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TAX & EXCHANGE CONTROL ALERT

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Draft tax amendment bills published for public comment: Changes to the employment tax incentive regime

On 28 July 2021, National Treasury and the South African Revenue Service (SARS) published the 2021 draft Taxation Laws Amendment Bill (2021 Draft TLAB) and the 2021 draft Tax Administration Laws Amendment Bill. The draft bills give effect to the announcements made in the 2021 Budget Speech pertaining to tax policy proposals.

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Draft tax amendment bills published for public comment: Changes to the employment tax incentive regime

In this article we briefly discuss one of the key proposed amendments: the amendments to the definition of “employee” in respect of the employment tax incentive (ETI).

On 28 July 2021, National Treasury and the South African Revenue Service (SARS) published the 2021 draft Taxation Laws Amendment Bill (2021 Draft TLAB) and the 2021 draft Tax Administration Laws Amendment Bill. The draft bills give effect to the announcements made in the 2021 Budget Speech pertaining to tax policy proposals.

We intend publishing specific comments and observations in relation to the proposed amendments over the coming months while the draft bills undergo their usual public consultation process. However, in this article we briefly discuss one of the key proposed amendments: the amendments to the definition of “employee” in respect of the employment tax incentive (ETI).

Background

On 22 July 2021, we published an [article](#) on SARS’ Binding Private Ruling 367 (BPR 367) which determined that students in a proposed training programme would not be considered “employees” as contemplated in the Employment Tax Incentive Act 26 of 2013 (ETI Act). BPR 367 also determined that the applicant taxpayer would not be entitled to claim an ETI in respect of any of the employees in question. We commented that BPR 367 may give some insight into National Treasury’s proposal in the 2021 Budget to amend the definition of “employee” in the ETI Act to counter certain abusive schemes in the market. It was further noted that imminent publication of draft legislation giving effect to the proposal would provide a better idea of the policy rationale behind the proposed change to the definition of “employee” (and the extent of the amendment).

Reasons for change

In the Draft Explanatory Memorandum to the 2021 Draft TLAB (Memo), National Treasury states that it has identified that some taxpayers have implemented certain schemes where they claim the ETI in respect of individuals who do not work for them, thereby failing to meet the definition of “employee” as outlined in section 1(1) of the ETI Act. The Memo comments that the nature of these schemes is (simply) to market and utilise the ETI as a means of facilitating the entry of qualifying, unskilled, inexperienced, previously disadvantaged South Africans into the modern economy.

Page 6 of the Memo clarifies the arrangement that is under Government’s microscope (the facts of which are similar to BPR 367):

“Eligible participants are recruited by a recruitment agency and employed by a participating employer for a fixed term period of 12 to 24 months. Participating employers engage with the recruitment agency to recruit eligible participants. Contracts signed by the eligible participants indicate the receipt of remuneration while ‘employed’ by the participating employer. Once ‘employed’, participants are trained by a training institution (over the 12 to 24 month period) and, in some cases, enrolled in Sector Education and Training Authority (SETA) accredited courses. The training institution is contracted by the participating employer at a cost equal to the remuneration stated in the eligible participant’s contract. The remuneration stipulated in the contract is paid to the training institution as opposed to being paid to the eligible participant.”

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It is National Treasury's view that "work" must actually be performed in terms of an employment contract and an employee must be documented in an employer's records as envisaged in the record keeping provisions contained in section 31 of the Basic Conditions of Employment Act 75 of 1997 (BCEA).

In some cases, the eligible participants are exposed to work-based exercises and activities by an independent company. The independent company is able to utilise the eligible participants for a fixed monthly fee, which similar to the remuneration, is not paid to the eligible participant. Once the training programme is completed, the eligible participant may work for the participating employer for the remainder of the 12 to 24 month period. In accordance with said scheme, the participating employer is then able to claim the ETI for the 12 to 24 month period that the eligible participant is supposedly 'employed' by the employer."

Proposed changes

The Memo states that in order to address the contraventions identified by Government, it is proposed that changes be made in the ETI Act to clarify that substance over legal form will be considered when assessing an employer's ability to claim the ETI. In this manner, it is National Treasury's view that "work" must actually be performed in terms of an employment contract and an employee must be documented in an employer's records as envisaged in the record keeping provisions contained in section 31 of the Basic Conditions of Employment Act 75 of 1997 (BCEA).

In order to claim the ETI, the eligible employer must hire a "qualifying employee". "Employee" is currently defined in section 1 of the ETI Act as a natural person:

- who works for another person; and
- who receives, or is entitled to receive remuneration, from that other person, but does not include an independent contractor.

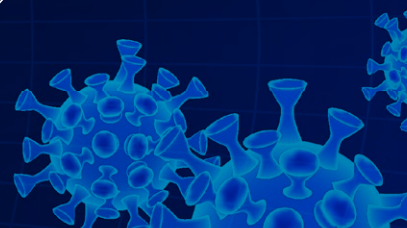
Clause 58(1) of the 2021 Draft TLAB now proposes inserting the following two additional requirements into the definition of "employee" in the ETI Act:

- a natural person who in any other manner assists in carrying on or conducting the business of that other person; and
- who is documented in the records of that other person as envisaged in the record keeping provisions in section 31 of the BCEA.

Over and above this, clause 59(1) of the 2021 Draft TLAB proposes inserting a specific proviso to section 6 of the ETI Act which sets out the requirements of a "qualifying employee". The proviso states that an employee must not, in fulfilling the conditions of their employment contract, be mainly involved in the activity of studying.

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It is worth emphasising that all taxpayers claiming the ETI would be well advised to consult with professional tax advisors to assess the impact of the pending amendments (as well as historical arrangements) for purposes of ensuring compliance and remedying any deficiencies.

While not stated in the Memo, one should note that in *Sekretaris van Binnelandse Inkomste v Lourens Erasmus (Eiendoms) Bpk 28 SATC 233*, the court held that in the context of determining whether total net profit was derived solely or mainly from dividends, the word "mainly" prescribed a purely quantitative standard of more than 50%. This meaning of "mainly" is also applicable in the context of other provisions in the Income Tax Act 58 of 1962, such as the definition of "impermissible trade" in section 12J. It is possible that the word "mainly" in the proposed proviso to section 6 of the ETI Act, will also be interpreted to mean more than 50%.

Effective date and discussion

The proposed amendments will be deemed to have come into operation on 1 March 2021 and apply to years of assessment commencing on or after that date. The legislation evidently has implications for many entities claiming the ETI in relation to schemes akin to the

one highlighted in the Memo by National Treasury. However, the legislation is still in draft form and public comments can be submitted to National Treasury on the proposed legislation until 28 August 2021.

Notwithstanding this, it is worth emphasising that all taxpayers claiming the ETI would be well advised to consult with professional tax advisors to assess the impact of the pending amendments (as well as historical arrangements) for purposes of ensuring compliance and remedying any deficiencies. Should a taxpayer be uncertain whether it would qualify for the ETI by entering into a specific arrangement, it should consult with its professional tax advisors beforehand. It can also consider applying to SARS for an advance tax ruling, as the applicant in BPR 367 did. It is worthwhile noting that audits of ETI claims are on the increase and taxpayers should be aware that SARS may impose penalties and interest in appropriate circumstances.

Jerome Brink

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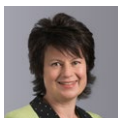
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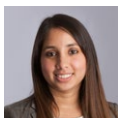
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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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