Dear Sir

SAICA PAYE SUB-COMMITTEE SUBMISSION

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

1. The PAYE regime relating to directors of private companies;
2. The penalty regime applicable to the late submission of PAYE reconciliations;
3. 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”);
4. The Fourth Schedule to the Act requires revision in light of recent amendments;
5. Pension income of non-residents;
6. Non-cash, ad-hoc awards;
7. Tax directives;
8. The treatment of back-dated remuneration; and
9. PAYE liabilities in relation to non-executive directors and nominees.

1. **The PAYE regime relating to directors of private companies:**
1.1. In terms of paragraph 11C(2) of the Fourth Schedule to the Income Tax Act No 58 of 1962 (the Act), companies are obliged to pay to the Commissioner tax based on the deemed income of individual directors. The deemed income is determined in accordance with the formula \( Y = \frac{T}{N} \) where

(a) “\( Y \)” represents the amount to be determined;
(b) “\( T \)” represents the balance of remuneration determined in terms of paragraph 2(4) (excluding any amount which was deemed to be remuneration in terms of this paragraph), paid or payable to that director by that company in respect of the last year of assessment of that director which ended before that month, less any amount—
   (i) contemplated in paragraph (d), (e) or (f) of the definition of “gross income” which is included therein; or
   (ii) which is included therein in terms of paragraph 11A; and
(c) “\( N \)” represents the number of completed months which that director was employed by that company during that last year of assessment.

1.2. Whilst the liability for the PAYE on the deemed remuneration which is in excess of the PAYE on actual remuneration lies with the employer, paragraph 11C(5) of the Fourth Schedule to the Act states that the director shall not be entitled to receive an IRP5 certificate from the company until such time as the director has paid to the company the PAYE paid by it to SARS.

1.3. The Act does provide for so-called “hardship directives”, paragraph 11(a) of the Fourth Schedule where the application of this legislation causes hardship for the relevant directors.

1.4. In this regard we refer you to paragraph 5 of the OPERATIONAL GUIDELINE TO EMPLOYERS – EMPLOYEES’ TAX: DIRECTORS OF PRIVATE COMPANIES (WHICH INCLUDE PERSONS IN CLOSE CORPORATIONS WHO PERFORM FUNCTIONS SIMILAR TO DIRECTORS OF COMPANIES) published on 19 February 2002 which deals with applications for tax directives in respect of director’s remuneration. As paragraph 5.1.1 is specifically relevant, we have reproduced it:

“Where a director’s expected remuneration for the current year is less than the remuneration received for the previous year and the application of paragraph 11C will lead to an overpayment of PAYE (hardship), the company (employer) or director may request the local SARS branch office for tax relief in terms of paragraph 11 of the Fourth Schedule.”

1.5. We understand that the legislation was introduced in response to reality that sometimes, the remuneration of a director of a private company is only determined after the end of the year of assessment, as the accounts of the company on which a decision is made on the quantum of the remuneration are only finalised after year end. The year ends of a number of companies are well before the end of February and
therefore in fact finalised by the end of the individual’s tax year. In practice the legislation only adds to the compliance burden of taxpayers, especially in private companies that form part of the listed group of companies as the possibility of the directors of private companies actually being able to manipulate the timing of their earnings, is miniscule.

1.6. Apart from the administrative burden on employers as a result of having to maintain loan accounts for the PAYE withheld on the deemed remuneration which is in excess of the PAYE on actual remuneration, many companies operate incentive bonus schemes based on the performance of the company as measured by the growth in headline earnings per share, cash flow return on investment or some other financial performance indicator. Sometimes also combined with the achievement of the individual director concerned of specific pre-determined goals. These bonuses tend to fluctuate with the performance of the company. Therefore, for example, if a company was highly profitable year one year, bonuses tend to be high. Often, this performance is not repeated in the following year (“year two”), but the directors are taxed throughout the year as if they will receive at least the same bonus as bonuses are included in “T” of the formula.

1.7. This inevitably results in hardship in year 2 for the directors concerned and the employers need to apply for hardship allowances, an additional administrative burden.

1.8. As an example, please see below an extract of the actual hardship allowance applied for by one of the big listed groups:

<table>
<thead>
<tr>
<th>Director:</th>
<th>2004 bonus</th>
<th>2005 bonus</th>
<th>Decrease:</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>368,439</td>
<td>128,232</td>
<td>-240,207</td>
</tr>
<tr>
<td>B</td>
<td>250,230</td>
<td>38,859</td>
<td>-211,371</td>
</tr>
<tr>
<td>C</td>
<td>330,017</td>
<td>76,344</td>
<td>-253,673</td>
</tr>
<tr>
<td>D</td>
<td>982,856</td>
<td>389,932</td>
<td>-592,924</td>
</tr>
<tr>
<td>E</td>
<td>461,136</td>
<td>259,742</td>
<td>-201,394</td>
</tr>
<tr>
<td>F</td>
<td>815,068</td>
<td>325,709</td>
<td>-489,359</td>
</tr>
<tr>
<td>G</td>
<td>696,676</td>
<td>600,000</td>
<td>-96,676</td>
</tr>
<tr>
<td>H</td>
<td>568,600</td>
<td>500,000</td>
<td>-68,600</td>
</tr>
<tr>
<td>I</td>
<td>602,604</td>
<td>500,000</td>
<td>-102,604</td>
</tr>
<tr>
<td>J</td>
<td>556,416</td>
<td>500,000</td>
<td>-56,416</td>
</tr>
<tr>
<td>K</td>
<td>569,015</td>
<td>500,000</td>
<td>-69,015</td>
</tr>
<tr>
<td>L</td>
<td>565,787</td>
<td>500,000</td>
<td>-65,787</td>
</tr>
<tr>
<td>M</td>
<td>1,080,666</td>
<td>750,000</td>
<td>-330,666</td>
</tr>
<tr>
<td>N</td>
<td>546,900</td>
<td>200,000</td>
<td>-346,900</td>
</tr>
<tr>
<td>O</td>
<td>485,635</td>
<td>250,000</td>
<td>-235,635</td>
</tr>
</tbody>
</table>
1.9. As can be seen, the excess PAYE as a result of withholding PAYE on the deemed remuneration can be significant. If a hardship allowance is not obtained, directors often have to borrow money to pay the excess PAYE, which will inevitably be refunded months later. The interest incurred, is not deductible for tax purposes.

1.10. The inclusion of incentive based bonuses in the deemed remuneration of a director of a private company for PAYE purposes is problematic for large, medium sized and small employers. Incentive based bonuses are just what it says: It is based on results. It is not a “right” or a “13th cheque”. The payment of PAYE on remuneration not actually paid to or owed to employees creates uncertainty around the cash flow planning of small businesses which in turn are detrimental to the general business environment in which small business (who trade as private companies or CC’s) operate.

1.11. The inclusion of bonuses in the deemed amount is unfair and creates unnecessary hardship and administrative procedures for employers.

1.12. It is our understanding that SARS has issued rulings to certain companies allowing them to withhold PAYE from the actual remuneration and not deemed remuneration for all their employees and for all years of assessment.

1.13. It is proposed that the separate PAYE regime applicable to directors of private companies be removed completely or that PAYE is payable on receipt/accrual of the bonus and not as part of the deemed remuneration.

2. **Revision of the Fourth Schedule:**

2.1. We believe that certain administrative provisions or requirements in the 4th Schedule to the Act needs to be updated. Recent developments, such as E-filing, E@syfile and the pre-population of tax returns have, in our opinion, made some of these provisions redundant. The following sections are examples of problematic areas:

2.1.1. Paragraph 13(2)(b) of the Fourth Schedule requires an employer to deliver, within 14 days after the employee has ceased employment, an employees’ tax certificate to that individual. Large organisations process up to 600 resignations per month and most payrolls are currently not able to process more than one final IRP5 run per annum. We maintain that the majority of these former employees apply for duplicate certificates at the end of the tax year when they attempt to complete their personal tax returns. In addition, the IRP5 now only acts as an audit document for the individual as the tax return would already be pre-populated with the information. We propose that this requirement be limited to instances such as deaths and / or immigration where the employee needs to submit their personal tax return for a different period. This requirement can be re-introduced when employers are required to submit
more frequent reconciliations, as announced by the Minister of Finance in the annual Budget Speech.

2.1.2. Paragraph 13(7) of the Fourth Schedule requires the employer to deliver the certificate personally to the employee, the authorised agent or the representative taxpayer or by registered post. Employers are now able to provide or make available these IRP5 certificates on intranets for their employees; to print at their own convenience. In addition, sending certificates by registered mail is very expensive for large employers.

2.1.3. Paragraph 13(8) of the Fourth Schedule determines that duplicate certificates need to be clearly marked as a “duplicate”. Employers are able to print electronic certificates, especially since the introduction of the SARS E@syfile program as an exact duplicate of the original, without changing any information. It seems onerous that the employer is still required to mark duplicate certificates as “duplicate”. In addition, where IRP5 certificates are made available on an intranet, it is unlikely that the employer would be able to manage the number of certificates printed by the employee.

2.1.4. Section 89quat provides that the due date for payment of employees’ tax shall be on last working day before the 7th if the 7th falls on a Saturday or Sunday. It is recommend that this provision be revised in light of electronic transfers as even if 7th is on Saturday or Sunday, the amounts due can be electronically scheduled to be in SARS’ bank account on the 7th.

3. **Non-cash, ad-hoc awards:**

3.1. Staff members may receive certain non-cash awards in the course of their employment, for example gifts, vouchers, meal vouchers etc. The taxation of significant incentive schemes and cash awards is, ordinarily, managed through the payroll and PAYE is calculated and withheld accordingly. However, most employers experience a number of administrative difficulties with regards to the taxation of small, ad hoc, non-cash awards and prizes.

3.2. There are a number of reasons for this, the most important being:

3.2.1. It is not always possible to identify the specific recipient;

3.2.2. It is not always desirable that the recipient become aware of the value of the award given;

3.2.3. It is not always possible to allocate a precise cost per recipient, where the awards are to groups of employees.

3.3. In addition, it is common business practice to use small, non-cash, promotional items to launch new business initiatives / strategies, products or to create general employee awareness. Examples of such items include CD’s, business folders, water bottles,
lunch bags, T-shirts, caps and pens given to employees in order to promote an employer sponsored event.

3.4. Although the Seventh Schedule does not provide any, even limited, exemption from awards given to employees, it is submitted that such items comprise part of an employer’s overall business spend and should, therefore, not comprise taxable benefits in the same manner that stationary or office equipment used by employees for personal use does not comprise taxable benefits in employees’ hands.

3.5. As the Act does not specifically make provision for such payments, it is recommended that a monetary limit be applied to the value of such items as follows:

3.5.1. **Branded items:** Items branded with the employer’s logo or product launch material are promotional and should, therefore, be given special consideration. It is clear that branded items are intended to be used for a specific promotional purpose. It is therefore recommended that all branded items with an individual, or cumulative value of below R500 should not be treated as taxable benefits.

3.5.2. **Non-branded items:** Items with an accumulated value below R500, per annum, that are provided to employees to promote advertising campaigns or employee motivational campaigns should not be treated as taxable benefits.

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

Yours faithfully

M Hassan CA(SA)
**PROJECT DIRECTOR: TAX**
*The South African Institute of Chartered Accountants*

cc: greg.smith@treasury.gov.za
    klouw@sars.gov.za