effectively, a company could incur a penalty of 20% of the amount due for that month if the monthly return was not submitted and paid timeously.

1.3. Any penalty regime should make provision for representation by the taxpayer or his or her representative to be heard at the penalty meeting where objection was raised against the levying of the penalty.

2. **The practical application of paragraphs 6(4)(bA) and 10(2)(bA) of the Seventh Schedule to the Act:**

2.1. The captioned paragraphs were introduced into the Act and are effective from 1 March 2008. The introduction presumably to provide more clarity around the employees’ tax implications relating to the inevitable private use by employees of employer owned cell phones and laptops. While these two amendments are welcomed, there is widespread uncertainty relating to the practical application of these two paragraphs. We recommend that SARS issues an Interpretation Note soonest to grant guidance in areas of uncertainty.

2.2. Issues that need to be addressed include the following:

2.2.1. Guidance is required on how to determine whether the phone or computer has been used mainly for business purposes. Questions that need to be addressed are for example whether employers can take into account received calls as well as calls made to determine the ratio of business use vs. private use of a cell phone. The fact that only calls made carry a cost should not be relevant to determine the use of the phone.

2.2.2. Employers also need guidance as to how often the determination of the ratio of use should be made. If the answer is monthly, this may mean some months (like December) may result in a taxable fringe benefit if the employee is on leave, while other months will be well below the 50%. Such a monthly analysis will be very time consuming.

Paragraph 6(3) of the Seventh Schedule provides that for employees’ tax purposes, an appropriate portion of the cash equivalent determined in relation to the use of an asset by an employee has to be apportioned to each period during the year of assessment that the employee is paid cash remuneration. The Act is however silent on the period over which the business use vs. private use has to be measured. As the cash equivalent of this fringe benefit is 15% per annum of the lesser of cost or market value of the asset at the beginning of the period of use, presumably one could argue that the same period should apply
to determine whether the fringe benefit has a R nil value. This may be largely academic in any event as the cost price of hand sets in terms of most cell phone contracts is R nil and arguably therefore the fringe benefit is also R nil.

As far as the fixed amount for phone calls plus the per call charge is concerned, the determination of the cash equivalent of this fringe benefit falls within the scope of paragraph 10(1) of the Seventh Schedule and is equal to the cost to the employer of having the service rendered. In practice this is determined on a monthly basis and therefore arguably the determination of whether the fringe benefit has a R nil value should also be done on a monthly basis.

2.2.3. As an example, if an employee is on a talk 500 contract (first 500 minutes are free) and he/she makes no business calls and just one 10 minute private call that month, the fringe benefit is arguably the whole 500 minutes bill for the month. Surely this is not intended.

3. **Pension income of non-residents:**

3.1. **Background**

3.1.1. Historically, the tax system in South Africa was based on the principle of source. Section 9(1)(g)(ii) of the Act provided, and still reads, that a pension or annuity shall be deemed to have accrued to any person from a source in South Africa if it has been received by, or has accrued to that person, if the services in respect of which that pension or annuity was granted, were performed in South Africa for at least two years of the ten years preceeding the date on which that pension or annuity first becomes due.

3.1.2. This section goes on to state that if the services in respect of which the pension or annuity was granted were performed partly in and partly outside South Africa, the pension and / or annuity is to be apportioned in the same ratio as the time during which the services were rendered in South Africa.

3.1.3. In 2001 that tax system was changed and it is now based on the principle of tax residency. People who are tax resident in this country are taxed on their worldwide income, with certain exemptions, regardless of where it is sourced. Individuals who are not tax resident in South Africa continue to be taxed in this country on a source basis. At the time that this change was introduced the Explanatory Memorandum to the Revenue Laws Amendment Bill, 2000, explained that foreign pensions would not be taxed “at this stage”. It was noted that this was merely an interim measure, and that this issue would be revisited over the next three years.
3.1.4. Consequently, section 10(1)(gC) was inserted into the Act. This section states that any amount of pension that is received by, or which accrues to any resident from a source that is outside South Africa, in consideration of past employment outside the Republic, shall be exempt from normal tax. Excluded from this exemption is any amount that will be deemed to be from a source in South Africa, as provided by section 9(1)(g) of the Act.

3.2. **The different interpretations**

3.2.1. In practice different interpretations as to how these sections ought to be applied have emerged.

3.2.2. The one view is that, the source rule contained in section 9(1)(g)(ii) cannot be applied, as the individual, regardless of his / her residency, has not worked in South Africa for at least two years out of the ten years before the pension accrues, the pension or annuity cannot be deemed to be sourced in South Africa. If it cannot be deemed to be sourced in South Africa, it must be foreign sourced and, therefore, would be exempt from tax in South Africa.

3.2.3. Accordingly to this interpretation, if the individual, whether tax resident or not, has been in South Africa for at least two years out of the ten years prior to the accrual of the pension and / or annuity, the income must be apportioned between that which is sourced in South Africa and that which is sourced elsewhere, with reference to the individual’s service period whilst he / she was a member of the fund and only the South African portion will be taxable in this country. The exemption in section 10(1)(gC) reinforces this principle for South African tax residents.

3.2.4. The other view is that, in the case of a South African tax resident, it is not necessary to determine where the pension and/or annuity is sourced, as they are taxed in this country on their worldwide income. Accordingly, section 9(1)(g)(ii) is, therefore, only applicable to non-residents. Section 10(1)(gC) remains applicable to a South African tax resident and will exempt any foreign sourced annuity or pension.

3.3. **The South African Revenue Service’s interpretation**

3.3.1. SARS has communicated that it subscribes to the latter interpretation. Their view can be summarised as follows:

   In the case of a South African tax resident:
   a) Section 10(1)(gC) of the Act applies, but only to pensions (i.e. not to lump sums); and
b) The remaining pension (i.e. the South African service portion) as well as the gross lump sum benefit less Second Schedule deductions is taxable in South Africa.

In the case of a non-resident:

a) The source rules are applicable; and

b) The true source in the case of occupational pensions is determined by reference to the place where the services were rendered.

3.4. Issues to be considered

3.4.1. In the Explanatory Memorandum for the amendments in 2001 it was stated that this would be an interim measure and that the issues would be revisited within three years. We believe that section 9(1)(g)(ii) is a legacy of the past, when South Africa still had a source base of taxation. In light of the change to a residency base of taxation, the taxation of foreign sourced pensions in this country should be revisited. We would suggest that the approach adopted in South Africa be aligned with the majority of international views and that pensions should be taxable only in the country of residence. For the sake of brevity, this solution will not be explored in more detail here.

3.4.2. The following questions / problems have been encountered with the current legislation and SARS’ interpretation thereof:

- A lump sum benefit is merely a commutation of the annuity paid to an individual. Accordingly, we are of the opinion that section 10(1)(gC) is applicable to both annuities and to lump sum benefits. In principle, both annuities and lump sum benefits should be treated, for tax purposes, similarly.

- What would happen in the event that an individual resigns from the fund and does not retire? Would the same interpretation be adopted by SARS?

- At what point, if any, would section 9(1)(g)(ii) be applicable if the true source of the pension will always determine the taxability of pensions and / or annuities in the case of non-residents?

- Practically, how should the directive, required by the Fourth Schedule to the Act, be applied for? Should only that amount which is deemed to be sourced in South Africa be disclosed to SARS or are taxpayers required to disclose the whole amount to SARS? Further, how do
taxpayers go about obtaining a directive for annuity payments where that annuity is to be apportioned?

4. **Tax Directives:**

4.1. **Tax directives for amounts contemplated in sections 8A, 8B and 8C:**

4.1.1. Sections 8A, 8B and 8C of the Act include in a taxpayer’s income the gains made in respect of the exercise of rights to acquire marketable securities or gains made in terms of the vesting of equity instruments. Gains determined in terms of section 8C and 8C are specifically included in the definition of ‘remuneration’ for purposes of the Fourth Schedule.

4.1.2. Paragraph 11A(4) of the Fourth Schedule requires employers to ascertain from the Commissioner the amount to be deducted from gains due in respect of gains made in terms of sections 8A, 8B and 8C. The SARS Guide for Employers in respect of Employees’ Tax (EMP10) states further that those employers must apply for IRP3 tax directives to ascertain the amount of employees’ tax to be withheld.

4.1.3. Paragraph 9(1) of the Fourth Schedule provides for the application of the tax deduction tables, subject to subparagraphs 9(3), (4), (5) and paragraph 10, 11 and 12 of the Fourth Schedule. Paragraph 11A is, therefore, not excluded from the application of the tax deduction tables. Paragraph 11A simply requires that the employers must ‘ascertain from the Commissioner the amount to be deducted’ and not that a directive need to be applied for. Directives, as provided for in paragraph 11(a) and (b) in the Fourth Schedule aims to provide relief to taxpayers from hardship suffered.

4.1.4. We believe, therefore, that an employer will be able to apply the tax deduction tables to remuneration received in respect of gains made in terms of section 8A, B and C upon approval from the Commissioner.

4.1.5. In addition, certain practical problems are experienced if tax directives are to be applied for equity instruments. Some of these problems are listed below:

- Employees’ tax needs to be withheld from gains made in respect of the vesting of equity instruments as provided in section 8C and not on the individual exercise of shares as per section 8A. As vesting of equity instruments may take place simultaneously for a large number of employees, to process individual applications is time consuming and not practical. In addition, complex schemes would offer the employee the choice to exercise the number of shares or rights to account for the
employees’ tax due on the vesting of the instrument. As such, this exercise is dependent on the employees’ tax due on the vesting and would require a tax rate to be calculated and applied.

- It is suggested that most employees that participate in the equity instruments as determined by section 8C is likely to have a marginal tax rate of 40%.

- Similarly, broad based share schemes could have a simultaneous vesting of taxable shares due to, for example, the forced sale of shares. In general, such schemes apply fairly low values per individual and most of the employees of the company would have been eligible to participate in the scheme.

- We believe that the SARS system would not be able to cater for multiple applications on short notice.

4.1.6. We believe, therefore, that the requirement to apply for an individual tax directive in respect of gains made on section 8A, 8B and 8C is only stated in the EMP10 guide, and not the Act. We request that the Commissioner would approve, per employer, a marginal tax rate to be applied to gains without requesting an individual tax directive.

4.2. **Tax directive applications in terms of paragraph 9(1) of the Fourth Schedule**

4.2.1. In addition to the above, employers apply for a tax directive on e.g. retirement and retrenchment in terms of legislation. The tax directive will be declined by SARS where an employee’s tax affairs are not in order. The employer will not be able to pay the money until the employee sorted the tax affairs with SARS.

4.2.2. It therefore seems that the main purpose for tax directive application is to allow the Commissioner to collect outstanding taxes due by the taxpayer / individual. The refusal of tax directives due to outstanding tax affairs of employees continue to create administrative difficulties for the administrators of share schemes. We propose that SARS issue an IT88 for outstanding taxes on receipt of the application for the tax directive in these circumstances and allow the employer to withhold employees’ tax at the maximum marginal rate. In these instances, the tax directive should not be refused.

5. **The treatment of back-dated remuneration:**
5.1. Payment of remuneration relating to allowances, overtime worked, backdated promotions and travel reimbursement normally happens in the month after the services were rendered or the business expenses incurred.

5.2. It is our understanding is that is a requirement from the labour law that the remuneration is reflected in the month in which the services were rendered and not in the month in which the payment was approved and paid to the employee.

5.3. The remuneration is therefore normally backdated, on a time driven payroll system, to the month in which the services were rendered and will therefore reflect on the IRP501 reconciliation declaration in the month in which the services were rendered and not necessarily when it accrued or was paid to the employee.

5.4. Entries can not be processed and paid in the month in which for e.g. overtime was worked due to the following payroll cycles:

5.4.1. Payroll data are captured into the payroll while the payroll is open for capturing.

5.4.2. Payroll closes to allow sufficient time for the processing and payment of salaries.

5.4.3. The payroll run and employees are paid.

5.4.4. Payroll re-opens to allow the capturing of data into the payroll in preparation for the following months’ payment.

Example:

5.4.5. Salaries are paid by the employer to employees on e.g. the 25th of February. To effect monthly payments to employees on the 25th February, the administrative cut-off date for the processing of payments would normally be the 15th of February to allow sufficient time for the processing and payment instructions to be captured into the payroll run.

5.4.6. Remuneration, e.g. allowances, overtime worked, backdated promotions and travel reimbursement, incurred in February may only be approved for payment and submitted to be captured and processed onto the payroll after the 15th of February which is after the close of the monthly payroll cut-off date.

5.4.7. As a result, the details of such remuneration due to an employee after the 15th of February would be processed and paid only on the 25th of March.
5.4.8. This will have the effect that the employees’ tax will only be paid to SARS on or before the 7th of April after the payment of the remuneration to the employee was made and not in the month after the services were rendered.

5.4.9. The remuneration may be approved after the 15th of February, and the remuneration therefore accrued to the employee’, in February. Alternatively, the remuneration may be approved by the line manager in the March and therefore only accrue in March when the remuneration is paid to the employee.

5.5. Employers do not have the ability to implement controls and processes in a payroll system to determine when the remuneration was approved for payment.

5.6. The above situation is further aggravated by employers who have employees as members of trade unions. Agreements between the employer and the trade union can stipulate that the employer must back-date salary increases to members of the trade unions. These increases can extend over different tax years.

5.7. To complicate matters even further, employers can reflect the remuneration paid in March for services rendered in February on the IRP5 certificates for the end of the tax year. This back-dated entry will result in a difference of employees’ tax liability paid per the EMP201 returns and the employees’ tax liability per the IRP501 reconciliation declaration.

5.8. Interest and penalties will automatically levied by SARS on this “late payment”.

5.9. The definition of gross income in Section 1 of the Act:

5.9.1. The remuneration does not necessarily accrue in the month in which the services were rendered as the remuneration may or may not be approved. The remuneration will only accrue to the employee once approved.

5.10. Paragraph 2 (1) of the Fourth Schedule of the Act:

5.10.1. The employees’ tax withheld from the remuneration is paid to SARS within 7 days after the end of the month during which the remuneration was paid to the employee.

5.11. No penalties and interest should therefore be levied on the “late” payment of remuneration as the employer complies with the Fourth Schedule of the Act.

6. **PAYE liabilities in relation to non-executive and nominee directors:**

6.1. There seem to wide-spread confusion as to whether the fees paid to non-executive directors are subject to PAYE or not. We respectfully request guidance from SARS in relation to this issue.
6.2. We also request confirmation on the tax implications of fees paid to nominee directors. Currently companies do not treat these fees as taxable in the hands of the nominee directors, but include the fees in the income of the company who has nominated the director.

Please do not hesitate to contact me should you wish to discuss the above.

Yours faithfully

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