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Submission File

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Dear SARS

CONCERNS REGARDING IRP3(s) DIRECTIVES

1. We herewith take an opportunity to present our comments on behalf of the South African Institute of Chartered Accountants' (SAICA) Employees' Tax sub-committee (a sub-committee of the SAICA National Tax Committee) on the updated IRP3(s) directives processes and procedures.

COMMENTS

Late notification of changes

2. It is our understanding that the SARS "Comprehensive Guide to the ITR12 Income Tax Return" was updated in August, September, December 2020 with the latest change taking place in July 2021. However, these changes were very poorly communicated, especially in respect of the changes made to the ITR12 Income Tax Returns (2019 onwards) in respect of the section 10(1)(o)(ii) exemption's application to the vesting of shares under sections 8A/C and the new interface on income tax assessment with the IRP3(s) directive. It is our understanding that there was no direct communication by SARS to employers and employers were not invited to provide comments on the changes that SARS has since implemented.

3. An extract from the latest version of this guide (version 25 – July 2021) on page 110 stipulates the following (portion highlighted in green is of relevance):

s10(1)(o)(ii) exemption relating to s8A/8C gains (excluding dividends)' will display. Please complete the following information in this section:

- **'Are you a SA resident as defined in the Income Tax Act?'** – Select Y or N
- **'In respect of section 10(1)(o)(ii) exemption claimed, how many s8A/8C gains are applicable during this year of assessment?'**
- Complete the following details for each gain indicated above:
  - **'Start date of the source period (when this shares were allocated) (CCYYMMDD)'**
  - **'End date of the source period (date of vesting) (CCYYMMDD)'**
  - **'For how many years of assessment during this source period did you qualify for the s10(1)(o)(ii) exemption?'**
  - **'Indicate the relevant year(s) of assessment'**
  - **'Total number of working days during the source period'**
  - **'Number of working days outside SA during the source period'**
  - **'Gross value of the gain'**
  - **'Exempt amount of the gain'**

Note: As from the 2019 year of assessment, this section of the return has moved to the tax directive form (IRP3(s)). The employer will complete this form and apply for tax the directive on behalf of the employee. When the ITR12 is assessed, the SARS system will take the exemption granted on the tax directive (s8A/8C) into account. For more information please refer to 'IT-AE-41-G01 - Completion Guide for IRP3(a) & IRP3(s) Form' on the SARS website.

4. It is therefore evident that the section 10(1)(o)(ii) exemption relating to section 8A/8C gains, will from the 2019 year of assessment, be included in the IRP3(s) directive rather than on the ITR12.

5. The last paragraph of the extract highlighted in green did not appear in the August version of the Guide. This change was made very late in the compliance year and if a return had already been submitted by an individual, the employer would now need to cancel the directive and resubmit it. The individual would then need to resubmit the ITR12 return for the year, even after an assessment may have been issued.

6. Submission: The timing of these changes is unfortunate considering that the filing season deadline for the submission of individuals who were non-provisional taxpayers tax returns was 22 October 2020 (manual filing) and 16 November 2020 (efiling), with many taxpayers submitting before these deadlines.

7. It would be sincerely appreciated if changes of this nature are communicated timeously to employers to enable them to make the necessary changes prospectively not retrospectively in order to avoid the unnecessary additional compliance costs that both the employer and employee now have to incur should the ITR12 have been submitted before these changes were communicated.

"Work days" requirement

8. The requirement that only a "working day" basis should be used when apportioning the accrual amount was only evidenced when SARS made changes in Interpretation Note 16 (Issue 2) dated 2 February 2017. Prior to this, the earlier Interpretation Notes included calendar day examples. Furthermore, SARS also had issued BCR 025 wherein SARS expressed the formula to be used by way of calendar days.

9. Many employers have always required their employees to provide them with their travel data i.e. date of leaving South Africa and date returning to South Africa to ensure that the employer can test that the calendar day (more than 183/60 continuous day) requirements of section 10(1)(o)(ii)(aa) and (bb) were met. Many employers have thus never requested

their employees to provide them with the working days as the earlier SARS Interpretation Notes 16 never required the apportionment to be done on this basis. For many employers to have to now obtain work days from employees for further tranche vestings of the same award would be onerous for the employer and an unnecessary burden on the employee.

10. In SARS' "Completion Guide for IRP3(a) and IRP3(s) forms – Revision 4" on page 19, it states that "*For old schemes entered into before 2018 year of assessment where the 'working days' are not available the calendar days can be used*".

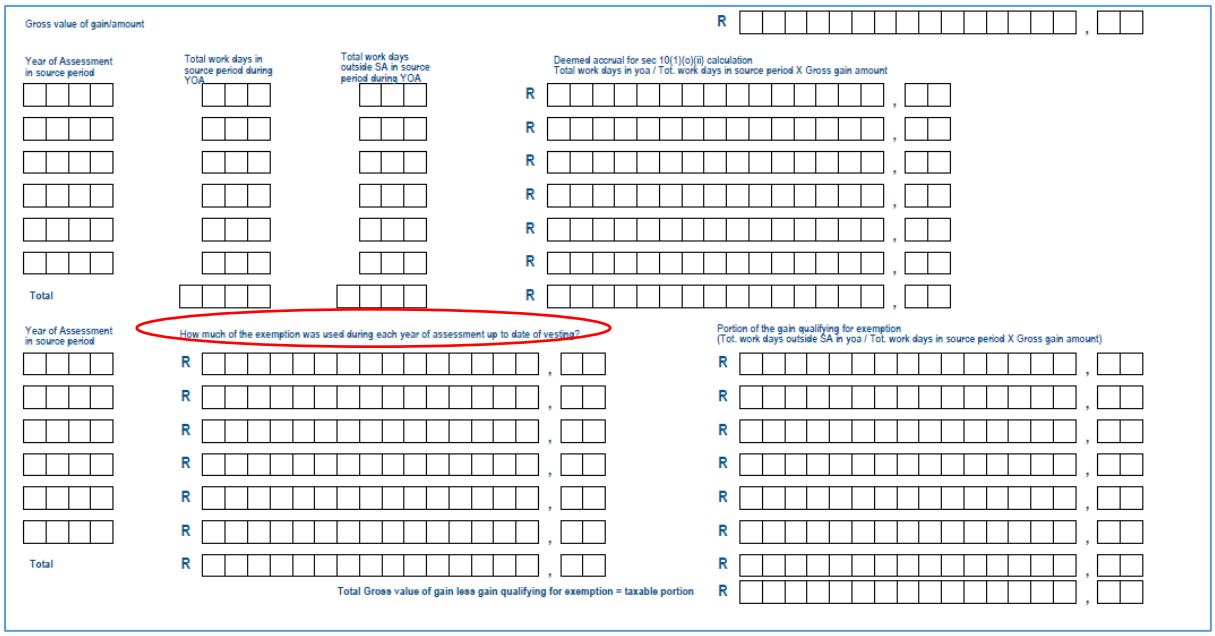
11. Employers understand the 2018 year of assessment to mean 1 March 2017 to 28 February 2018. Hence old schemes entered into before 1 March 2017 can still use calendar days as the basis for an apportionment. However, the very next sentence in the Guide states that "*For schemes with a start date after 1 March 2018 only working days can be used*".

12. <u>Submission:</u> SARS should clarify what apportionment basis should be used for the period between 1 March 2017 to 28 February 2018.

13. Employers are also finding it difficult reconciling the SARS' guidance setting out that both calendar days and work days can be used in certain circumstances, with the wording in the actual IRP3(s) Application for a Tax Directive: Section 8A or 8C amount only referring to work days.

14. <u>Submission:</u> Guidance on this matter should be provided and the IRP3(s) application form should be updated accordingly.

15. Another area of confusion is on page 3 of the actual IRP3(s) Application in the section that states the following: "*How much of the exemption was used during each year of assessment up to date of vesting?*"



16. There is no clear guidance by SARS on this form nor in their Guide that this must only be applied to years of assessment starting from the 2021 year of assessment since it is the first year that a current R1.25m cap must be applied to the exemption being claimed. A tax vesting could take place in the 2021 year of assessment and award date of 1 March 2016, thus spanning five years with the following years of assessment: 2017, 2018, 2019, 2020 and 2021.

17. Submission: Clarity and guidance on how this section should be completed as mentioned above would be greatly appreciated.

Burden on employers due to uncertainty of information

18. As mentioned above, SARS has updated the IRP3(s) directive but the changes proposed will create a substantial burden on the employer. Below is a screenshot and the full text from the "IBIR-006 Tax Directives Interface Specification, IBIR-006 Rev 6.103" dated 10 December 2020 of what is required to be included in the directive:

IRP 3(s)

- Date of accrual
- PAYE number of the Employer
- Name of Employer
- Start Date of the source period relating to the section 8A/8C gain
- End Date of the source period relating to the section 8A/8C gain
- Total number of work days during source period relating to the section 8A/8C gain
- Number of work days outside SA during source period relating to the section 8A/8C gain

- Gross Value of gain/amount
- Is the employee a tax resident? (Y/N)
- If the employee is a tax resident?
  - Is the exemption in terms of section 10(1)(o)(ii) applicable? (Y/N)
- If the exemption in terms of section 10(1)(o)(ii) is applicable
  - For each qualifying 12 months period during which the exemption in terms of section 10(1)(o)(ii) applies
    - Start Date
    - End Date
    - Total number of work days during the 12 months qualifying period(s)
    - Number of work days outside SA during the 12 months qualifying period(s)
  - For each Year of Assessment for which the exemption in terms of section 10(1)(o)(ii) is applicable during the source period provided
    - Year of Assessment in source period
    - Total work days in source period during Year of Assessment
    - Deemed accrual for section 10(1)(o)(ii) calculation (Total work days in Year of Assessment / Total work days in source period X Gross gain amount)
- If the employee is a tax resident and the exemption in terms of section 10(1)(o)(ii) is applicable, or the employee is not a tax resident
  - Exempt amount of the gain under section 10(1)(o)(ii)

19. The concern with the question "*Is the Employee a tax resident?*" is that it will place an unnecessary burden on the employer. In order to answer this question, the employer will have to collect this information from its employees and then have to rely on the accuracy of the answer provided by the employees who may struggle themselves to fully understand the concept and implications.

20. Furthermore, in terms of this extract, an employer is required to have, readily available, the amount of the R1.25m that was used during each tax year during vesting for each applicable employee. As this information is only available to the individuals via their final assessments (for reasons such as multiple employers, offshore remuneration not paid via the South African payroll, non-assessed returns) an employer will only be able to, at best, guess this information based on what information they have on their payroll. Alternatively, they would need the information from the individuals which again may not be available/accurate or forthcoming.

21. A more common issue that will arise is that many companies have March vestings so if an employee has a section 8C event on 1 March they are not going to be in a position to determine the immediately preceding year's limit.

22. Furthermore, there is no interaction between the IRP3(s) and IRP3(q). It is our understanding that an employer will need to get a directive to withhold an amount from the section 8C gain as usual and then the payroll should override/apply it with the agreement obtained under the IRP3(q) directive.

23. Submission: It is unclear, from a legislative perspective, if this is the correct treatment. In this regard we refer to paragraph 10 of the Fourth Schedule not applying to paragraph 11A withholding requirements - although SARS were issuing IRP3(q)'s for share gains.

24. Although not directly related to the IRP3(s) directive, an employer will not know when an option will be exercised (as it is up to the employee) so the employer is unlikely to be in a position to get an IRP3(q) in place before the withholding is due unless they apply for one every year regardless. In general, it is difficult to provide a methodology for the IRP3(q) where there may be shares (or other variable compensation) in the mix (or potentially not as the case may be) as these can materially alter the effective tax rates depending on numerous factors. Particularly as the sourcing period applicable to shares can cover multiple years and countries with very different tax regimes for shares vs monthly remuneration which is usually limited to one other country.

25. Submission: We would like to suggest a workshop in order to unpack the practicalities and practices in place for share schemes and the interplay of the section 10(1)(o)(ii) exemption.

26. As mentioned above, one of the fields that needs to be completed on the IRP3(s) is the workday requirement. This is a heavy burden because in some cases an employer would need to look back many years and the compliance costs versus the benefit is questionable. Although it is SARS' view that employers should know where and when their employees are working, it is not always that simple. For instance, where individuals have been working for an overseas entity within the group (before coming/returning to SA), the employer will definitely not have this data. Especially where the employer is only withholding due to perhaps pragmatic reasons under paragraph 11A. Requiring this information suggests

some level of a crystal ball to know where an employee may end up before the end of the sourcing period.

27. Another example of information that would be difficult to obtain, is the R1.25m exemption amount. In instances where employees have gains vesting in March, it is impossible to get the R1.25m data for prior years. Especially in the allowable timeframe as SARS' view is that even under paragraph 11A, withholding is due by the 7th following the month of the taxable event. This poses a problem where it is effectively not in the control of the employer to obtain data timeously which they need to sign off as being true and correct before, the amount has even been assessed (correctly) by SARS. Notwithstanding, the employer remains liable for penalties and in many cases SARS rejects directive applications and/or takes months to resolve (either on SARS or the employee's side).

28. Other than the double withholding that is likely to occur, as the sourcing methodology (work days) combined with the 10(1)(o)(ii) workings is so prescriptive, there are many instances where economic double taxation arises.

29. A foreign employer may have South African resident employee's working for them but these employees have never worked in South Africa. Before, the income would have been fully exempt under 10(1)(o)(ii) but now with the limitations, the overseas employer, under paragraph 11A has an obligation to withhold in South Africa on the share gains of that employee even though there may be no obligation to do so for "normal" remuneration purposes under paragraph 2.

30. To summarise: The directive requires roughly three calculations – one to calculate that the 10(1)(o)(ii) requirements have been met based on the calendar days, one to calculate the work days in each qualifying period and one to calculate the gain/exemption attributable to each year of assessment which regularly does not match the qualifying period calculated.

31. With regard to the qualifying periods that need to be disclosed to SARS (specifically the workday disclosure within those periods), it is our view that this has no discernible value as it does not necessarily tie up with any numbers in the calculations as the qualifying periods can start or end outside the sourcing period or overlap with each other within the sourcing period. It is unclear to us how SARS will use this information to verify the calculations. Furthermore, the questions do not refer to "qualifying" work days outside of South Africa in the year of assessment,

32. Submission: The questions in the SARS Guide should be adjusted to refer to "qualifying" workdays or alternatively return to calendar days to ensure that the calculations are being determined on the same basis. This will ensure that the calculations don't result in mismatches of data and therefore differing tax results.

33. Persons who don't yet qualify for the section 10(1)(o)(ii) exemption as they may have only recently left (or may later qualify as they may for example be short of the 60 days) – no current qualifying period may yet exist - this is problematic as an employer would need to either manipulate or apply for a directive on the full gain and then cancel the directive and reapply again later with the updated data once a qualifying period can be established.

34. Submission: We would like to suggest a workshop in order to unpack the practicalities and practices in place for share schemes, the new directives and the interplay of the section 10(1)(o)(ii) exemption.

35. The directive requires the following declaration by employers: "*I declare that the information furnished is true and correct in every aspect*". When there are so many challenges (and reliance on residency status/calendars etc.), this declaration puts the employer in a tricky situation as they can naturally rely on what the individual provides to them but that doesn't dampen the unease that not all the information may be available and accurate at the time of completion of the directive.

36. Submission: This use of tax directives in the above cases is not ideal considering that international employers already perceive South Africa to be a country where tax compliance is considered to be complex and costly. Offshore parent companies are deciding not offering an alternative to these shares schemes, especially in respect of employee share plans, and the outcome of this is that South Africa is losing out on tax revenue.

37. Share plans are a good way of redistributing wealth within South Africa and the restrictive compliance requirements should be reconsidered, as should section 8B, to promote further foreign currency inflows into the country.

38. Although we understand that the corrections by the employer on the IRP3(s) by recording the exempt days as deductions, will ensure that the individual will be subject to tax only on those South African related days, the employers will not be in a position to accurately provide all the information required to ensure that the calculation is completely correct.

39. It is our understanding that it is South Africa's goal to make ease of doing business in South Africa simpler and easier. The compliance burden with regard to the IRP3(s) directives is one area that could be simplified to not only ease the compliance burden but also to improve the inflow of foreign currency into the country.

40. We conclude by requesting that SARS engage with employers who are involved in this very specialized area of mobile employees before any further changes to Guides and Tax Directive application forms are made as this is a complex area of tax for both employers and employees.

Submission of IRP3(s) tax directive applications

41. Taxpayers are currently experiencing the following additional issues in relation to the submission of the IRP3(s) tax directive applications:

42. Where an individual does not qualify for the section 10(1)(o)(ii) exemption in one of the 12-month periods falling within the vesting period, this results in an error when submitting the tax directive application. An example of this is where an employer had an employee who qualified for the exemption in two years out of three years in the vesting period. The employee worked for 10 days outside South Africa during the non-qualifying 12-month period and the details were therefore not included in the section of the form where it states: "*Indicate the qualifying 12 months period(s) during which the exemption in terms of section*

10(1)(o)(ii) applies". This resulted in an error when trying to submit the form. The employer called SARS and asked what they were supposed to do. The SARS official did not have an answer other than to suggest to the employer that they reflect the non-qualifying workdays under this section and try to submit. The employer did so and the tax directive was issued, however, the portion of the share gain relating to the 10 days was incorrectly taken into account as exempt income. The system therefore does not appear to be able to accurately deal with days worked outside of South Africa during a non-qualifying 12-month period.

43. The second issue relates to the fact that SARS appears to believe that the 12-month periods must be exactly aligned to the vesting period. So if there is a 12-month period that commences before the beginning of the vesting period that could potentially provide a better result, this cannot be used. This has been addressed in point 31 above.

44. The third issue relates to where multiple vestings take place on the same day. The system will accept only one vesting on a particular date and reject all others. The only way to get around this is to change the vesting date for each of the equity instruments by one day.

45. Submission: SARS should provide clarity on how to address these practical concerns. We would like to suggest a workshop in order to unpack the practicalities and practices in place for share schemes and the interplay of the section 10(1)(o)(ii) exemption.

Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

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The South African Institute of Chartered Accountants