

25 January 2015

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Dear Ms. Mputa

RE: EXPANDED ANNEXURE C 2015 SUBMISSION – PROFESSIONAL MEMBERSHIP FEES

Following our VAT submission on Annexure C 2015 dated 25 November 2014, you invited us to make additional submissions relating to professional membership fees that address not only the VAT concerns but also any concerns relating to Income Tax.

We would like to thank you for the opportunity. Set out below is our view on the current implications of the VAT and the Income Tax involving three equivalent scenarios – all of which give rise to different results. Questions have been raised as to the rationale for these differences and requests exist for consistency.

I. Background

Many professions or trades in South Africa require statutory registration in order to practice. These professions include doctors and nurses who must be members of the Health Professions Council of South Africa, engineers who must be members of the Engineering Council of South Africa and surveyors who must be members of the South African Council for Professional Surveyors. Likewise, accountants and lawyers also must be members of certain statutorily determined professional bodies in order to serve in various functions, including as tax practitioners. These regulatory requirements (and associate membership fees) seek to ensure that “professionals” have a mandated level of competence and integrity to practice their trades.

The membership of professional bodies are mostly limited to natural persons who directly practice their profession or trade. Payment for membership can either be undertaken:

- (1) by the individual member as sole proprietor or as a partner in a partnership;
- (2) by the individual member’s employer (typically an incorporated practice); or
- (3) by the individual member directly as an employee.

To better explain these scenarios, we will illustrate the payment of membership fees by medical doctors who actively engage in practice with patients in the case of all three scenarios.

II. Scenarios

A. *Sole proprietor or partnership medical practices*

A doctor who practices as sole proprietor or in partnership is the direct owner (or part-owner) of the trade or business in which that doctor is engaged. This directness of membership greatly simplifies both the VAT and Income Tax implications because the doctor is directly paying membership fees in furtherance of a trade or business to which that doctor is directly engaged.

- VAT: In the case of VAT, the doctor in this scenario is clearly entitled to claim the VAT input for professional subscription fees because these fees are in the course and furtherance of a business making taxable supplies (treating patients). This principle is correct as this membership is a direct precondition to further the medical practice enterprise in making taxable supplies.
- Income Tax: Similarly for income tax, the expense is actually incurred in the production of income and in the course of the medical trade, thus being deductible for income tax purposes. Subscriptions to professional bodies that “enable the taxpayer to trade” have explicitly been held to be deductible on this basis (See ITC 787 in respect of medical practitioners and ITC 671 in respect of accountants).

B. *Company reimbursement of employee medical doctor fees*

For commercial reasons, many professionals choose to do business by means of an incorporated company in order to limit potential legal liability. This is the typical HMO model. In this scenario, the company employs doctors, all of whom must belong to a professional body in order to render professional services on behalf of the employer. In many cases, the directors of these professional companies are simultaneously both owners and employees with the fees being paid for the employment aspect of their relationship.

- VAT: In these scenarios, the professional company appears unable to claim the VAT input. According to SARS, the supply by the professional company is made directly to the employee as opposed to the employer. Though this strict approach may be correct in law, the employer is effectively bearing the VAT without reimbursement. As a result, the VAT “sticks” at the wrong level and is indirectly borne again when the ultimate consumer pays for medical services. This strict view results in additional costs for juristic medical practices as opposed to those businesses engaged in the same activities in the form of a sole proprietor or partnership. A similar position would be the reimbursement of personal subsistence for employees spending a night away on business. Here the supply is also directly to the employee for direct consumption by the employee.

However, it is clear that the consumption is indirectly consumed by that employer in the furtherance of its enterprise when reimbursing the employee for the expense. Section 17(2)(a)(i)(aa)(ii) of the VAT Act allows input credit nonetheless. Employee membership should be viewed as equivalent to these travel expenses as a matter of policy.

- **Income Tax:** In respect of income tax, a medical practice as employer will be entitled to deduct the expense as employment costs. The cost is in the production of employer income and in the course of the employer's trade as a medical practice. Note also that the employer payment does not give rise to additional taxable income for the employee. Because these professional fees are a condition of employment, the Seventh Schedule will treat the benefit as having a nil value.

B. Doctor employee membership fees

In many cases, medical employees will be required to pay for their own membership fees. These doctors (often junior) are typically employees of companies and larger partnerships.

- **VAT:** An employee who renders employment services will not be able to register as a VAT vendor as salary earned does not constitute taxable supplies. Employee costs – no matter what the business connection – simply fall outside the VAT net. The employee exclusion from qualifying as a registered VAT vendor is standard international practice. Nonetheless, this exclusion should not be a principle for denying the VAT input on employer reimbursements as indicated above, where supply is in fact indirectly being utilised by the employer in the course and furtherance of its enterprise. A specific exclusion in these circumstances should apply to the employer vendor.
- **Income Tax:** If the employee pays membership fees, section 23(m) of the Income Tax Act will prevent the employee from claiming deductions, notwithstanding that the expense is in the production of income and in the course of the employee's trade. This limitation was introduced by the Taxation Laws Amendment of 2002 and according to the corresponding explanatory memorandum (at pg. 6), it was merely performed to simplify the taxation of employment. However, this denial of deductions does create an unfair disparity, as compared to other deductible business expenses of employees such as wear & tear for work computers (i.e. section 11(e) SARS Income Tax). This result seems especially unfair in the case of doctors and nurses employed by Government because these employees do not enjoy the benefit of their employer paying for their professional memberships.

III. Summary

In our view, employer reimbursement of professional fees should qualify as valid input credits so that the VAT does not create an intermediate (but final) unreimbursed expense at a business-to-business level. Other

employee business reimbursements such as business related entertainment in respect personal subsistence of employees, qualify for input credits even though no credit would apply if paid by employees directly. In addition, while section 23(m) is aimed at narrowing employee deductions, membership fees are clearly not an expense that can be falsely manipulated and are on par with other business expenses such as wear & tear, bad debts and legal expenses currently falling outside the prohibition of section 23(m).

We hope that you will favourably view our submission. Should you wish to discuss any matter pertaining to this submission, please do not hesitate to contact us as we would appreciate the opportunity for further discussion.

Yours sincerely,

Mr Erich Bell

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