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**RE: ANNEXURE C PROPOSAL: DIRECTORS – VAT VERSUS PAYROLL**

We thank you for the invite to the pending meeting concerning the taxation of company directors. Although the proposal is focused on the potential application of VAT, we believe that the issue can only be resolved by also taking into account PAYE (i.e. the Fourth Schedule).

## **1. Contextual Background**

Directors fall into three categories. In terms of the Companies Act, directors are divided between executive directors and non-executive directors. Executive directors are typically also employees of the company (e.g. the Chief Executive Officer and the Chief Financial Officer) while non-executive directors are not. The King Codes further divide non-executive directors into two further categories – regular non-executive directors and independent directors. Independent directors may not have any significant shareholdings or other business interests in the company for which the independent director is serving.

Non-executive directors operate in different circumstances. Some directors may serve on a single board while others may have multiple board positions. Some directors may be retired while others are engaging in directorships in addition to other forms of consulting work.

Non-executive directors typically receive an annual fee, a fee based on the boards served or a fee based on the proposed meetings to be attended. Long-distance travel and accommodation are usually reimbursed. However, non-executive directors must typically bear their own costs – computer, supplies, general office space – but total costs of this kind are probably less than 25 per cent of gross proceeds in most cases.

## **2. Employees versus Independent Contractors**

Directors, non-executive or otherwise, of a private company are viewed as employees subject to the Fourth Schedule regardless of their circumstance. Directors of other companies (e.g. public companies, state-owned companies and non-profit companies) fall under the general facts and circumstances of case law (Interpretation Note 17). As such, most non-executive directors (not serving a private company) probably qualify as independent contractors, meaning that no Fourth Schedule withholding is required. Most of these directors work outside the offices of the company they serve and serve in relation to only a few board meetings per annum.

## **3. VAT Enterprise**

Non-executive directors may arguably fall within the “enterprise” definition. These directors potentially can be viewed as engaged in an “activity” that is carried on “regularly” in furtherance of supplying services for consideration, and the activity is carried on in the form of a commercial, financial or professional concern. Registration may accordingly be possible if the R50 000 threshold is reached and will be required if the R1 million threshold is breached.

As a practical matter, the R1 million threshold will be breached only for a certain select set of executive directors. Independent directors are typically paid less than other non-executive directors. Public and state-owned company directors are typically more highly paid, especially if from the financial sector. Alternatively, the person at issue may hold multiple directorships or be otherwise engaged in other VAT enterprise professional service activities with the directorship acting as supplemental income.

## **4. VAT and the Fourth Schedule**

VAT does not apply in certain circumstances if Fourth Schedule PAYE applies. In particular, common law “employees” or common law “holders of an office” fall outside the VAT enterprise definition if subject to

Fourth Schedule withholding. Private company directors presumably fall within this exclusion if these directors are viewed as “holders of office”.

## **5. Practicalities**

From a compliance level, most directors do not view themselves as running a VAT enterprise in a fashion equivalent to a typical service consultant, making VAT enterprise treatment for non-executive directors as a trap for the unwary. VAT registration can also be a cumbersome process for independent directors that work only occasionally throughout the year. From a SARS perspective, the enforcement cost versus collection benefit is also not worthwhile because the director/company relationship is a business-to-business supply. The net result is a VAT charge for the director and a corresponding input claim for the company.

## **6. Recommendation**

We recommend that all directors be placed solely within the PAYE system and fully excluded from the VAT system. Under this approach, any director receiving compensation should fall within PAYE withholding regardless of whether the director is a board of a private company or other company. All amounts subject to Fourth Schedule withholding should be excluded from the VAT system (regardless of whether the person is a common law employee or office holder).

The net outcome will improve both enforcement and compliance. PAYE withholding is fairly easy to perform for the company and much easier from a SARS / director compliance perspective. Most directors will find the mechanism easier than the current potential VAT risk. Collections will probably increase due to the reduced risk of tax evasion.

The only issue for most independent directors will be the potential application of section 23(m). We suggest that this group be treated as commission-paid employees given the loose day-to-day connection to the company. Unlike employees, independent directors operate from their own locations and are not reimbursed for most basic expenses (other than long-term travel and accommodation).

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SAIT thanks National Treasury and SARS for the open engagement on this very important matter. We appreciate the fact that comment was requested before sending the proposed legislation to the Standing Committee on Finance.

Yours sincerely,

**Keith Engel**  
**Chief Executive**