15 May 2009

South African Revenue Service
Private Bag X923
PRETORIA
0001

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

Dear Sir/Madam

CALL FOR COMMENT: INTERPRETATION NOTE 35 EMPLOYEES’ TAX:
PERSONAL SERVICE PROVIDERS AND LABOUR BROKERS
“(INTERPRETATION NOTE)”

We refer to your call for comment regarding the above-mentioned document that was placed on your website. Set out below please find SAICA’s comments, which have been provided by members of our National Tax Committee:

1. General

1.1 While SAICA recognises that the use of “Independent Contractors” and “Service companies” may have been abused by a limited number of taxpayers, the changes have caused major problems for many taxpayers who have started out new business ventures. South Africa requires small businesses to create employment. Unfortunately this legislation hampers this as not many genuine new businesses commence trading with three or more full time employees.

1.2 Further, in many cases, these businesses rely on one major client at that infant stage and hence fall foul of the 80% of income rule. Our members’ experience has been that this is only achieved after approximately two years. Hence, for this period, PAYE is deducted which severely affects the cash flow of the business and further, the business is unable to claim all the expenditure it is “rightfully” entitled to claim.

1.3 It is as a result of SAICA’s previous submissions that the number of full-time employees was reduced from four to three but this is still not a solution to the problem that the legislation has created.
2. **Paragraph 3**

2.1 On page two of the Interpretation Note, the very last paragraph (extract from the Act), second sentence, the sentence is missing an "of" and should read: "...on a full time basis engaged in the business of such company".

3. **Paragraph 4**

3.1 We request that paragraph 4.1 subparagraph (c) gives guidance on the application of the exclusion from being a personal service provider on account of employing three or more unconnected full-time employees. What kind of employees can be taken into account? Should they be directly involved in the provision of the services or can support personnel also be counted? From example 1, it would appear that support personnel can be included in determining the number of full-time employees. Can the cleaning personnel and the garden staff also be included in the count?

3.2 The same uncertainty (see 3.1 above) applies to labour brokers. The service that a labour broker provides is the provision of people. Are the people being supplied to client’s also full time employees "of that labour broker engaged in the business of the labour broker of providing persons to or procuring persons for clients"?

3.3 Paragraph 4.1 subparagraph (c) of the Interpretation Note provides guidance as to the determination of whether a company/trust/close corporation falls within the scope of the definition of a personal service provider. We suggest that paragraph (c) should be the first test as compliance to this test will make any further enquiries irrelevant.

3.4 We request that the whole sequence of the decision making process be reconsidered (after applying the test as indicated in paragraph 3.3 of this document) as to whether a person is an employee as defined or not. One must firstly determine if the person is independent, or an employee in terms of the common law test, and should the common law test indicate independence then the statutory test, in the definition of remuneration, should be applied to determine if it is excluded. The Interpretation Note states that the sequence should be the other way around. Similarly, the decision chart provided in respect of an (a) type of employee in the Annexure’ should, firstly, apply the common law test and, thereafter, the statutory test.

3.4 It is suggested that for the sake of clarity, paragraph 4.2 subparagraph (c) of the Interpretation Note should read as follows: "the labour broker is contractually obliged by the client to provide the services of an employee specified by the client by name."

3.5 Definition of 'personal service provider', paragraph 1 of the Fourth Schedule of the Income Tax Act: Paragraph 4 of the Interpretation Note subparagraph (c) prescribes that taxpayers should determine “whether the company employed (or is likely to employ) three or more full time employees throughout the particular year of assessment that are on a full time basis engaged in rendering the service. . . . . .”
Does the above-mentioned mean that, should the contractor (company) due to, for example, retrenchment or resignation, only have two independent employees for a portion of the tax year, that the contractor (company) is a 'personal service provider' for the entire year of assessment and that the consequences of section 23(k) apply for the full tax year? If that is the case, what is the 'employer' to do in respect of payments already made earlier in the year when the contractor did have three or more full time employees and, consequently, where no employees' tax was withheld from those payments?

It is requested that the Interpretation Note provide clarity in this regard.

3.6 Paragraph 4 of the Interpretation Note subparagraph (d) (page 6), second bullet under paragraph (d), the interpretation note advises that the employer should determine whether the contractor (employee) mainly performs their duties on the premises and is supervised and controlled. According to legislation the test is not whether a contractor (employee) mainly performs their duties on the client's premises, but if the employee is required ("must be" is the wording used in the Act) to render their duties mainly on the client's premises and that person (contractor) is subject to the control or supervision of the client as to the manner in which the duties are performed or are to be performed. The discussion in the Interpretation Note in this regard therefore does not appear to be correct and we respectfully request that it be revised.

3.7 The last sentence of paragraph 4.1 (on page 7) of the Interpretation Note merely refers to paragraph 11. This should be amended so as to clarify that the reference is to paragraph 11 of the Fourth Schedule to the Act (as opposed to a paragraph in the Interpretation Note itself).

4. Paragraph 5

4.1 We recommend that paragraph 5 of the Interpretation Note should also mention that personal service providers and labour brokers without IRP30's are excluded from the turnover tax regime (6th Schedule).

4.2 Also under paragraph 5, the Interpretation Note states that employers should anticipate at the outset that the 80% income requirement may not be met during the year. Employers are required to predict the future - this does not appear to be possible.

5. Paragraph 6

5.1 Paragraph 6 of the Interpretation Note states that the employer has to bona fide rely on the affidavit. How far does the employer have to go to satisfy himself that the affidavit is proper? We request that the Interpretation Note provide further guidance in this regard.

6. Annexure

6.1 In our view, the flow diagram provided in respect of an (a) type of employee at Annexure A should firstly apply the common law test and thereafter the statutory test (please refer to SAICA submission in Draft Interpretation Note 17).
6.2 Annexure A also does not provide for the application of the proviso to exclusionary paragraph (ii) (i.e. consideration as to whether the person employs three or more employees on a full time basis - please refer to SAICA submission in Draft Interpretation Note 17).

6.3 Annexure A: Third column, paragraph (c) type employee: With regard to a labour broker (natural person):

- The flow diagram indicates that one need to consider whether the labour broker is registered for employees' tax purposes. All labour brokers will not necessarily need to register for employees' tax purposes. In terms of paragraph 15 of the Fourth Schedule, where all the employees of an employer will earn below the threshold, there is no obligation to register.
- The flow diagram indicates that it should be considered whether 3 factors are present (i.e. 80% from one client, contractual obligation etc). It is submitted that this question should be changed to whether the labour broker is in possession of an IRP 30 exemption certificate as these factors needs to be applied by SARS when considering the IRP 30 application and not by the person determining the labour broker's status.
- The flow diagram indicates that the dominant impression test should be applied to labour brokers where applicable. It is submitted that this is not in line with the Interpretation Note. It is also not considered to be in line with legislation and this also raises the question whether one should apply the provisions for individual contractors to labour brokers. SARS should elude whether this is their intention

7. General

7.1 As the Interpretation Note correctly points out, since 1 March 2009 the “labour broker” definition only applies to natural persons (companies and trusts removed). Therefore companies (including close corporations) and trusts that could previously apply for IRP 30 exemption certificates will now fall under the ‘personal service provider’ definition.

7.2 Many employers however appear to be unaware of this change and still insist on companies and trusts providing them with an IRP 30 exemption certificate. We therefore request that SARS consider doing a media release explaining the new requirements to employers.

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