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South African Revenue Service
Private Bag X923
Pretoria
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BY E-MAIL: policycomments@sars.gov.za

Dear SARS

COMMENTS ON THE DRAFT INTERPRETATION NOTE 16 (Issue 3): EXEMPTION FROM INCOME TAX: FOREIGN EMPLOYMENT INCOME (Section 10(1)(*o*)(ii))

1. We herewith take an opportunity to present our comments on behalf of the South African Institute of Chartered Accounts' (SAICA) Employees' Tax sub-committee (a subcommittee of the SAICA National Tax Committee) on the draft Interpretation Note 16 (issue 3) dealing with the exemption of foreign employment income from tax in terms of section 10(1)(o)(ii) of the Income Tax Act, No 58 of 1962 (the Act).

2. Our submission includes a discussion of some of the most pertinent matters, which we believe require most urgent attention and we suggest that this submission be read in conjunction with our submission on Draft Interpretation Note 18 (Issue 4) dealing with section 6*quat* of the Act.

3. We would like to thank SARS for the opportunity to provide constructive comments in relation to this draft interpretation note. SAICA believes that a collaborative approach is best suited in seeking actual solutions to complex problems.

CONCERNS

Local versus foreign employers

4. From a policy and administrative perspective, the interpretation note should clearly distinguish the application of section 10(1)(o)(ii) in respect of South African employed outbound employees from its application to foreign employed outbound employees. The interpretation note currently does not distinguish between South African employers and foreign employers (with no representative employer in South Africa).

5. We still believe that much of the confusion and challenges by business with the legislation is also directly related to these matters being combined rather than being addressed separately in the legislation.

6. SARS has financial and audit jurisdiction over the South African employers and those foreign employers with a representative employer in South Africa and this should be considered in reducing the administrative burden on these employers and employees.

7. However, SARS has no such legal authority over foreign employers with no representative employer in South Africa and the Interpretation Note should clearly note this so that such employers are clear on their obligations, if any, in terms of the South African law.

8. Submission: Interpretation Note 16 should be updated to clarify that SARS only has financial and audit jurisdiction over the local South African employers employing South African outbound employees. Foreign employers (that have no representative employer in South Africa) are not bound by this Interpretation Note and the outbound employees of these entities would be required to pay provisional tax on the foreign remuneration received by them.

9. The IRP 6 forms would require amendments to clearly cater for the disclosure of the foreign remuneration, the section 10(1)(o)(ii) exemption and the section 6*quat* rebate.

The interpretation relevant to the treatment of travel allowances

10. Paragraph 4.1.1 of the draft Interpretation Note deals with "remuneration", however, it does not provide any specific reference to the treatment of a travel allowance.

11. However, in the Frequently Asked Questions: Foreign employment income exemption (Section 10(1)(o)(ii) of the Income Tax Act, 1962) – Issue 2, recently published by SARS, it provides the following two questions and answers relating to travel allowances:

    FAQ11: If I receive a travel allowance and a portion of the allowance is exempt under section 10(1)(o)(ii), can my taxable income be reduced in respect of all my business kilometres travelled?

    SARS answer: Your taxable income can only be reduced in respect of business kilometres travelled during the period when the allowance was included in taxable income.

    FAQ12: If I received remuneration in excess of R1 million, which includes a travel allowance, how will the R1 million exemption be attributed on assessment in respect of the travel allowance?

    SARS answer: The R1 million exemption must be apportioned on a pro rata basis between the travel allowance and the total remuneration.

12. The word 'allowance' came into section 10(1)(o)(ii) in 2007. Section 16(g), of the Revenue Laws Amendment Act, 2007, deleted from the words preceding subparagraph (i), in subsection (1)(o), the following words: "*as defined in paragraph 1 of the Fourth Schedule*". It then added (section 16(i) of this Act), amongst others, the words "*by way of any … allowance"* to section 10(1)(o)(ii).

13. The Explanatory Memorandum explained it as follows:

> *"… the ambit of the exemption be limited to specific types of remuneration for services rendered and not to all the types of income included in the definition of 'remuneration' in paragraph 1 of the Fourth Schedule to the Income Tax Act".*

14. It then is evident that the intention was to include, as amounts qualifying for the section 10(1)(o)(ii) exemption, only certain amounts. At the time, 60 per cent of the amount of any allowance or advance in respect of transport expenses referred to in section 8(1)(b) was included in remuneration – the 60% has since been increased to 80%.

15. In terms of section 8(1)(a)(i)(aa), of the Income Tax Act, any amount which has been paid or granted during a year by his or her principal as an allowance or advance, must be included in the taxable income of the person (referred to as the 'recipient'). The amount to be included in taxable income excludes any portion of any allowance or advance actually expended by that recipient on travelling on business.

16. In the Income Tax Act, unless the context otherwise indicates, "**income**" means the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II – see section 1(1). "Gross income", as defined in section 1(1), doesn't include an amount referred to in section 8(1).

17. However, section 10(1)(o)(ii) specifically includes, for purposes of the exemption, … *an amount referred to in section 8*. It of course also includes other amounts. It appears that the intention was to exempt from normal tax the "portion of any allowance or advance actually expended by that recipient" as envisaged by section 8.

18. Footnote 5, in the draft Interpretation Note, states that in the context of section 10(1)(o)(ii), this refers to "allowances, advances and reimbursements under section 8(1)".

19. The Taxation Laws Amendment Act, 2019, amends section 8(1) and it reads as follows:

> *There shall be included in the taxable income of any person (hereinafter referred to as the 'recipient') for any year of assessment any amount which has been paid or granted during that year by his or her principal as an allowance or advance, excluding any portion of any allowance or advance <u>to the extent that allowance or advance or a portion of the allowance or advance is exempt from normal tax under section 10(1) or has</u> actually <u>been</u> expended by that recipient …*

20. The draft Explanatory Memorandum explains the amendment to section 8 as follows:

> *"Currently, section 10(1)(nA) of the Act makes provision for exemption in respect certain employment-related allowances, for example, a uniform allowance. As a result, if the allowance is exempt in terms of section 10(1)(nA), such amount is excluded from "income" as defined in the Act. However, section 8(1) of the Act includes any such allowance, that is for example exempt in terms of section 10(1)(nA) of the Act directly into a person's taxable income. This means that, notwithstanding that the allowance is exempt, it becomes subject to tax as a result*

of its direct inclusion into taxable income in terms of section 8(1) of the Act. In order to address this anomaly, it is proposed that changes be made in section 8(1) of the Act to exclude exempt allowances or advance in terms of section 10(1) from taxable income".

21. The same will apply with respect to the travel allowance. The allowance is not included in gross income and it is therefore not possible that the 'unspent portion' of the allowance or advance can be *exempt from normal tax under section 10(1)*. It will be included in taxable income. It can then not reduce the allowance for purposes of section 8(1) either.

22. Based on the same principles, the SARS view that the allowance must be apportioned is also not supported by the law.

23. Whilst the words, "*to the extent*" would allow for apportionment, because no part of the allowance qualifies for the exemption, no apportionment (on a pro rata basis or otherwise) can be made.

24. Submission: It is suggested that the treatment of allowances is specifically dealt with in the Interpretation Note. It would be appropriate to also add examples.

25. The answers in the FAQ's should also be amended.

26. Another amendment to the FAQ's that is required is the reference to "financial emigration" in question 18. Despite numerous media articles using this term, the Financial Surveillance Department at the South African Reserve Bank have stated that there is no such thing as "financial emigration". A person can either emigrate for exchange control purposes or become a non-resident for tax purposes, but these are two distinct processes with different requirements and outcomes.

27. It is suggested the FAQ's document be amended to utilise the correct terminology for exchange control purposes and to clearly explain the differences between the exchange control and tax processes for emigration/becoming a non-resident so as to clarify the confusion currently abound in the market place.

28. As the travel allowance will not be exempt in terms of section 10(1)(o)(ii), employees earning below the R1 million exemption threshold will still be subject to tax on this amount. This seems to defeat the intention of the blanket R1 million exemption.

29. A further concern relating to the travel allowance, is the employees' tax implications thereof. Should an employee earn more than R1 million and receives a travel allowance, this travel allowance will be subject to employees' tax. Should this amount be subject to tax in the foreign country as well, the employee could be at a cash-flow disadvantage until the assessment stage, especially if the employee travels extensively. This is particularly true if the concerns regarding the documentation requirements discussed from point 42 below are taken into account.

30. Submission: To ensure that the policy intent of the changes to section 10(1)(o)(ii) are achieved, the taxation of the travel allowance for those employees' earning below R1 million should be reconsidered.

31. Various options are available to assist employees that are out of pocket until the assessment date in respect of travel allowances. A more accurate assessment of the private travel could be made (very administratively burdensome) or travel allowances received by the employees working abroad could be excluded from the ‘remuneration’ and taxed only on assessment, although this would still not solve the problem for those earning below R1 million. Alternatively, section 10(1)(o)(ii) could refer to ‘remuneration’ as defined in the Fourth Schedule, but any necessary amendments as required above could made to that definition instead of changing the definition of ‘remuneration’ in the Fourth Schedule.

Employees’ tax implications on fringe benefits

32. The introduction of the R1 million limit has necessitated that employers of outbound employees now have to account for and quantify each and every potential fringe benefit (according to South African income tax law) resulting from a foreign assignment. The result is that a large number of foreign-sourced fringe benefits, that are not regarded as fringe benefits in the foreign country, now have to be accounted for in the South African payroll (taking the DTA into account). Payroll personnel will now have to be upskilled in order for them to be in a position to work through the complex scenarios that result from global employment. Clear guidance on the tax treatment of these fringe benefits is therefore required, but the draft Interpretation Note is silent on these matters other than saying the fringe benefits are taxable according to the Seventh Schedule.

33. There will also be no payroll support for these benefits in the foreign country and the taxation implications and documentary proof required in relation to these benefits would now need to be explained to the employees.

34. The starting point for determining the taxation treatment of these benefits, provided in the foreign countries, is ascertaining whether the amounts paid by the employer (that would in normal circumstances be regarded as a fringe benefit in South Africa) are actually fringe benefits. In some circumstances, these benefits are a necessity, not a personal benefit for the employee. An example of this is the armed escorts to/from the airport to the ‘compound’ where the employee will be staying in the foreign country, to prevent kidnappings for instance. These scenarios will require payroll personnel to work through all the different types of scenarios per employee (per country) before being in a position to determine whether or not a payment is a fringe benefit for purposes of the Seventh Schedule (something that they have not been required to do before in respect of these foreign payments).

35. Should the amounts paid qualify as a fringe benefit in terms of the Seventh Schedule, the taxable amounts will need to be calculated subject to the valuation methodologies in the South African legislation. An example of where this becomes problematic is, for instance, the residential accommodation fringe benefit. In this instance, a South African employer would need to get the details about the number of rooms, electricity or fuel payments paid in the foreign country. Although not impossible to obtain the necessary information and calculate the fringe benefit, the timing of receipt of the documents and the administrative burden in this regard is what is of concern.

36. The translation of the fringe benefits on a monthly basis also needs further consideration as the Frequently Asked Questions states the amounts need to be translated at the

average exchange rate. This is problematic for employees' tax purposes as the average exchange rate will not be known until the end of the year of assessment (see points 57 – 66 below).

37. Submission: Further time is requested to implement the proposed changes as employers will be required to upskill their payroll staff and communicate the changes to their employees working abroad to ensure that they are aware of them and how it affects them. A change in employment contract might also be necessitated. The employees/employers will also be required to obtain the necessary supporting documentation to ensure that the fringe benefit is correctly calculated and the correct tax is withheld (taking the DTA into account). The supporting documentation will also become important if a foreign tax rebate is claimable (where applicable). More guidance on these matters (especially the supporting documentation – see points 49 - 53 below) is requested.

38. Regarding the residential accommodation fringe benefit, it is suggested that the housing fringe benefit be based on **cost** rather than the **formula** provided for in the Seventh Schedule as the cost to the employer of this benefit is readily available. This change will reduce the administrative burden in calculating this fringe benefit. As regards employer owned property, it is suggested that the cost of a similar residence be obtained and used as the value on which the fringe benefit is determined.

39. Alternatively, a similar exemption to that applicable to inbound expatriates (paragraph 9(7A)) for a period of 2 years would alleviate the complexity in this environment.

40. From an employees' tax perspective, to cater for the difficulties mentioned above on a monthly basis, it is suggested that only a percentage (eg. 80%) of the value of the fringe benefits that are taxable (ie. where the R1 million limit is exceeded) be included in remuneration (as is currently allowed for the travel allowance).

41. It is suggested that the treatment of fringe benefits be specifically dealt with in the Interpretation Note. It would be appropriate to also add examples to specifically show how the ordering of the fringe benefits that exceed the R1 million (ie. that are only partly exempt) are taken into account.

Employees' tax implications and directives

42. The following was added to the draft Interpretation Note (last paragraph in paragraph 4.2):

> "*An employer may at his or her discretion, under paragraph 10 of the Fourth Schedule, apply for a directive from SARS to vary the basis on which employees' tax is withheld monthly in the Republic. The potential foreign tax credit is taken into account to determine the employees' tax that has to be withheld for payroll purposes. This is not the actual granting of the section 6quat credit. The employee is still required to submit an income tax return in which the actual foreign tax credit under section 6quat should be claimed*".

43. The withholding of employees' tax is relevant where the employer is an employer that is registered in terms of paragraph 15 of the Fourth Schedule (local employer or a foreign employer with representative in South Africa); the employee works outside the RSA and

the foreign country also requires the withholding of a tax on the remuneration. The fact that both countries will then withhold an amount for tax will result in a cash flow problem for the employee.

44. The proposed practice general prevailing is that the employer must apply for a directive to solve this problem. The legislation deals with the application for a directive in paragraph 10 of the Fourth Schedule. However, paragraph 10 is subject to paragraph 2(4) and 11.

45. The problem is that paragraph 2(4) of the Fourth Schedule to the Income Tax Act doesn't allow for the employer to take the foreign tax into account when the amount of employees' tax that is to be withheld from this remuneration is determined. It is agreed that the section 6*quat* rebate is only granted on assessment.

46. Paragraph 11 does not appear to permit an application for a directive in these circumstances. In terms of paragraph 11(a)(ii), SARS will only authorise the employer:

> *"to refrain from deducting or withholding any amount … by way of employees' tax from any remuneration due to any employee of that employer; or*
>
> *to deduct or withhold by way of employees' tax from any remuneration in terms of paragraph 2, a specified amount or an amount to be determined in accordance with a specified rate or scale,*
>
> *<u>in order to alleviate hardship to that employee due to circumstances outside the control of the employee".</u>*

47. <u>Submission</u>: It is suggested that paragraph 11 of the Fourth Schedule be amended to specifically deal with this application for a directive in these circumstances. In other words, to add to paragraph 11, "*in order to take into account a foreign tax that is withheld from the same remuneration*".

48. Assuming that the directive application route is 'correct', it is submitted that this is an onerous and protracted process that, considering the number of applications, is likely to place more strain on SARS' resources and it will also be administratively burdensome for the relevant employers.

49. SARS generally requires copious amounts of information before granting a directive which may result in valuable time being lost and the employee being subjected to cash-flow constraints.

50. <u>Submission:</u> Legislative clarity with regard to the application for a directive in the abovementioned circumstances is required.

51. Detailed guidelines should be provided regarding what documentation would be acceptable for purposes of claiming the foreign tax credit through the payroll, specifically in respect of countries where no income tax assessment is issued by the revenue authorities (self-assessment system), no tax return is required (i.e. all taxes are payable via the payroll) – similar to what has been mentioned in draft Interpretation Note 18 (Issue 4).

52. The format in which these documents should be submitted to SARS should also be clarified.

53. Without this clarity, employees will be subject to double taxation until SARS grants a refund, creating a serious cash-flow issue or shortfall until the refund is granted. This probability leaves our members uncomfortable given the refund history of SARS in recent years.

54. The timing of the payment of foreign taxes required to enable a claim through the payroll is also of importance.

55. Often the taxes are paid on foreign amounts at different times. For example, if the payroll is in South Africa and taxes are only due on assessment in the foreign country, the question arises what is the timing for purposes of the foreign tax credit claim.

56. Submission: We recommend that SARS consider this matter in the Interpretation Note especially where foreign tax differences may arise.

Translating remuneration to the currency of the RSA

57. The next problem that arises with respect to employees' tax is where the employer, registered as such with SARS, uses a foreign currency to remunerate the employee. The Interpretation Note does not deal with this at all.

58. Under section 25D(3) of the Act *the employee* may elect that all amounts received by or accrued to, or expenditure or losses incurred by that person in any currency other than the currency of the Republic, be translated to the currency of the Republic by applying the **average exchange rate** for the relevant year of assessment.

59. *The employer*, specifically where the employer is a company, must translate any expenditure incurred by it during the year of assessment in any currency other than the currency of the Republic, to the currency of the Republic by applying the **spot rate** on the date on which that amount was so received or accrued or expenditure or loss was so incurred.

60. This may result in an employer providing the employee with an IRP5 where the amounts of remuneration were translated using the spot rate. The employee may then want to apply the average exchange rate for the relevant year of assessment, but would not be able to amend the amounts on the IRP5.

61. Submission: This problem can be solved by allowing the employee to make an adjustment on the ITR12 income tax return. This should be catered for in the law and on the ITR12 tax return.

Translating remuneration and foreign tax to the currency of the RSA

62. In terms of section 6*quat*(4), the amount of any foreign tax proved to be payable as contemplated in subsection (1A) or any amount paid or proved to be payable as contemplated in subsection (1C) in respect of any amount which is included in the taxable

income of any resident during any year of assessment, shall be translated to the currency of the Republic on the last day of that year of assessment by applying the **average exchange rate** for that year of assessment.

63. The problem here is, where the employer applies for a directive, as proposed in the draft Interpretation Note (see comments above), it is unclear what exchange rate should be used. The average exchange rate for that year of assessment will only be known on the last day of the year of assessment.

64. As defined in section 1(1) of the Act, "**average exchange rate**" in relation to a year of assessment means the average determined by using the closing spot rates at the end of daily or monthly intervals during that year of assessment which must be consistently applied within that year of assessment.

65. Submission: For purposes of the directive the spot rate at the end of the month can be used, but it would then require an adjustment to be made on the last day of the year of assessment.

66. This issue must be dealt with in the Interpretation Note. It is possible that an amendment to the Act may well be necessary.

Apportionment of income (paragraph 4.3 of the draft Interpretation Note)

67. Paragraph (C) of the proviso to section 10(1)(o)(ii) states that, for the purposes of section 10(1)(o)(ii):

> *where remuneration is received by or accrues to any employee during any year of assessment in respect of services rendered by that employee in more than one year of assessment, the remuneration is deemed to have accrued evenly over the period that those services were rendered*.

68. An example of when such an apportionment is required would be a bonus that accrues in one year but in relation to services rendered in both the current and the previous year; or a gain included in income under section 8C.

69. We agree with the changes made, by adding the words 'accidental' and 'incidental' in the sentence below and they are welcomed:

    "… *if the services rendered inside the Republic by a person are merely casual and accidental, or subsidiary and incidental, then the originating cause of the employment income will be fully outside the Republic and no apportionment will be necessary*."

70. The current practice generally prevailing, however, is that "*it is accepted that it is correct to apportion income if it is clear that a portion of such income relates to services rendered both inside and outside the Republic*." Example 2 in the draft Interpretation Note illustrates SARS's view of how apportionment should be done.

71. What is not recognised in the example is the fact the amounts that accrue to the individual in respect of the services rendered in the foreign country, New Zealand, may differ from

the amounts that the individual may be entitled to in respect of the services rendered in the RSA. By applying the apportionment method as suggested in the draft Interpretation Note, a part of the amount directly attributed to the foreign services will actually be excluded from the exemption.

72. Submission: It is suggested that the apportionment should only applied to amounts that remain the same, and that amounts of remuneration that accrue to the employee in respect of the services rendered abroad be excluded when the formula is applied.

The IRP5 and the codes to be used

73. In paragraph 5 of the draft Interpretation Note it is stated that:

> "*code 3652 may not be used for any remuneration item that may qualify for exemption under section 10(1)(o)(ii) as there are specific foreign income source codes for each item that should be used. If an employer discloses any foreign sourced income under code 3652, the exemption under section 10(1)(o)(ii) will not be applied on assessment*."

74. The following is added in the draft Interpretation Note:

> "*An employer that is satisfied that the exemption under section 10(1)(o)(ii) applies, should disclose the salary income in the following way: To the extent that the remuneration is exempt, it must be disclosed under the foreign income source code indicating the amount from which no employees' tax was withheld, and if the remuneration exceeds R1 million and becomes subject to normal tax, the excess remuneration should be disclosed as a separate line item under the same foreign source code indicating the amount from which PAYE was withheld*."

75. The example that is given, applies this interpretation, and explains it as follows:

- Code 3601 – Salary earned in South Africa (if applicable), subject to normal tax.
- Code 3651 – Salary earned outside of South Africa that is less than R1 million and exempt under section 10(1)(o)(ii) with no PAYE.
- Code 3651 – Salary earned outside of South Africa that exceeds R1 million, with PAYE.

The above principle will apply in the same way to all relevant remuneration items.

76. This is an incorrect interpretation of the Act.

77. In terms of paragraph 13, of the Fourth Schedule, *an employees' tax certificate … shall show the total remuneration of such employee* … As defined, in paragraph 1 of the same Schedule, *"remuneration" means any amount of income …* The amount that is exempt from normal tax under section 10(1)(o)(ii) is not 'income' and it should therefore not be reflected on the IRP5.

78. Submission: It is agreed that the employer will have to use a code for this amount, but the code 3651 can't be used. It is suggested that a new unique code be provided by SARS to be used for this. It should be included in the Interpretation Note and an example should be added.

Impact on section 10(1)(gG)

79. Section 10(1)(gG) of the Act makes provision for the exemption of amounts received from risk policy benefits, where the premiums paid by an employer have been deemed to be a taxable benefit.

80. However, with the proposed changes to section 10(1)(o)(ii), certain or all of the premiums paid might fall within the R1 million exemption and no longer be regarded as a taxable benefit in terms of sub-paragraph (a) of the definition of "taxable benefit" in paragraph 1 of the Seventh Schedule to the Act.

81. Submission: The legislation should make it clear whether the section 10(1)(gG) exemption still applies under these circumstances or how section 10(1)(o)(ii) of the Act would interact with section 10(1)(gG).

CONCLUSION

82. With no final clarity on the above challenges with regard to section 10(1)(o)(ii) likely to be forthcoming before the end of 2019 and with only a two-month period thereafter before its implementation date, it seems unreasonable of SARS and National Treasury to expect employers to affect the required amendments to their payroll systems.

83. We urge the National Treasury to postpone the implementation date of the changes to section 10(1)(o)(ii) to provide employers with time to amend their payroll systems and to cater for the other administrative and legislative changes that are required in order to comply with the law as envisaged by the National Treasury and SARS.

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

Yours sincerely

Tarryn Atkinson
Chairperson: Employees' Tax Sub-Committee

Dr Sharon Smulders
Project Director: Tax Advocacy

The South African Institute of Chartered Accountants