South African Institute of Tax Professionals

25 November 2014

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Dear Ms. Mputa and Ms. Collins

RE: ANNEXURE C PROPOSALS 2015

Thank you for the opportunity to contribute proposals for the inclusion in Annexure C of the Budget Review 2015.

Set out below, is the consolidated commentary on **Personal Income Tax matters only**, developed from both an internal review of the provisions as well as from consultations with members, stakeholders and industry. The commentary reflects the collective view of members, stakeholders and industry role players consulted.

We have also included various submissions on policy matters which we would like the opportunity to further discuss with National Treasury.

All references to sections below refer to sections of the Income tax Act (No. 58 of 1962) (hereinafter "ITA"), unless stated otherwise.

1. PERSONAL INCOME TAX – POLICY MATTERS

1.1. S10(1)(q) study expenses

Problem statement

Section 10(1)(q) currently only provides for tax relief where the study bursary is provided prior to commencement of study, with an obligation to repay the amount should the student not be substantially

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successful with his or her studies. The tax incentive is not for the employer but for the relevant employee who will not be taxed on the benefit.

Though we understand that National Treasury has purposefully implemented this provision according to the current policy, it is unclear why this policy stance is taken. In effect, it compels the employer to take a financial risk by providing the money for the studies up front and then having to recover the amount, if possible, should the studies not have been successfully completed and mostly over an extended period with interest. As the employer receives no tax benefit from this arrangement, it is unclear why National Treasury wants the employer to carry the risk as this exemption is an incentive on the employee to further his/her studies, as funded by the employer on successful completion, without incurring a tax cost. It is also unclear what mischief would result if an employee is "rewarded" for successful completion of his or her studies by having the actual cost of such onerous study investment settled by the employer without a tax cost.

It is submitted that there is no difference for the employee by having to carry the risk of the finance for the studies upfront or afterwards should he or she be unsuccessful. It just results in financial institutions having to take the risk of finance (which is their core business) rather than employers who are not debt funders. In a country short on skilled and semi-skilled labour, it is submitted that the exemption should encourage as many employers as possible to provide such study finance. Therefore the tax benefit for the employee should not create commercial risk for the employer in doing so. It also recognises that further study in South Africa is a great financial burden, especially on the poor who should benefit from every available opportunity to be skilled in order to better their earning potential.

Proposed solution / recommendation

It is proposed that National Treasury reconsider the current policy in respect of this 'employee-only' study exemption so that employers are encouraged to increase their investment in employees. It is, however submitted this will only occur if the commercial realities of financial risk are also recognised in the policy stance.

1.2. Medical Insurance

Problem statement

Though we agree with the policy stance that medical scheme contributions should be the preferred method for incentivising saving for medical expenses, especially as it provides members with guaranteed minimum benefits, these same guaranteed benefits makes entry level medical scheme membership very expensive. Medical cover is, however, in many instances the difference between life and death and the medical insurance industry has sought to overcome this problem by introducing insurance products that provides some form of cover that reduces this risk without providing the extensive benefits that a medical scheme would normally provide.

These products are mainly aimed at the poorer and needier part of the population as the more financially privileged can in fact afford full medical scheme cover. For example, two products are currently available that cover domestic workers for day to day doctor visits and medicine for less than R250 per month, making this a viable option for employers. The policy question is whether there is room for tax relief for these products without incentivising non-membership of medical schemes?

It is submitted that such scope is possible by providing a taxable benefit exemption or tax deduction for a limited capped amount which reflects National Treasury's policy to rather encourage medical scheme membership but does provide effective relief to cover the cost of these products.

For example, a capped exemption of R250 per month would at least ensure that no added tax cost is incurred.

Proposed solution / recommendation

It is submitted that, as an initial policy consideration, National Treasury should consider looking at a benefit exemption or tax deduction of a capped amount per month, especially where such employer does not have a group medical scheme benefit.

2. PERSONAL INCOME TAX – TECHNICAL CORRECTIONS

2.1. RAF lump sum on return to home country

Problem statement

Expatriate employees who are employed in South Africa for fixed terms, for example 5 years, can in many instances not become members of the SA resident employer's pension or provident fund because of the fixed term of employment. To ensure tax efficient retirement savings in this period, these employees are compelled to contribute to a retirement annuity fund.

The current definition of "retirement annuity fund" in paragraph (b)(x) prescribes the terms of the fund's rules as to when a lump sum amount can be withdrawn. The events are limited to:

- Retrenchment;
- Withdrawal of an amount under the threshold; or
- Emigration of a resident.

In most instances none of these apply to an expatriate employee returning to his or her home country which means that this person cannot exit those funds from South Africa.

Proposed solution / recommendation

It is proposed that a new paragraph (b)(x)(ee) be inserted that allows for the withdrawal of the lump sum amount as per paragraph (2)(1)(b)(ii) of the Second Schedule, where an expatriate employee returns to his home country.

2.2. Foreign employment – bonuses and lump sums

Problem statement

Section 10(1)(o)(ii) of the ITA exempts amounts of remuneration received by or accrued to a person while such person is exercising employment outside South Africa and the days' requirements are met. This section specifically includes commission, bonuses and share gains which takes the form of lump sums. Where the employee is rendering services both in and outside South Africa and the amount accrues or is received while in South Africa, the full amount is taxable notwithstanding that it is received or accrued in respect of not only the period in South Africa, but for the period outside South Africa as well. The converse would also apply if the amount is received or accrued while the person is rendering services outside South Africa.

Proviso (C) to section 10(1)(o)(ii) of the ITA only deems the amount to have accrued or received over a period (i.e. not on actual accrual or receipt date) if the period is over two years of assessment. However, the same principle applies where the amount pertains to a single year of assessment in which services were rendered in or outside South Africa and the amount received or accrued is in respect of that year only or part of that year (i.e. bonus for employee who started in the middle of the year). SARS' IN 16 does not currently deal with this matter.

Proposed solution / recommendation

It is proposed that proviso (C) to section 10(1)(o)(ii) be amended to allow the deemed equal accrual or receipt of a lump sum amount over the whole period for which it was earned, irrespective of whether it was in a single year or over more than one year.

2.3. Short term business travellers

Problem statement

A non-resident employee who is legally employed in SA becomes subject to the SA PAYE requirements unless a DTA provides taxing rights to the employee's country of residence (usually if the employee does not reside in SA for more than 183 days in that year). This also applies even if the "economic employer" (i.e. employer who does not necessarily directly pay but in fact carries the ultimate cost) is a non-resident employer but the legal employer is a SA Resident.

A further problem is that, notwithstanding that the non-resident employee may not become tax liable in SA, the current requirements still impose an obligation for such person to render a return, which for a short term assignment means doing so moths after the person has already left SA.

To deal with this same problem, the Her Majesty Revenue and Customs ("HMRC") has introduced measures to limit the PAYE administration for short term non-resident business visitors. These measures are contained in the *CWG2 Employer Further Guide to PAYE* and are set out in the PAYE82000 appendix, whereby various categories of short terms (i.e. less than 183 days) are created which are divided according to the relevant days in the UK, namely 1-30, 31-60, 60-90, 91-150 and 151-183, each with PAYE relief but with its own disclosure obligations. These exclusions only apply subject to specific conditions which include that the relevant employee's stay is not part of a longer intended stay and the person is a resident of a treaty country. For persons who stay for periods less than 60 days, it is not a requirement that he or she is economically employed by a non-resident employer.

For the 1-30 day period, the employer will have no PAYE obligations in respect of such employee and for persons in the under 60 day period, the employer must merely confirm that there is no formal contract of employment with the UK employer. It is submitted that a similar exclusion should apply in SA for both PAYE and income tax in order to prevent such persons the inordinate amount of tax administration that results from short term business visits.

In principle, non-resident taxpayers should not have a tax compliance obligation if they are not liable to taxes in SA or are liable to taxes but accrue less than the tax threshold.

<u>Proposed solution / recommendation</u>

It is proposed that a *de minimus* is introduced for exemption from PAYE and income tax return submissions on similar grounds as the UK model for the 30 day or 60 day rule for PAYE exemption. This will greatly reduce the administration of both the resident employer having to make the determination or that of the economic employer and also limits the employee's obligation to comply with tax administration where no tax payment obligation exist in SA.

The exemption should also be applicable where the relevant person will earn amounts below the tax threshold in such period.

2.4. Foreign medical scheme taxable benefit

<u>Problem statement</u>

The current valuation of the taxable benefit for employer paid medical scheme contributions in paragraph 12A(1) of the Seventh Schedule correctly applies to contributions made to both SA registered medical schemes and similar foreign registered funds. This is also matched by a medical tax credit in section 6A of the ITA.

However, the taxable benefit charging section, paragraph 2(i), only refers to contributions made in respect of a "benefit fund" as per paragraph (b) of that definition in section 1 of the ITA. That definition only applies to medical schemes registered in SA. The result is that even though there is a valuation provision and a tax rebate for contributions to similar foreign medical funds, there is no charging provision to bring it within the ambit of the taxable benefit valuation provision. This seems to merely be an oversight.

Proposed solution / recommendation

It is submitted that paragraph 2(i) of the Seventh Schedule should be amended as follows:

"…the employer has during any period directly or indirectly made any contribution or payment, to any fund contemplated in paragraph (b) of the definition of "benefit fund" in section 1 or any fund which is registered under any similar provisions contained in the laws of any other country where the medical scheme is registered, for the benefit of any employee or the dependents of any employee…".

2.5. *De minimus* exemption for gifts to employees

Problem statement

It is common for employers to provide employees small token gifts during special events, such as T-Shirts and water bottles at team building functions, or for special occasions such as spoons for a wedding gift or bottle packs for pregnancy. However, the current provisions of paragraph 2(a) and 5 of the Seventh Schedule does not provide for an exemption even if the asset is perishable such as flowers or a fruit basket. Taxing these amounts is unpractical in many instances such as at teambuilding where it is impossible to determine whether everyone took a T-Shirt or water bottle. However, for employers to remain fully compliant they would have to subject these asset amounts to employees' tax which is administratively burdensome. Paragraph 10(2)(c) avoids this position in respect of services by excluding amounts utilised for the better performance of duties, at a place of recreation provided by the employer or if used by employees in general.

Proposed solution / recommendation

It is submitted that that paragraph 5 be amended to provide for a similar exclusion as in paragraph 10(2)(c) as well as a *de minimus* annual amount (for example R500) for special occasions such as weddings and births.

2.6. Change of residence

Problem statement

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Section 9H(2) of the ITA provides that where a person other than a company ceases to be a resident then that person will be deemed to have disposed of all of his or assets on the day before ceasing to be a resident. The question arises that if a person is deemed to be exclusively resident for the purposes of determining taxing rights on a particular amount, does that trigger section 9H? The Explanatory Memorandum on the Exchange Control Amnesty Amendment of Taxation Laws 2003 stated as follows:

"Any person exclusively deemed to be a resident of another country for the purposes of one or more tax treaties (by virtue of the tie breaker rules or otherwise) will not be a resident for the purposes of the Income Tax Act, 1962, regardless of any other rules pertaining to the definition of resident contained therein."

Therefore, does section 9H apply to a taxpayer who is resident in SA and a foreign country and then is exclusively resident as a result of the DTA? This would put taxpayers in a very punitive environment if they are to pay CGT merely as a result of the DTA.

For example, a SA resident who works as an expatriate in the UK for 5 years sells his house in SA to purchase a flat in London. In terms of local law, the UK and SA will have taxing rights to the salary but in terms of clause 2 of the DTA the UK will have exclusive rights if the person has a permanent home or habitual abode in the UK, irrespective of whether he is a SA national. Does the DTA result in section 9H applying?

Proposed solution / recommendation

Section 9H should be clarified for persons other than companies to ensure that a DTA does not result in section 9H applying where in terms of the local law the person is still tax resident in SA.

Should you have any enquiries or wish to discuss the submissions made please do not hesitate to contact me.

Yours sincerely,

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