South African Institute of Tax Professionals

24 November 2017

The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS, 299 Bronkhorst Street
PRETORIA
0181

BY EMAIL: Nombasa Langeni (Nombasa.Langeni@treasury.gov.za)
Adele Collins (acollins@sars.gov.za)

RE: ANNEXURE C FOR 2018 BUDGET: PERSONAL TAX

We have attached the comments from the SAIT Personal Tax Technical Work Group on the draft Taxation Laws Amendment Bill pertaining to key Personal Tax issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

Please do not hesitate to contact us should you need further information.

Sincerely,

Beatrie Gouws

Vice Chair of the Personal Tax Technical Work Group

ANNEXURE C FOR 2018 BUDGET: PERSONAL TAX

ANNEXURE C FOR 2018 BUDGET: PERSONAL TAX

1. SECTION 10(1)(o)(ii) OF THE INCOME TAX ACT, NO. 58 OF 1962 (THE ITA) – AMBIT

This submission addresses the ambit of the exemption post the amendment in the Taxation Laws Amendment Bill, 2017 (TLAB) to be effective from 1 March 2020.

1.1 The legal nature of the problem

Section 10(1)(o)(ii) of the ITA has been amended with effect from 1 March 2020 to, in addition to all of the current requirements, only apply to exempt remuneration from income tax "*to the extent to which that remuneration does not exceed one million Rand in respect of a year of assessment*".

It is accepted by most of the industry that the new exemption cap should limit the impact of the amendment for lower to middle class self-sponsored South African tax residents who are working abroad in high income tax jurisdictions (e.g. an individual that took a work opportunity abroad, will not have an income tax liability up to the first R1,000,000 in remuneration earned abroad).

However, from an initial high-level analysis, the R1 million exemption will provide little relief for employer-sponsored assignees that typically have high tax-equalised remuneration packages (including benefits and tax gross-ups), which will leave the employers (or individuals, where no equalisation applies) worse off.

Other than the tax gross-up (e.g. in the case of tax equalisation), the other major fringe benefit that impact the taxable remuneration of the employer-sponsored assignees significantly, is the provision of residential accommodation. Residential accommodation is often a large part of an international assignee's package, irrespective of whether the assignee will be living in Rwanda or the United Kingdom.

It is notable that the principle of treating residential accommodation as exempt for assignees is at least partially recognised in terms of inbound assignees in paragraph 9(7A) of the Seventh Schedule to the ITA.

However, residential accommodation is but one of a myriad of additional fringe benefits that one typically finds in an international assignee's package. Whereas a self-sponsored employee typically receives a basic salary with a bonus, most international assignee packages contains fringe benefits that are geared towards providing them with a quality of life equivalent to that which they would have enjoyed at home.

1.2 A detailed factual description of the affected transaction

Whilst we appreciate the decision to keep the exemption in place (albeit with a cap), we would like to motivate in this submission, and through future engagements for further tweaking of the exemption, specifically to also cater for employer-sponsored employees. That said, we do recognise that we would have to present specific facts to motivate any request for further nuancing of the exemption. We are engaging with our members and intend to submit information backing this submission as soon as it becomes available.

1.3 The nature of the business impacted

Employer-sponsored employees that are South African tax residents, and their employers (often multi-national groups).

2. SECTION 10(1)(o)(ii) OF THE ITA AND SECTION 6*QUAT*

This submission addresses the expected increase in applications for a tax credit in terms of section 6*quat* as a result of the amendment of section 10(1)(o)(ii) of the ITA, with effect from 1 March 2020.

2.1 The legal nature of the problem

In future, should a South African tax resident only enjoy limited relief in terms of section 10(1)(o)(ii), they may be eligible to claim a tax credit in terms of section 6*quat* to the extent that the individual paid income tax in the country where the services were rendered.

Section 6*quat* has been amended numerous times and considering the expected influx of applications, it is recommended that a comprehensive review be conducted by National Treasury to ensure that the section is fit for purpose.

We also recommend that the section mandates the SARS to issue regulations to deal with the practical difficulties that taxpayers currently experience with the section (e.g. having to provide proof of taxes paid, the interplay between employees' tax and income tax, etc.).

2.2 A detailed factual description of the affected transaction

An employee of a South African headquartered multi-national group who works and suffers tax in a foreign jurisdiction should be entitled to a foreign tax credit against its South African employees' tax and income tax liability on the foreign income.

2.3 The nature of the business impacted

Individuals applying for a tax credit in terms of section 6*quat*, and employers applying for a tax directive to apply the 6*quat* tax credit upfront in their payrolls.

South African Institute of Tax Professionals

3. ROLL-OVER RELIEF FOR THE TRANSFER OF ASSETS OUT OF TRUSTS FOLLOWING SECTION 7C

3.1 The legal nature of the problem

Section 7C became effective from 1 March 2017 to treat the interest foregone on an interest-free or low-interest loan to a trust as a deemed donation by the individual lender/s. The implementation of section 7C has dramatically altered the consequences for taxpayers who hold have sold their assets to trusts on loan account, often as part of their estate planning. Many taxpayers would like to transfer these assets out of the trusts but find the transaction taxes, and particularly the transfer duty, to be prohibitive.

3.2 A detailed factual description of the affected transaction

Many taxpayers have sold their assets to their family trusts, often on interest-free loan account. These assets could include, for example, commercial properties, residential properties and farms. These taxpayers will now be suffering donations tax at 20% on the deemed donation of the interest foregone (i.e. shortfall before the official rate of interest). Many of these taxpayers would prefer to unwind their trust structures, and sacrifice the estate planning benefit of generation skipping, as section 7C is acting as an effective deterrent.

Over recent years, National Treasury have introduced measures to address the perceived tax abuse of trusts. The Davis Tax Committee have also recommended stricter measures in relation to trusts. We propose that a window of opportunity to allow the transfer of assets out of trusts on a tax neutral basis so that the trusts can be wound-up should be introduced. All taxes, including capital gains tax and dividends tax, and duties, including transfer duty and securities transfer tax, should be considered in this regard.

3.3 The nature of the business impacted

Trusts and taxpayers who have made loans to trusts.

4. SECTION 11(L) DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS TO RETIREMENT FUNDS

4.1 The legal nature of the problem

Section 11(1)(l) of the Income Tax Act provides for a deduction of retirement fund contributions contributed by an employer in relation to its employees.

4.2 *A detailed factual description of the affected transaction*

In practice, employers incur the unconditional liability and will accrue for a particular month's contributions at month end, but the actual cash payment to the retirement fund is often only made in the first week of the following month due to the month-end payroll reconciliation process. The payment of these contributions is strictly governed and regulated, for example by the Pension Funds Act.

Our members have brought to our attention that certain SARS offices has started interpreting section 11(1)(l) as requiring the actual payment of the amount to the retirement fund and are disallowing expenditure actually incurred at year end but which has not yet been physically paid to the retirement fund.

We are of the view that the employer contribution should be deductible in the period in which it incurred the unconditional liability, which is also the period of employment to which it relates. Given that employer contributions now attract PAYE, the liability for which arises when the unconditional obligation is incurred, such treatment would ensure that the income tax deduction in the employer and the PAYE liability in the employee is aligned.

4.3 *The nature of the business impacted*

All employers who make retirement fund contributions to retirement funds for the benefit of their employees.

5. SECTION 25 AND THE FINALISATION OF DECEASED ESTATE (PRACTICAL PROBLEM)

5.1 *The legal nature of the problem*

In terms of section 25, as it applies to deaths on or after 1 March 2016, the deceased estate, as opposed to the heirs, are taxable on the post-death income. SARS interprets this to mean that the executor of the deceased estate must continue to submit returns of income for each year of assessment until the liquidation and distribution account (L&D) becomes final. Only thereafter is the post-death income taxable in the hands of the heirs.

While we acknowledge that this might well be the correct interpretation of the law as it stands (as set out in the recently updated interpretation notes 69 and 79), we would like to highlight that it causes significant problems in practice, which are very difficult to overcome within this interpretation.

5.2 A detailed factual description of the affected transaction

The fact that the estate must account for the income until the L&D becomes final and not only until it is drawn is the concern. The L&D only becomes final when it has lain for inspection without objection for 21 days. The L&D is drawn as at a point in time and the income arising in the estate up to that point in time is accounted for in that L&D. The L&D includes, as a liability, the estate's liability to SARS for the assessment/s relating to the income accounted for in that L&D. The L&D is submitted to the Master of the High Court & SARS for audit and, only once the audits are completed and the Master's requirements complied with, does the Master authorise the executor to advertise the account. The 21-day advertising period runs its course and, if no objections are lodged, the L&D becomes final. If objections are lodged, the dispute/s relating thereto may take a considerable time to be settled, at the end of which, it may be that the objections are not sustained and the L&D only then becomes final. Consequently, significant time passes after the point in time to which the L&D has been drawn and the income accounted for and assessed by SARS to the point in time that the L&D becomes final. During this time significant further income frequently arises which would, as per the recent SARS interpretation notes, need to be taxed in the estate. This would require further income tax returns to be submitted & assessed, the liability for which would not have been reflected in the L&D and which, had they been so reflected, may have prompted further objections. In addition, while the revised assessment/s are being finalised, further income would continue to arise which, in turn would require yet further returns & assessments, and so on, ad infinitum. Therefore, an amendment is requested to the effect that the estate must account for income up to the point in time to which the L&D is drawn not the point in time it becomes final. The income in the estate thereafter should be taxable in the hands of the heirs, perhaps on the basis that it is received directly on their behalf.

5.3 The nature of the business impacted

Deceased estates and their heirs and executors.

6. SECTION 4 OF THE EMPLOYMENT TAX INCENTIVE ACT, NO. 26 OF 2013 (THE ETI ACT)

6.1 The legal nature of the problem

Section 4 of the ETI Act functions as an anti-abuse mechanism in that it requires employers wishing to claim ETI, to keep the employee's <u>wage</u> above the wage regulating measures prescribed, or alternatively at least 'R2000 in <u>wage</u> for 160 hours of work' per month.

In order to ensure fair treatment where no wage regulating measure applies (there is an hourly wage available), section 4(1)(b) requires employers to 'gross-up' the actual wage paid in the month, if there are less than 160 'employed and paid remuneration' hours in a month.

Wage (as opposed to remuneration), refers to basic salary (that is, excluding variable remuneration and fringe benefits). Furthermore, the hours referred to in connection with 'wage' is standard hours only (excluding overtime and unpaid hours).

The fact that the gross-up provision (section 4(1)(b)) does not refer to an amount per hour (currently the R2000 refers to an individual working for 5 days at 8 hours per day, for 4 weeks = 160 hours), creates significant practical difficulties for employers wishing to claim the ETI.

6.2 A detailed factual description of the affected transaction

An employee earns R12.00 as an hourly wage for a standard hour of work.
Application:

1. In a 4-week month the employee works 5 days for 8 hours at R12.00 per hour. The employee will not qualify for ETI (wage = R1920 pm)

2. In a 5-week month the employee works for 5 days for 8 hours at R12.00 per hour. The employee will qualify for ETI (wage = R2 400 pm),

3. Proposed solution

   We propose that section 4(1)(b) of the ETI Act be amended to specify that an employee must be paid at least R12,50 per hour before qualifying for EYI purposes (R12,50 = R2000/160 hours).

6.3 The nature of the business impacted

All employers that claim ETI.

7. SECTION 9(4) OF THE ETI ACT

7.1 The legal nature of the problem

We understand that section 9(4) of the ETI Act was introduced to prevent abuse of the incentive, in that employers that were not incentivised through the ETI Act to create new jobs for youth, seek to benefit at a later stage by claiming ETI from the *fiscus*.

It is clear from the above that in principle, no ETI should be available to be claimed at a point in future should an employer not have claimed ETI in respect of an employee at the outset.
However, currently the legislation does not clarify whether an ETI claim is forfeited if the employer did not calculate the ETI correctly at the time of the claim and seek to correct the ETI through submission of the EMP501 return at a later point.

7.2 A detailed factual description of the affected transaction

Example 1

An employer in error does not load a fringe benefit (unapproved group life contributions) onto the payroll. As a result, the employer calculates ETI and employees' tax exclusive of this fringe benefit. Employees' tax is paid over to SARS, and ETI is claimed. At a later stage, the employer is alerted through a SARS audit and corrects the employees' tax payable. The employer also recalculates the ETI claim.

Variable 1: After the recalculation, the employees' tax liability has increased, and the ETI claim has diminished. The employer must pay SARS the employees' tax due, and must pay back the ETI overclaimed.

Variable 2: After the recalculation, the employees' tax liability has increased, <u>and</u> the ETI claim has increased. In theory, the employer must pay SARS the employees' tax due, but what about the ETI underclaimed?

Example 2

The payroll officer of an employer is unaware of certain transactions taking place in the business of the employer. The payroll calculates and processes the employees' tax and ETI based on the information in the payroll each month, and the EMP201 with the declaration of the employees' tax payable and ETI claimed is submitted monthly.

The EMP201s are reconciled via an EMP501: From 1 September to 31 October for the 6-month period ending 30 August each year, and from 1 March to 31 May for the 12-month period ending 28/29 February each year. When the payroll officer starts the reconciliation process in September, they notice that certain payroll items were not processed. In order to fix the error, the items are loaded onto the payroll, and the underpayment of employees' tax is reconciled (and the payment made to SARS). However, at the same time, the effect of the 'new' payroll items changes the ETI claimed.

Variable 1: After the recalculation, the employees' tax liability has increased, and the ETI claim has reduced. The employer must pay SARS the employees' tax due, and must pay back the ETI overclaimed.

Variable 2: After the recalculation, the employees' tax liability has increased, <u>and</u> the ETI claim has increased. In theory, the employer must pay SARS the employees' tax due, but what about the ETI underclaimed?

We propose that section 9(4) of the ETI Act be amended to clarify that where ETI was claimed, adjustments to the ETI may be processed irrespective when such adjustments take place.

7.3 The nature of the business impacted

All employers that claim ETI.