4 DECEMBER 2015

TAX ALERT

IN THIS ISSUE

VICTORY FOR TAXPAYER IN MOTOR VEHICLE SALARY SACRIFICE SCHEME

In the recently reported case of *Anglo Platinum Management Services v SARS* [2015] ZASCA 180 (Anglo), the judgment of which was delivered on 30 November 2015, the Supreme Court of Appeal (SCA) ruled in favour of the taxpayer in respect of a motor vehicle salary sacrifice scheme. The judgment stresses the importance of employers and employees properly agreeing to, understanding and correctly implementing remuneration structures that contain a salary sacrifice component.

PROPOSED EXTENSION OF EXISTING PRESCRIPTION PERIODS (SECTION 99 OF THE TAX ADMINISTRATION ACT)

Section 99 of the Tax Administration Act, No 28 of 2011 (TAA) prescribes the period of limitations (ie prescription) for the issuance of assessments.

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The courts have acknowledged the fact that it is lawful for an employee to sacrifice their salary in return for some quid pro quo from the employer, which has the effect of reducing the employee's ultimate tax liability.

Before dealing with the SCA judgment, it is useful to touch on the basic principles of a 'salary sacrifice' arrangement, or more eloquently put, a 'salary substitution' arrangement. I use the word 'substitution', as that is what it boils down to: it is the substitution of a cash component of an employee's overall cost to company remuneration package, for a non-cash benefit, that generally results in a lower amount subject to the deduction of employees' tax.

Historical case law on the issue of 'salary sacrifice' or 'salary substitution' schemes (see *ITC 1663* 61 SATC 363 and *ITC 1682* 62 SATC 380) does not provide clear guidance, but the courts have acknowledged the fact that it is lawful for an employee to sacrifice their salary in return for some *quid pro quo* from the employer, which has the effect of reducing the employee's ultimate tax liability. The above was confirmed in the *Anglo* case. The important aspect of such a scheme seems to be that it must be implemented properly, there must be attention to detail, and that the provisions of the Income Tax Act 58 of 1962 (Act) and, in particular, the Seventh Schedule to the Act, dealing with fringe benefits, are carefully considered.

Furthermore, it is important that there is a valid agreement (or agreements) between the employer and employee, both parties understand the implications of the agreement (or agreements), the 'salary sacrifice' must be made prior to the accrual of any amount, and relevant internal policies and procedures are adhered to. The aforementioned was seemingly adhered to in the Anglo case, which involved a salary sacrifice scheme whereby employees substituted a portion of their cash remuneration in exchange for a non-cash use of a motor vehicle benefit. The case did not focus on the determination as to whether a fringe benefit for the use of a motor vehicle actually existed – the question was whether the mechanics of the scheme resulted in an antecedent divestment of a right to remuneration. In other words, did the scheme result in the employees divesting themselves of an amount, after accrual? If so, the salary sacrifice scheme would not be properly implemented.

The salient features of the scheme, as set out by the SCA, were as follows:

- the employees had to complete certain documentation which set out how they wished their 'cost to the company' remuneration packages to be structured, as between cash and other benefits, which included the use of a motor vehicle.

VICTORY FOR TAXPAYER IN MOTOR VEHICLE SALARY SACRIFICE SCHEME

CONTINUED

The South African Revenue Service argued that the entitlement to the aforementioned 'credit' and the obligation to pay the premiums, are inconsistent with a genuine 'salary sacrifice' scheme as, in substance, the employees retain their power over their salary packages.

- once an employee had chosen to participate in the scheme and had selected a vehicle of his choice, Anglo purchased it and paid the dealer in cash. The vehicle was then entered into Anglo's asset register and depreciation was claimed on it.
- the vehicle was registered in the employee's name, but Anglo owned the vehicle until the employee had 'settled' the finance obligation and paid the related fringe benefit tax on it.
- the cost of the vehicle purchase was recovered from the employee through a monthly deduction – predetermined at the time they elected to participate in the scheme – from the portion of their salary they had to forego in return for the use of the vehicle.
- The cost recovered from the employee also included a notional interest portion and insurance premiums.

The abovementioned process was, however, not at the heart of the dispute. The scheme had two more complex elements being:

i) the entitlement of the employees to claim an amount of credit in the notional account; and

ii) their contractual obligation to pay insurance premiums on the motor vehicles. The South African Revenue Service (SARS) argued that the entitlement to the aforementioned 'credit' and the obligation to pay the premiums, are inconsistent with a genuine 'salary sacrifice' scheme as, in substance, the employees retain their power over their salary packages.

The witness for Anglo testified that 'notional accounts' were prepared, which it sent to its employees who chose the taxable benefit of the use of their motor vehicles. The 'notional accounts', set out the 'optimal value' of the motor vehicle, defined as the 'theoretical representation' of the capital amount outstanding at the end of each month determined according to the reducing cap method. This was part of the methodology used to determine the actual value of the motor vehicle, taking into account the 'deemed' finance costs. In addition to being represented as part of the capital cost of the motor vehicle, 'notional interest' was recorded separately in the notional accounts.

The 'notional accounts' also detailed actual payments Anglo made for maintenance and running expenses, insurance premiums and licensing fees. The aforementioned payments were debited to the 'notional account', as was the 'notional interest'. The predetermined monthly deduction from the employee's salary appeared from month to month as a credit in the 'notional account'.

It appears that, from time to time, there would be a shortfall in the 'notional account' where the actual expenditure plus 'notional interest' exceeded the amounts credited to an employee through the monthly deduction, resulting in a recovery from the employee. Where the amount credited to the employee exceeded the expenditure, the employee could withdraw the money available, once every quarter, subject to the deduction of employees' tax. If the credit amount was not withdrawn, it would be rolled over into the following month or quarter. At the

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CONTINUED

The SCA concluded that, in substance and in form, Anglo and its employees participating in the scheme achieved what they set out to do: fund a taxable benefit from a 'salary sacrifice'.

end of the financial year the credit (if any) would be paid to the employee, subject to the deduction of employees' tax.

Counsel for SARS pushed Anglo's witness to concede that the credit in the 'notional account' was in fact a contractual right to claim the credit and not merely an election. The SCA accepted that the employees had a right to claim any credit in the 'notional accounts', but that they could elect not to claim it quarterly, in which case they could still claim whatever credit remained at the end of the financial year. The SCA stated that the amounts that became available to be claimed quarterly were both unanticipated and insignificant simply because it was not possible to predetermine future running expenses and 'notional interest' for the motor vehicles. The SCA went on to state that the fact that these insignificant and unanticipated amounts *"could (not would)"* become available to the employee in the future because of inevitable future adjustments to the predetermined cost of the benefit cannot and does not detract from the efficacy of the scheme.

Properly understood, the SCA stated that the credit to which an employee became entitled when he elected to participate in the scheme, was *not* unconditional, but in fact a contingent right, exercisable at a later date and on the occurrence of an uncertain future event. If the event did not materialise there was no right to be exercised and until it was exercised there could not have been an accrual of income.

The SCA concluded that, in substance and in form, Anglo and its employees participating in the scheme achieved what they set out to do: fund a taxable benefit from a 'salary sacrifice'. The SCA stated that this was achieved by properly designing and implementing the scheme and that the recovery of the vehicle total cost, including the running expenses was obtained from the salary sacrifice, not from the employees.

On the basis that the credit claimable arose from a small unpredicted and unanticipated future contingency, the SCA ruled that SARS' argument that the use of the vehicles was in reality a consideration received by each employee as part of their employment and thus taxable under paragraph (c) of the definition 'gross income', as opposed to paragraph (i) as a taxable benefit by virtue of a valid salary sacrifice, had to fail.

The important aspect that employers should take from the Anglo case is that 'salary sacrifice' arrangements remain perfectly legal. The difficulty that often arises is that the actual implementation and maintenance of a scheme, doesn't necessarily reflect what has been agreed to with the employee and vice versa. Anglo effectively countered SARS' arguments that there was an antecedent divestment of a right to income, on the basis that it paid attention to detail and the scheme reflected, in substance and in form, what the parties agreed to and intended with its implementation and what it set out to achieve in the first place.

Ruaan van Eeden

PROPOSED EXTENSION OF EXISTING PRESCRIPTION PERIODS (SECTION 99 OF THE TAX ADMINISTRATION ACT)

The Tax Administration Laws Amendment Bill, 2015 (TALAB 2015) proposes to extend the aforementioned time periods by introducing new ss(3) and ss(4) to s99 of the TAA.

In terms of the new ss(3) the Commissioner for SARS may, by prior notice of at least 30 days to the taxpayer, extend any of the aforementioned periods or an extended period under s99, before the expiry thereof...

Section 99 of the Tax Administration Act, No 28 of 2011 (TAA) prescribes the period of limitations (ie prescription) for the issuance of assessments.

Section 99 currently states that the South African Revenue Service (SARS) may not make an assessment in terms of Chapter 8 of the TAA, *inter alia*:

- three years after the date of assessment of an original assessment by SARS;
- (in the case of self-assessment for which a return is required) five years after the date of assessment of an original assessment by way of self-assessment by the taxpayer or, if no return is received, by SARS; or
- (in the case of a self-assessment for which no return is required) after the expiration of five years from either the date of the last payment of the tax for the tax period or the effective date, if no payment was made in respect of the tax for the tax period.

As s99 of the TAA currently reads, the above periods do not apply to the extent that:

- (in the case of assessment by SARS) the full amount of tax chargeable was not assessed due to fraud, misrepresentation or non-disclosure of material facts; or
- (in the case of self-assessment) the full amount of tax chargeable was not assessed due to fraud, intentional or negligent misrepresentation, intentional or negligent non-disclosure of material facts or the failure to submit a return or, if no return is required, the failure to make the required payment of tax.

The Tax Administration Laws Amendment Bill, 2015 (TALAB 2015) proposes to extend the aforementioned time periods by introducing a new ss(3) and ss(4) to s99 of the TAA. In terms of the new ss(3) the Commissioner for SARS may, by prior notice of at least 30 days to the taxpayer, extend any of the aforementioned periods or an extended period under s99, before the expiry thereof, by a period approximate to a delay arising from either:

- a failure by a taxpayer to provide all relevant material requested under s46 of the TAA; or
- resolving an information entitlement dispute, including legal proceedings.

The new proposed ss(4) provides that the Commissioner for SARS may, by prior notice of at least 60 days to the taxpayer, extend any of the aforementioned periods, before expiry thereof, by three years in the case of an assessment by SARS or two years in the case of self-assessment, where an audit or investigation under Chapter 5 of the TAA relates to:

- the application of the doctrine of substance over form;
- the application of Part IIA of Chapter III of the Income Tax Act, No. 58 of 1962 (ITA) (the general anti-avoidance rule (GAAR)), s73 of the Value-Added Tax Act, No 89 of 1991 or any other general anti-avoidance provision under a tax Act;

PROPOSED EXTENSION OF EXISTING PRESCRIPTION PERIODS (SECTION 99 OF THE TAX ADMINISTRATION ACT)

CONTINUED

According to the Memorandum on the Objects of the TALAB 2015, too many of SARS' resources are spent on information entitlement disputes which result in insufficient time for SARS to ensure that it has all relevant information at its disposal to make a correct assessment.

- the taxation of hybrid entities or hybrid instruments; or
- s31 of the ITA (the transfer pricing provisions contained in the ITA).

According to the Memorandum on the Objects of the TALAB 2015 (Memorandum), too many of SARS' resources are spent on information entitlement disputes which result in insufficient time for SARS to ensure that it has all relevant information at its disposal to make a correct assessment. The Memorandum states that the failure by taxpayers to provide information or information entitlement disputes is often tactical or vexatious, given that taxpayers are aware of the period within which SARS must finalise the audit and issue additional assessments. It is further said that information entitlement disputes are often based on convoluted or strained interpretations of the relevant provisions of the TAA and some matters subject to audit may be so complex that it is impossible to meet the prescription deadline, particularly in the context of audits requiring SARS to consider the application of the GAAR or transfer pricing audits.

The proposed amendments to s99 of the TAA seek to address these issues by providing for an extension of the existing prescription period before the existing prescription period comes to an end. This is to allow the taxpayer an opportunity to make representations as to why the existing prescription period should not be extended.

Mareli Treurnicht

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

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