14 OCTOBER 2016

TAX AND EXCHANGE CONTROL ALERT

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TAXABLE BENEFITS PROVIDED TO EXPATRIATE EMPLOYEES SECONDED IN SOUTH AFRICA

The nature of the business of many multinational companies requires them to send their employees to other countries across the globe in order to, among other things, manage and assist with special projects, implement firm-wide systems and ensure a standard level of quality in operations. Such seconded employees are often subject to tax in their host country, yet remain tax residents in their home country.

A STEP IN THE RIGHT DIRECTION: SMALL BUSINESS CORPORATIONS REGIME EXTENDED TO PERSONAL LIABILITY COMPANIES

On 8 July 2016, National Treasury (Treasury) released a draft Taxation Laws Amendment Bill (TLAB) and specific draft regulations related thereto, all of which aim to give effect to the various tax proposals announced in the 2016 National Budget Speech. One of these proposals relates to the extension of the small business corporations (SBCs) tax regime to personal liability companies (PLCs).

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TAXABLE BENEFITS PROVIDED TO EXPATRIATE EMPLOYEES SECONDED IN SOUTH AFRICA

In order to avoid the potential double taxation of remuneration, many multinational companies implement a tax equalisation package with employees, whereby the tax on remuneration for the seconded employees remains the same regardless of where they are working in the world.

The Tax Court had to consider issues arising as a result of the tax arrangements entered into between the host country employer and its expatriate employees who were seconded from their home countries to work in South Africa.

The nature of the business of many multinational companies requires them to send their employees to other countries across the globe in order to, among other things, manage and assist with special projects, implement firm-wide systems and ensure a standard level of quality in operations. Such seconded employees are often subject to tax in their host country, yet remain tax residents in their home country.

In order to avoid the potential double taxation of remuneration, many of these companies implement a tax equalisation package with such employees, whereby the tax on remuneration for the seconded employees remains the same regardless of where they are working in the world. In other words, it is agreed between the relevant parties, that the host country company will cover all taxes incurred on remuneration derived in the host country, such that the seconded employee is in the same tax position as if he were working solely at home. This mechanism is seen as useful in attracting many employees to sign up and agree to secondments which is essential to the sustainability of such businesses.

In ABC (Pty) Ltd v C:SARS, as yet unreported, Tax Court (Johannesburg), Case No. IT13775, handed down on 29 April 2016, the Tax Court had to consider issues arising as a result of the tax arrangements entered into between the host country employer (Taxpayer) and its expatriate employees who were seconded from their home countries to work in South Africa under a similar arrangement as described above.

Facts

Without repeating the facts verbatim, the following was relevant:

- the Taxpayer was part of the ABC Group, a worldwide organisation which required its various operations throughout the world to operate on a similar basis and apply similar standards;
- as part of its global business imperative, employees of the ABC Group were required to work for short or medium term periods in foreign countries;
- invariably these seconded employees remained residents in their home countries and continued to submit tax returns there;
- the standard employment relationship within the ABC Group operated on a tax equalisation basis as described above but which essentially involved the expatriate employees paying the exact same effective rate of tax in their host country as they would have paid had they remained in their home country;
- in order to protect the interests of the Taxpayer and the ABC Group, payments were made to identified tax consultancy firms for services rendered in respect of the Taxpayer's expatriate employees; and
- the employees had no choice regarding the provision of the tax consultancy services as it was one of their conditions of employment.

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Keightley J held that the tax consultancy services which were provided free of charge to the expatriate employees were benefits with a monetary value and accordingly fell within the definition of "gross income".

Issues

The parties were in agreement that the following two issues needed to be considered by the court:

- whether the payments made by the Taxpayer to the tax consultants fell within the ambit of paragraph (i) of the definition of "gross income" in s1 of the Income Tax Act, No 58 of 1962 (Act) and, if so;
- whether the payments constituted taxable fringe benefits within the ambit of paragraphs 2(e) or 2(h) of the Seventh Schedule to the Act.

First Issue: whether payments made fell within definition of paragraph (i) of gross income of expatriate employees

The first question which needed to be considered was whether the expatriate employees received or accrued any benefit or advantage from the Taxpayer's payment of the tax consultancy fees within the meaning ascribed in paragraph (i) of the definition of "gross income".

The Taxpayer's main contention that the expatriate employees received no benefit or advantage was that such employees were not placed in a better financial position as a result of the tax consultancy services than they would be without them being provided. Furthermore the expatriate employees' position was not improved as a result of the Taxpayer's payments to the tax consultants and the utilisation of their expertise because the employees' salary and tax obligations remained the same as a result of the tax equalisation arrangement.

SARS's main counter-argument was that the tax consultancy fee paid by the Taxpayer in respect of the expatriate employees was a benefit for which they otherwise would have had to pay had the agreement between the Taxpayer and the employees not provided differently. In other words, while there was no outward increased benefit to the Taxpayer's financial position, there was also no reduction as a result of having to pay such expenses out of their own pockets in the ordinary course.

Keightley J held that SARS's argument was consistent with the historic case law and that the tax consultancy services which were provided free of charge to the expatriate employees were benefits with a monetary value and accordingly fell within the definition of "gross income". Therefore the Taxpayer's argument that there was no actual outward benefit to the expatriate employees' financial position was not relevant.

Analysis

The very nature of a taxable benefit is that it often involves a salary sacrifice which is a substitution of a cash component of an employee's overall cost to company remuneration package, for a non-cash benefit, that may result in a lower amount subject to the deduction of employees' tax. As it happens, paragraph (i) of the "gross income" definition refers to the "cash equivalent value" rather than an "amount". As the value of such benefits are often difficult to establish, the Seventh Schedule provides for specific calculation methods in this regard. It therefore follows that, in addition to the court's reasons for its decision on this issue, the Taxpayer's argument would not, in my view, hold water as it matters not whether employees are placed in a better financial position

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The court agreed with SARS contentions and held that if one had regard to the actual nature of the services rendered they were for the employees' private use, which was to comply with the individual tax obligations of the employees with SARS.

or not, but rather whether a benefit has been granted which has a "cash equivalent value" calculated in accordance with the Seventh Schedule to the Act. Clearly where payments are made by employers on behalf of employees for services provided to employees for private purposes, such payments will result in a measurable "cash equivalent value".

Second issue: whether the benefits granted were taxable under either paragraph 2(e) or 2(h) of the Seventh Schedule to the Act

The crux of the second issue was whether the employees had utilised the tax consultancy services for their private or domestic purposes. Importantly, the parties agreed that, to the extent that the tax consultancy services were not wholly utilised for the employees' private use but also partly for the use of the employer's business, then such payments would fall outside of paragraph 2(e) of the Seventh Schedule to the Act.

The Taxpayer's main argument in this regard was therefore that the contractual relationship between it and the employees were such that the Taxpayer was bound to pay the employees' tax and that the services of the tax consultant were, at the very least, partially for the Taxpayer's own business purposes. As it so happened, any refunds due by SARS were in fact paid over to the Taxpayer and not the expatriate employees.

SARS on the other hand, stated that when considering the actual services rendered, they were plainly for the employees' domestic or private use, which was demonstrated in the description of the services in question, namely registration/de-registration as a taxpayer with SARS, preparation and submission of annual income tax returns, and review of annual income tax assessments. In essence these services related solely to the individual tax obligations of each employee and were quintessential to the relationship between SARS and the individual employee taxpayer.

The court agreed with SARS's contentions and held that if one had regard to the actual nature of the services rendered they were for the employees' private use, which was to comply with the individual tax obligations of the employees with SARS. Keightley J, however, pointed out that while it may be so that, as between the Taxpayer and its expatriate employees, the intention of obtaining services was also to assist the Taxpayer to fulfil its contractual obligations to those employees, such consideration of the intention of the parties was not the determinative factor.

Keightley J thereafter, referred to *CSARS v Brummeria Renaissance (Pty) Ltd 69 SATC 205*, in which the Supreme Court of Appeal (SCA) held that even though a receipt or accrual is in a form other than money (in that case the benefit of the use of an interest-free loan), which cannot be alienated or turned into money, it did not mean that the receipt of the right has no monetary value. The *Brummeria* case stated that the test to be applied in order to determine whether a receipt or accrual has a monetary value is therefore an objective one and not subjective. The learned judge in the *ABC* case then applied the *Brummeria* principle in considering from an objective point of view, whether the tax consultancy services were for private use.

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The judgment re-emphasises that employers must be very careful when making any payments for and on behalf of employees no matter the extent of agreements between the parties and what their intentions are.

Analysis

There is an argument that the application of the objective test in the *Brummeria* case as to whether something is utilised for private or domestic purposes is slightly misconstrued. This argument is based on the fact that, in *Brummeria*, the court applied such a test within a slightly different context. Despite this argument, the objective test is nevertheless the correct one as the court should look to the purpose of the cheap or free services and not the intention of the parties in providing such services. This is consistent with the literature on the issue and the parties in *ABC* agreed to this approach.

What is not clear from the judgment is the exact nature of the business of the Taxpayer and the ABC Group. To the extent that the Taxpayer could prove to the court that its business was of such a nature that it had to second employees offshore but that in order to attract such employees it had to offer tax equalisation packages, then the case may have had a different outcome. In other words, there may be a persuasive argument in favour of the Taxpayer that, in the event of the tax equalisation packages not being offered to employees, then such employees would not agree to secondments which would be irreparably detrimental to the ongoing sustainability of the Taxpayer's business and therefore not wholly expended for the employees' private purposes. Unfortunately, the judgment is silent on any such evidence or arguments put forward in this regard.

Conclusion

The judgment re-emphasises that employers must be very careful when making any payments for and on behalf of employees no matter the extent of agreements between the parties and what their intentions are. Even to the extent that such services are provided voluntarily by the employer without regard to the employee's requirements, such as security services at a key employee's home, it is often difficult to ensure such benefits fall outside of fringe benefits tax as contemplated in the Seventh Schedule to the Act.

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A STEP IN THE RIGHT DIRECTION: SMALL BUSINESS CORPORATIONS REGIME EXTENDED TO PERSONAL LIABILITY COMPANIES

The SBC tax regime, which was introduced in 2001 to stimulate development and encourage fixed capital formation, allows for certain concessions to entities which comply with the definition of a SBC as set out in s12E(4)(a) of the Income Tax Act.

On 8 July 2016, National Treasury (Treasury) released a draft Taxation Laws Amendment Bill (TLAB) and specific draft regulations related thereto, all of which aim to give effect to the various tax proposals announced in the 2016 National Budget Speech. One of these proposals relates to the extension of the small business corporations (SBCs) tax regime to personal liability companies (PLCs).

According to the Explanatory Memorandum to the TLAB, the scope of the definition of SBC was "intentionally limited to curb the disguise of passive income and remuneration as business earnings".

By way of background, the SBC tax regime, which was introduced in 2001 to stimulate development and encourage fixed capital formation, allows for certain concessions to entities which comply with the definition of a SBC as set out in s12E(4)(a) of the Income Tax Act, No 58 of 1962 (Act). The concessions are in the form of progressive tax rates applicable to entities qualifying as SBCs (ie 0%, 7%, 21% or 28%) and the granting of special allowances for the manufacturing assets used by SBCs. These allowances include a 100% tax deduction for the costs of new and unused manufacturing plant and machinery brought in to use by the SBC as well as a three-year accelerated write-off for other types of assets.

As mentioned above, for an entity to qualify as a SBC, the entity must meet certain requirements which comprise four key areas, namely (i) a legal entity requirement, (ii) a holder of shares requirement; (iii) a gross income limitation requirement, and (iv) a business activity requirement. For purposes of this article, we will only discuss the legal entity requirement.

Legal entity requirement

When the SBC tax regime was introduced in 2001, one of the requirements for qualifying as a SBC was that the taxpayer had to be a juristic person in the form of a close corporation or a company registered as a private company in terms of the then applicable Companies Act, No 61 of 1973 (Old Companies Act). According to the Explanatory Memorandum to the TLAB, the scope of the definition of SBC was "intentionally limited to curb the disguise of passive income and remuneration as business earnings". The reasoning for such limitation was that such a disguise would have allowed persons rendering professional services to take advantage of the progressive tax rates that apply to SBCs instead of having the disguised passive income and remuneration taxed at 28%.

As a result of the abovementioned limitation, an entity could not qualify as a SBC, if more than 20% of its income and capital gains was made up of passive income and income earned by the entity as a result of rendering certain professional services which were performed by a person who held an interest in the entity.

The abovementioned limitation was relaxed in 2005 and entities that rendered personal services could qualify as SBCs (provided that they employed at least three full-time employees who did not have an interest in the entity and were not "connected persons" (as defined) in relation to those that have an interest in the entity).

Under the Old Companies Act, a PLC fell within the definition of a private company. Historically therefore, PLCs could have qualified as SBCs. This situation, however,

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The move to include PLCs in the SBC tax regime will be welcomed by qualifying PLCs as such inclusion is in line with the objectives of the SBC tax regime, namely the development and fixed capital formation of SBCs.

no longer prevails due to the fact that when the new Companies Act, No 71 of 2008 came into effect, PLCs were expressly excluded from the definition of a private company. Consequently, PLCs, which in most cases render personal services, cannot qualify as SBCs for tax purposes and as a result cannot benefit from the SBC tax regime.

In order to rectify this anomaly, Treasury proposed that PLCs be expressly included in the definition of SBC in s12E(4) of the Act. However, PLCs will be subject to the requirement of employing at least three full-time employees who do not have an interest in the entity nor are related to any person who has an interest in the entity.

The TLAB proposed that the abovementioned proposal would take effect as of 1 March 2016. Pursuant to the public consultation process regarding the amendments proposed by Treasury, the Standing Committee on Finance indicated in its Draft Response Document dated 21 September 2016, that PLCs will benefit from the SBC regime in respect of the years of assessment commencing from the 2013 year of assessment, as the years of assessment prior to that would have prescribed.

In conclusion, it is quite clear that the move to include PLCs in the SBC tax regime will be welcomed by qualifying PLCs as such inclusion is in line with the objectives of the SBC tax regime, namely the development and fixed capital formation of SBCs.

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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 3 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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