DLA CLIFFE DEKKER HOFMEYR

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TAX ALERT

DRAFT INTERPRETATION NOTE – USE OF EMPLOYER OWNED PHONES AND COMPUTER EQUIPMENT

The South African Revenue Service (SARS) recently released a Draft Interpretation Note (Draft Note) dealing with taxable benefits arising from the use of employer owned cellular phones and computer equipment, including employer funded communication services.

Various amendments were made to the Seventh Schedule of the Income Tax Act, No 58 of 1962 during 2008, particularly dealing with the private use of cellular phones and computer equipment, to eliminate the perceived prohibitive nature of compliance and enforcement costs associated with the aforementioned benefits. The main thrust of the amendments was to provide for no value to be placed on the fringe benefit where an employer owned asset (eg cellular phone or laptop) was used mainly for purposes of the employer's business. A similar no value fringe benefit was placed on services (eg airtime or data contract), again with the proviso that the services were utilised 'mainly' for purposes of the employer's business.

The Draft Note essentially confirms what is meant by used 'mainly' for the employer's business as being a 'quantitative measure of more than 50%'. The Draft Note states that the assessment of the 'mainly' rule will be done on a case by case basis taking into account, among others, the nature of the employee's work, job responsibilities, qualifying criteria for the entitlement to the use of the asset/service and the conditions attached to using the asset/service.

SARS states that it will take policy documents into consideration, meaning that employers must ensure their human resources and remuneration policies are kept up to date and more importantly, ensure that the relevant policy actually reflects the practical application thereof. It's of no use having a tax compliant policy in place that is not adhered to by employees in practice, which could result in assessments for additional taxes, penalties and interest. In any event, the onus will be on both the employer and employee of proving, based on the facts of each case, that the asset or service is/was used mainly for purposes of the employer's business.

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The Draft Note also deals with the valuation of 'free' minutes for fringe benefit purposes according to an acceptable formula, which may be used to determine the cost of each 'free' minute. The determination of the cost of a 'free' minute becomes relevant in cases where the business portion of a monthly contract needs to be determined.

In the case of prepaid airtime, the Draft Note states that the value of the prepaid voucher will be a taxable benefit to the extent that it is used by the employee for private or domestic purposes. Essentially, a fringe benefit will be triggered under the free or cheap service provisions.

Finally, the Draft Note deals with the fringe benefit implications of a split billing arrangement between the employer and employee. The Draft Note states that the portion of the bill relating to the employer constitutes a free or cheap service in the hands of the employee and one would need to apply the 'mainly for purposes of the employer's business' test to determine whether employees' tax will arise. In the case of an employee portion, the Draft Note states that in the absence of an employee reimbursement, a taxable fringe benefit arises as a debt has been settled by the employer. Where the employee carries the cost of his portion, without any portion settled by the employer, no taxable fringe benefit will arise.

It must be stated that an Interpretation Note does not constitute legislation. In other words, an Interpretation Note can only interpret the law and cannot create law. In addition, taxpayers are not bound to an Interpretation Note, but can question its interpretation in a court of law. Given that the documentation is still in draft form, it may be subject to change after the end of the commentary period.

Ruaan van Eeden

CONVERSION OF A PUBLIC COMPANY TO A PRIVATE COMPANY

The South African Revenue Service (SARS) has released a number of binding class and private rulings of late. One of the interesting rulings is Binding Class Ruling 033 (BCR 33) which deals with the capital gains tax consequences for a public company upon conversion, in terms of the Companies Act, No 71 of 2008, to a private company.

The issue is that a 'disposal' for purposes of paragraph 11 of the Eighth Schedule to the Income Tax Act, No 58 of 1962 (Act) includes the 'conversion' of an asset. The SARS Comprehensive Guide to Capital Gains Tax (Issue 4) states that a 'conversion' involves a substantive change in the rights attaching to an asset and gives the example of the conversion of a company into a share block company as amounting to a substantive change in rights.

In BCR 33 it was noted that the conversion from a public company to a private company entailed limited amendments to the company's memorandum of incorporation (MOI), restricted to the following:

- Inserting provisions prohibiting the offering of the company's securities to the public and restricting the transferability of its securities.
- Deleting the provisions dealing with share warrants.
- Removing the power of the directors of the company to apply for a stock exchange listing of the company's securities.
- Removing provisions anticipating the securities of the company being listed on a stock exchange.

Despite these minor amendments to the company's MOI, it was held that the conversion would constitute a part-disposal of the shares held by the shareholders. That is, the 'conversion' will entail a change in rights in that the shareholders of the public company will now be bound by the new restrictions in the amended MOI.

Despite there being a 'disposal', BCR 33 confirmed that the part-disposal of the shares held by the shareholders in the company will not result in any capital gain or capital loss as a result of paragraph 33(1), read with paragraph 31(3) of the Eighth Schedule to the Act.

It is interesting to compare BCR 33 with Binding Private Ruling 83 (25 May 2010) (BPR 83), which considered whether steps taken by a company to convert to a protected cell company (PCC) under legislation governing its commercial activities, entailing amendments to its incorporation documentation and other related administrative actions, will give rise to a 'disposal' by the shareholders of that company. BPR 83 held that the steps taken by the company to be recognised as a PCC did not constitute a 'disposal' in terms of paragraph 11 of the Eighth Schedule to the Act. Importantly, the ruling notes that the conversion did not change the company into a different legal entity, nor did it replace existing shares with new shares. A number of other related rulings have also been issued by SARS.

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These two rulings illustrate the fine line between there being a 'disposal' and no 'disposal' for purposes of the Eighth Schedule to the Act (even though no adverse tax consequences were triggered upon the conversion from a public company to a private company). Taxpayers entering into transactions involving some form of conversion must therefore carefully analyse their particular circumstances to establish whether there has been a substantive (or not so substantive) change in rights of the parties to determine whether there has been a 'disposal' for purposes of the Eighth Schedule to the Act.

Andrew Lewis

CASH INCENTIVES TO INDEPENDENT SALES PERSONS

In binding private ruling 115 (BPR 115) the South African Revenue Service (SARS) considered the following set of facts:

- A manufacturer sells its goods to various retailers and wholesalers.
- The manufacturer wants to run a 'reward' or 'incentive' scheme to encourage sales persons to sell the manufacturer's goods.
- The sales persons are employed by the various retailers and wholesalers and not by the manufacturer and as such are independent from the manufacturer.
- The manufacturer does not have any control or supervision over the sales persons and the retailers and wholesalers may prohibit the sales persons (being their employees) from taking part in the scheme.
- The sales persons will not operate from the premises of the manufacturer but from the premises of their employers.
- Each sales person taking part in the scheme will receive a card, onto which cash credits will be loaded.
- The amount of cash credits to be allocated to a sales person's card will depend on the sales performance of that individual.
- The sales persons may use the cards at their discretion to pay for various goods and services.
- The cards will be credited from time to time from a separate bank account held by the manufacturer.

The concern, from a tax perspective, was whether the cash credits received by the sales persons would constitute 'remuneration' as defined in paragraph 1 of the Fourth Schedule to the Income Tax Act, No 58 of 1962. If it were to constitute 'remuneration', employees' tax would have to be accounted for. This is so because where an employer pays remuneration to an employee, the employer becomes liable to withhold employees' tax in terms of paragraph 2(1) of the Fourth Schedule to the Act.

In simple terms, an employee is defined as anyone who receives remuneration and an employer is defined as anyone who pays remuneration. Accordingly, for purposes of employees' tax one must have regard to whether "remuneration" is payable or receivable and not to whether there is an employer-employee relationship in common law terms.

'Remuneration' is broadly defined as "*any amount of income which is paid or is payable to any persons by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commissioner, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise and whether or not in respect of services rendered…(a) including any amount referred to in paragraph (a), (c), (cA), (d), (e), (eA), or (f) of the definition of "gross income" in Section 1 of this Act*" but does not include "*any amount paid or payable in respect of services rendered or to be rendered by any person…in the course of any trade carried on by him independently of the person by whom such amount is paid or payable and of the person to whom such services have been or are to be rendered…*"

Without giving any reasons, SARS ruled that the amount would not constitute 'remuneration' and that employees' tax will not have to be accounted for by the manufacturer. It is, however, not entirely clear how the 'rewards' escape the definition of 'remuneration', for example, whether it is due to the independence of the sales persons or due to some other reason.

Nevertheless, SARS specifically points out in their ruling that the amounts will constitute 'gross income' in the hands of the sales persons and it will be subject to normal tax.

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