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**RE: DRAFT TAXATION LAWS AMENDMENT BILL, 2017 & DRAFT TAX ADMINISTRATION LAWS  
AMENDMENT BILL (TALAB), 2017: COMMENTS PERTAINING TO KEY PERSONAL TAX ISSUES**

We have attached the comments from the SAIT Personal Tax Work Group on the draft Taxation Laws Amendment Bill (draft TLAB) and draft Tax Administration Laws Amendment Bill (draft TALAB) 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.

Yours sincerely

**Beatrice Gouws**  
**Vice Chair of the Personal Tax Work Group**

## PERSONAL TAX ISSUES

### 1. Tax relief for Bargaining Councils regarding tax non-compliance

#### *Proposed amendment*

Some bargaining councils have not deducted Pay-As-You-Earn (PAYE) from a large number of members for holiday, sick leave and end of the year payments extending back a number of decades. Government is providing relief on the basis that some of these bargaining councils would be at risk of closure or would suffer severe financial distress if high penalties and interest are imposed for non-compliance. However, bargaining councils are expected to be fully tax compliant going forward and will not be afforded relief in future.

#### *Problem identified and suggested solution*

1. Problem identified: Bargaining Councils have a variety of funds that deal with benefits other than holiday, sick leave and end of the year payments, and with potential liabilities for taxpayers, other than the Bargaining Councils. Yet, the relief is offered only for Bargaining Councils in respect of funds providing holiday, sick leave and end of the year payment benefits.

For example:

- Medical benefit funds, such as wellness and medical aid funds
- Disability cover / Survivor benefits, such as a death and disability scheme and a permanent disability scheme
- Other funds, such as maternity and funeral funds

Suggested solution: It is proposed that the relief be extended to cover the full array of benefit funds.

2. Problem identified: It is not clear how the current legislation applies in respect of Bargaining Council funds and there seems to be a great deal of confusion in the industry about the way forward regarding future tax compliance. For example, it is not clear whether sick pay funds (due to the uncertainty that an event would take place occasioning a payout), should be treated in the same way

as the standard employer group life setup (premium is a fringe benefit but the payout is not taxable). Furthermore, whilst it is clear that the payout from a leave pay fund should lead to an employees' tax liability for the fund/Bargaining Council, it is not clear on what basis the contribution to the fund would not generate a fringe benefit (resulting in double tax). There is also uncertainty regarding the tax treatment of medical benefit funds and disability benefit funds.

Suggested solution: It is proposed that clarity be provided regarding the expected tax treatment of the various Bargaining Council funds.

## **2. Repeal of foreign employment income exemption**

### *Proposed amendment*

It is proposed that the current section 10(1)(o)(ii) exemption be repealed. As a result, all South African tax residents will be subject to tax on foreign employment income earned in respect of services rendered outside South Africa with relief from foreign taxes paid on the income under section 6quat of the Act.

### *Problem identified and suggested solution*

1. Problem identified: The effect of the repeal of the exemption on business in South Africa has not been analysed. The direct cost of the increased tax burden that will have to be carried by employers as a result of the repeal is likely to have a significant impact on their bottom line. Particular concerns are possible retrenchments, the continued competitiveness of South African business in the continent, and of South Africa as the 'Gateway to Africa'.

Suggested solution: It is proposed that the repeal of the exemption be postponed until an economic analysis can be done on the potential effect on business, the labour market, and the economy of the country.

Note that these points have been discussed in more detail in the 15 May 2017 collaborative submission by Deloitte, EY, KPMG, PwC, SAICA and SAIT to National Treasury on Foreign Remuneration Exemption.

We further note that our experience indicates a widespread hostility to the proposed repeal of the exemption as suggested. Employers and employees are very upset about the potential added costs, risks and compliance burden involved. As you are aware, many expatriates have been signing a petition and voicing their opposition in various media platforms. We also expect a number of foreign-located individuals to emigrate if the exit charge is not too significant. There is also an indication that the proposed repeal is negatively impacting the question of business making use of South Africa as a 'Gateway to Africa' in structuring their group activities.

2. Problem identified: The tax credit system is complex and difficult to negotiate. We say this based on difficulties and time delays experienced by individuals who do not qualify for the exemption (such as contractors and short-term assignees) and who has to make use of the credit system. It is particularly difficult to provide sufficient proof of foreign taxes having been paid, especially in cases where certain self-assessment taxes do not require any assessment from the revenue authorities and the only proof that the individual would have of taxes having been paid would be their foreign tax return. The loss due to the cash flow and the administrative cost will have a profound effect on business should the tax credit system not run smoothly.

Suggested solution: It is proposed that the repeal of the exemption be postponed until the regulations required to regulate the tax credit system have been negotiated, promulgated, and implemented by SARS.

3. Problem identified: There is no mechanism in our employees' tax (PAYE) legislation to take foreign payroll withholding taxes into account to reduce the amount of PAYE to be withheld and paid over to SARS on a monthly basis. The effect could, therefore, be that the South African employer is obliged to withhold PAYE in both South Africa and the foreign jurisdiction on the same remuneration throughout most of the year until assessment. The cash flow hardship for

employees who work in foreign jurisdictions where the tax rates are not low could accordingly be severe. For example, if the income tax rate in the foreign jurisdiction is say 30%, the combined PAYE could be as high as 75% during the year. Taxpayers would then be required to seek refunds at year-end to reduce this double tax burden.

Suggested solution: It is proposed that the repeal of the exemption should not go ahead without a monthly tax credit mechanism against the South African PAYE. Special arrangements will also be required for the payroll system operates in a foreign location.

### **3. Refinement of measures to prevent tax avoidance through the use of trusts**

#### *Background*

It is intended to amend section 7C to widen its ambit, to include loans advanced to companies held by trusts. The proposed extension of section 7C will cover companies that are a connected person in relation to the trust.

Of concern is the fact that the amendment is too wide and will accordingly have numerous unintended consequences.

#### *Example 1*

Company A established an employee share scheme which has as its legal base a vested trust owning 20% of the issued equity shares of Company A. All the employees are vested beneficiaries of the share scheme trust, including the Founder, Mr X, who is also an employee. Separately and unrelated to the share scheme, Mr X owns all of the shares in Company B. Mr X has partially funded the acquisition of an asset by Company B by advancing an interest-free loan to Company B. Mr X is a connected person in relation to Company B, and also in relation to the trust. The result is that Company B and the trust are connected persons in relation to each other. Mr X's personal loan to Company B will therefore be subject to Section 7C, despite the fact that neither the funding nor Company B having anything to do with the trust.

### *Example 2*

Mr A established a trust for his family, which does not hold any underlying company. His wife, Ms A, who is a beneficiary of the trust, is an independent businesswoman, who wholly-owns a resident company, Company C. She has partly-funded the operations of Company C with an interest-free loan from her own funds. Company C and the trust are connected persons because Ms A is a connected person to Company C, and is also a connected person to the trust. Ms A's personal loan to Company C will be subject to Section 7C, despite neither the fact that the funding, nor Company C having anything to do with the trust.

### *Suggested solution*

It is proposed that the reference to a “connected person” in subparagraph (ii) be limited to paragraph (d)(i) of the definition of connected person. This change would mean that the focus would require a more than 50 per cent share ownership connection.

## **4. Excluding employee share scheme trusts from measures to prevent tax avoidance through the use of trusts**

### *Proposed amendment*

In order ensure that employee share schemes are not negatively affected, it is proposed that a specific exclusion for employee incentive schemes should be provided. However, certain requirements must be met for the exclusion to apply. These requirements are introduced in order to ensure that owners of businesses do not abuse the exclusion to transfer wealth to family members that are in the employ of the business.

### *Problem identified*

One of the requirements for the exclusion to apply is that no person who holds at least 20% of a widely-held company (together with his connected persons) participates in the employee share scheme. Yet, there are owner-managed companies and family businesses that have employee share schemes in which the owners and/or their families would also participate. If this requirement were to apply, the entire

employee share scheme would be caught, even in relation to non-connected employees. This would mean that the full loan by the company to the trust to acquire the shares would be tainted despite the lack of any tax avoidance intention.

#### *Suggested solution*

Consideration should be given to apportioning the loan between the tainted portion and the excluded portion. In other words, to the extent that at least 20% owner/s (together with their connected persons) have a beneficial interest, the tax avoidance rules can apply.

### **5. Clarifying the rules relating to the taxation of employee share- based schemes**

#### *Proposed amendment*

In order to address the anomaly arising from the interaction between section 8C(1A) of the Act and paragraph 80(2A), the proposed legislation adds new paragraph 64E into the Eighth Schedule (which deals with disposals by a trust in terms of a share incentive scheme). This legislation clarifies the amounts included in the employee's income in terms of section 8C of the Act will be disregarded by the share incentive scheme for CGT purposes. In addition, changes will be made to paragraph 80(2) of the Eighth Schedule to clarify that these provisions will be subject to paragraph 64E of the Act. Paragraph 80(2A) of the Eighth Schedule will be deleted.

*General note:* Amendment strongly welcomed. This amendment solves a longstanding problem.

### **6. Reimbursive travel - Proposed amendment of paragraph 1 of Fourth Schedule (and see also section 8(1)(b)(iii))**

#### *Proposed amendment*

National Treasury is tightening the rules for reimbursive allowances in order to increase the level of monthly withholding in certain circumstances. In practical terms, the reimbursive allowance rules apply

when an employer sets travel reimbursement by formula (e.g. kilometres travelled) but reimburses the employee for travel only once the travel is complete.

Under current law, employers can set the travel reimbursement at varying rates per kilometre but tax ultimately applies if the employer rate per kilometre exceeds the rate set by Government Gazette (which is R3.55 per kilometre for the 2018 tax year). This tax on the excess depends on many factors (e.g. size of car and split between personal and business travel). On the other hand, the new proposal requires this excess to be taken into account on a monthly basis (in lieu of a sole calculation at year-end). The amendment will be generally effective from 1 March 2018.

#### *Problem identified*

It is our view that the proposal will create an unnecessary administrative burden for the employer's payroll systems and personnel. This additional administrative burden will arise in the logistics and practicalities associated with the actual processing of the reimbursement claims submitted by employees. Further problems arise when one takes account of the cut-off required by the employer's payroll in order to process the monthly payroll.

The administrative burden becomes even worse when an employer sets varying rates according to levels of seniority and/or value of vehicles etc... As an example, an employee with an employer using varying rates may qualify at the beginning of the tax year for an employer rate less than the government Gazette rate but end the year with a higher employer rate due to a promotion. In this circumstance, the payroll needs to ensure that the payroll/IRP5 certificate coding for travel is correctly changed from 3703 (non-taxable reimbursement) to 3702 (taxable reimbursement).

A further burden is placed on the payroll due to an increase in processing work. For instance, many payrolls have a cut-off on and around the 20th of each month. If, according to the proposal, the amount of the travel reimbursement in excess of R3.55 per kilometre is to be subject to the determination of PAYE, SDL and UIF, the collating, vetting and processing of these claims becomes a necessity before the 20th cut-off. The question then arises how to deal with payments made after the 20th to the end of the month.



*Other considerations:*

- One question is whether the proposed higher level of withholding will merely result in employees opting for a higher travel allowance. The monthly withholding tax dispensation for the travel allowance is 80% or 20%, depending on certain circumstances. Therefore, the change may result in a lower level of monthly withholding if this shift to a travel allowance arises.
- The proposal will have a direct impact on an employee's monthly cash-flow. This reduced cash-flow adversely impacts the money available for the employee to defray business related travel costs.
- The calculation of, and the deduction for, retirement fund contributions will similarly increase by the increase to the remuneration definition. Yet, the intention of the reimbursement is for an employee to defray business travel costs. The reimbursement is not intended to be used as means of enhancing contributions to a retirement fund.

*Suggested solution*

We are of the view that *status quo* should be maintained in respect of reimbursive travel allowances. Nonetheless, if the proposal is legislated, should the travel reimbursement not perhaps qualify as 'variable remuneration' as envisaged in section 7B of the Act. This approach would generate a PAYE deduction only once the travel reimbursement is paid – potentially allowing employers to collate, vet and process such payments (as an example, by the 1st week of subsequent month).