DLA CLIFFE DEKKER HOFMEYR

TAX ALERT

12 April 2013

DRAFT INTERPRETATION NOTE – TAX TREATMENT OF TIPS FOR RECIPIENTS, EMPLOYERS AND PATRONS

The question regarding the tax implications in relation to the receipt of tips in the service industry (and other industries), has created much uncertainty over the past few years.

In 2011, the South African Revenue Service's (SARS) Advance Tax Ruling Unit released a binding class ruling dealing with the potential pay-as-you-earn (PAYE) implications of tips received by an employee from a satisfied customer. In particular, the binding class ruling (BCR 27) dealt with the question as to whether tips received by employers on behalf of employees (from satisfied customers) constituted 'remuneration' as contemplated in paragraph 2(1) of the Fourth Schedule to the Income Tax Act, No 58 of 1962 (Act). In other words, whether an employer incurred an obligation to withhold PAYE from the tips received by their employees from satisfied customers. It was accepted in BCR 27 that because a tip is paid by the satisfied customer and not the employer, the tip does not constitute remuneration and as such does not give rise to a withholding obligation for the employer.

In a recent draft interpretation note released by SARS, SARS aims to clarify the tax position relating to the receipt of tips. From the outset it must be noted that the draft interpretation note does not deal with the tax implications of the compulsory service charges which are added by the owner to the patron's bill (for example, adding a 10% service fee to a restaurant bill for tables of greater than eight guests), as these service charges are generally received by the owner for his own benefit and thus included in that owner's gross income. The draft interpretation note therefore only focuses on the tax implications of the tripartite tipping relationship between the employee, the employer and the patron. However, for the purpose of this article, we will only consider the potential tax implications of the bipartite tipping relationship between the employer and the employee.

For purposes of clarity, the potential tax implications for each party are dealt with separately below:

The employee

- From the employee's perspective, it is critical to establish whether the tip constitutes 'gross income' as defined in s1 of the Act. 'Gross income' is defined as "the total amount in cash or otherwise received by, accrued to or in favour of a resident during a year of assessment, which is not of a capital nature."
- In addition, paragraph (c) of the definition of 'gross income' specifically includes "any amount, including any voluntary award, received by or accrued in respect of services rendered or to be rendered."
- Accordingly, once it is established that an amount has been received by or accrued to the employee, the next step is to determine whether the amount was received in respect of services rendered or to be rendered.
- On this point, the draft interpretation note specifically states that it is a well-established practice and fact that a tip is worked for and is therefore an expected source of income for the employee. The mere fact that the tip is paid by the patron and not the owner, does not alter the fact that there is a direct causal connection between the services rendered and the tip received.
- Accordingly, tips are received in respect of services rendered and therefore fall within paragraph (c) of the definition of 'gross income'.
- Therefore, an employee is required to declare all income in the form of tips in their annual income tax return and income tax will be payable by the employee if the taxable income exceeds the annual threshold.

continued

IN THIS ISSUE

- The facts and circumstances of a particular case will determine whether the tips constitute 'remuneration' as contemplated in paragraph 2(1) of the Fourth Schedule to the Act. In most situations, the tip will constitute remuneration as defined and the recipient will not be required to register for provisional tax. However, in those limited circumstances where the tip does not constitute remuneration, the recipient will be required to register for provisional tax.

The employer

- The potential tax implications for the employer will depend on whether the employer is acting as a conduit for the patron or in his own capacity when paying the employee a tip.
- In situations where the employer is acting as a conduit, in other words where the employer merely facilitates the transfer of the tips into the employee's bank account, the employer will not be required to withhold employees' tax from the tips received by the satisfied customer and paid over to the employee. Under these circumstances, the employer will also not be required to include the tips in the leviable amount for Skill Development Levy (SDL) purposes or to make or withhold any contribution in respect of the Unemployment Insurance Fund (UIF).
- However, where the employer receives the tip for his own benefit and on his own behalf and subsequently decides to pay the employee a tip in his own capacity, the obligation to withhold employees' tax will depend on whether or not the amount so paid constitutes remuneration.
- Where the amount constitutes remuneration, the owner will be obliged to withhold employees' tax and will also be required to include the tip in the leviable amount for SDL purposes and to make his own UIF contribution as well as withhold the employees' UIF contribution. On the other hand, where the tip does not constitute remuneration, no employees' tax must be withheld and the owner will also not be required to include the tip in the leviable amount for SDL purposes or to make or withhold any contribution in respect of UIF.

Although the draft interpretation note is useful in that it seeks to establish that a tip is in fact subject to tax, the question is whether SARS has given enough thought to the administrative burden created by the taxing of such tips. In particular, whether SARS has the necessary resources to ensure that all employees declare their tips received in their annual income tax returns.

SARS has indicated that comments on the draft interpretation note are due by no later than 31 May 2013.

Nicole Paulsen

VAT TREATMENT OF DEMONSTRATION MOTOR VEHICLES

When a car dealership acquires a motor vehicle purely for the purposes of demonstration use, the question that arises is whether it constitutes a taxable supply for purposes of Value-Added Tax (VAT).

Section 17(2)(c)(ii) of the Value Added Tax Act, No 89 of 1991 (Act) provides that "a motor car acquired by such vendor for demonstration purposes or for temporary use prior to a taxable supply by such vendor shall be deemed to be acquired exclusively for the purpose of making a taxable supply."

Can one interpret the relevant section to read that a motor car acquired by a dealer for demonstration purposes will always be deemed to be acquired exclusively for the purposes of making a taxable supply or should the section be interpreted to mean that the input tax credit can only be claimed to the extent that the motor vehicle has been acquired by the vendor for demonstration purposes prior to a taxable supply by the vendor? In the latter case, one would think that the dealer will have to sell the motor vehicle to make a taxable supply. If the first-mentioned interpretation has merit, then the only requirement is that the dealer should have acquired the motor car for demonstration purposes.

Even in the context of the first interpretation, reference is made to a motor car that is acquired by the vendor. The question is whether the word 'acquired' also includes the renting of a vehicle as opposed to acquiring ownership. In *CIR v Freddies Consolidated Mines Ltd 21 SATC 132* it was indicated that the word 'acquired' should be construed as meaning "the acquisition of a right to acquire the ownership of property." Similarly, in *SIR v Wispeco Housing (Pty) Ltd 35 SATC 14* it was indicated that the word 'acquired' does not mean the acquisition of actual ownership of the property, but the acquisition of the right to acquire the ownership of property at such a time as may be designated in the relevant contract. A narrower approach was adopted in *Transvaal Investment Co Ltd v Springs Municipality 1922 AD 337* where it was indicated that the word 'acquire' connotes ownership, that is the acquisition of *dominium*.

Given the fact that the courts have adopted a wider meaning to the word 'acquire', it seems that, even if the first interpretation is preferred, ie that the only requirement is that the vendor should have acquired the motor car for demonstration purposes, whether or not prior to a taxable supply, the requirement seems to suggest that the motor car should have been acquired by the dealer. An interesting scenario that could arise is where a lease agreement is entered into, whether it can be argued that the motor car would not have been acquired even though the use of the motor car would have been transferred to the dealer. In other words, on either interpretation, it would seem that the dealer should have 'acquired' the motor vehicle and only an option to acquire the motor vehicle would not be sufficient. It may be possible to argue that a motor vehicle acquired for demonstration purposes could qualify, whether or not it is prior to a taxable supply but such argument is not without risk. It would seem that the dragon is in the detail.

Carmen Moss-Holdstock

DLA CLIFFE DEKKER HOFMEYR

CONTACT US

For more information about our Tax practice and services, please contact:

Emil Brincker
Director
National Practice Head
T +27 (0)11 562 1063
E emil.brincker@dlacdh.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@dlacdh.co

Johan van der Walt
Director
T +27 (0)11 562 1177
E johan.vanderwalt@dlacdh.com

Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@dlacdh.com

Andrew Lewis
Senior Associate
T +27 (0)11 562 1500
E andrew.lewis@dlacdh.com

Danielle Botha
Associate
T +27 (0)11 562 1380
E danielle.botha@dlacdh.com

Heinrich Louw
Associate
T +27 (0)11 562 1187
E heinrich.louw@dlacdh.com

Tessmerica Moodley
Associate
T +27 (0)21 481 6397
E tessmerica.moodley@dlacdh.com

Carmen Moss-Holdstock
Associate
T + 27 (0)11 562 1614
E carmen.moss-holdstock@dlacdh.com

Nicole Paulsen
Associate
T + 27 (0)11 562 1386
E nicole.paulsen@dlacdh.com

BBBEE STATUS: LEVEL THREE CONTRIBUTOR

JOHANNESBURG

1 Protea Place Sandton Johannesburg 2196, Private Bag X40 Benmore 2010 South Africa
Dx 154 Randburg and Dx 42 Johannesburg

T +27 (0)11 562 1000 **F** +27 (0)11 562 1111 **E** jhb@dlacdh.com

CAPE TOWN

11 Buitengracht Street Cape Town 8001, PO Box 695 Cape Town 8000 South Africa
Dx 5 Cape Town

T +27 (0)21 481 6300 **F** +27 (0)21 481 6388 **E** ctn@dlacdh.com

www.cliffedekkerhofmeyr.com