



**NATIONAL
TREASURY**

Office
Commissioner

Enquiries
J J Louw

Telephone
012 422 5155

Facsimile
012 422 5254

Room

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**THE CHAIRPERSON
PORTFOLIO COMMITTEE ON FINANCE
(PCOF)
NATIONAL ASSEMBLY**

**South African Revenue
Service**

299 Bronkhorst Street,
Nieuw Muckleneuk, Pretoria
P O Box 402, Pretoria, 0001
SOUTH AFRICA
E-mail jdelarey@sars.gov.za

**COMMENTS ON REPRESENTATIONS TO THE PCOF ON THE
IMPOSITION OF PAYE ON DIRECTORS' REMUNERATION IN TERMS OF
THE REVENUE LAWS AMENDMENT BILL, 2001**

SARS and the National Treasury wish to respond to the issues arising from the proposal to bring directors of private companies within the employees' tax system by imposing PAYE on directors' remuneration.

1 Reason for the proposal

At present directors of private companies are not subject to monthly Pay-As-You-Earn (PAYE) deductions on their salaries and other remuneration. In the past this has been justified on the basis of the practical problems that arise when—

- fixing a private company director's final remuneration for a year of assessment; and
- subjecting advances paid to directors to PAYE.

The result of this concession is that private company directors need only settle the tax bill on their salaries when they make their provisional tax payments and finally on assessment.

This gives private company directors a substantial cash-flow advantage over ordinary employees. In addition, public companies have devised structures to permit their directors to take advantage of this cash-flow advantage.

In order to create equity between directors and ordinary employees, the Revenue Laws Amendment Bill proposes that the exemption from the payment of employees' tax that directors of private companies enjoyed be withdrawn and that these private companies pay an amount of tax on behalf of directors based on the directors' remuneration for the previous year of assessment as a form of a minimum amount.

2 Concerns and alternatives raised

a) Limit to salaries

Directors of private companies should be divided in two categories–

- Directors in receipt of a monthly salary and a profit share or incentive bonus; and
- Directors of companies and close corporations that are owner managers of the business that do not earn a monthly salary but whose income is determined once the financial statements of the entity are finalised.

SAICA's proposal is to make a distinction between these two categories and only taxing directors in the first category on notional amounts. This proposal is not acceptable. If such a system is introduced the directors in the first category will make use of the opportunity to restructure their salary packages to fall within the second category and only receive advances from the company during the year in order to still get the deferral benefit of paying provisional tax only.

b) Formula

Two fundamental practical difficulties concerning the application of the proposed formula were raised.

- Notional amount exceeds actual remuneration.

Cash flow difficulties will arise where the final amount of remuneration actually paid to the director in respect of a year of assessment is well below the remuneration of the previous year. The salaried director should not be placed in a worse position than a normal employee. (SACOB; SAICA)

The existing provisions of paragraph 10 of the Fourth Schedule which grant a discretion to the Commissioner to apply a different basis of determining PAYE to be deducted from remuneration will also be applicable in the case of directors subject to PAYE. This will enable the Commissioner to direct that the PAYE in terms of the formula be determined on a reduced notional remuneration where the reduced amount can be justified by the employer.

Where the Commissioner is not satisfied that an alternative basis of determining PAYE is warranted in the circumstances, the director will be entitled to a refund of excess PAYE on assessment.

A concern was raised that the application of paragraph 10 will place an administrative burden on both the Commissioner and business. As this is a relief measure to cater for hardship situations, which will not be automatically granted, the administrative implications should not be excessive.

➤ Double tax.

Where the same amount is subject to PAYE twice because actual remuneration was received after the company had paid tax in accordance with the formula on a notional amount. (SAICA)

Cognisance was taken of the practical difficulties identified and revised proposals have been included in the Bill. Paragraph 9 of the Fourth Schedule has been amended to provide that in determining the employees' tax deducted from the actual remuneration of directors, the amount of tax deducted in terms of the formula in respect of the year of assessment of the director must be taken into account.

The current formula to implement this proposal is the product of the consultative process, during which the first proposals in this regard were substantially modified to address the practical problems that were identified by commentators. This proposal is a workable one that will be monitored for unintended consequences for either taxpayers or the fiscus.

c) Systems

Systems changes will be required by companies to administer the payment of PAYE on amounts paid to directors. Many private companies which do not currently pay PAYE will have to register for PAYE for the first time. (SAICA)

The provisions will only apply with effect from 1 March 2002, which will enable companies sufficient time to introduce changes to systems and register as employers for PAYE purposes.

d) Election

Introduce a system where a director may elect to be subject to PAYE at normal rates or at a fixed percentage, e.g. 30 per cent instead of the normal deduction tables. (Mr. Ken Andrew)

The introduction of such a system will still result in a deferral benefit to directors and will create a precedent which may lead to requests from other groups of employees for similar treatment.

In addition, this proposal will not solve the concern raised that the director may still be taxed on a notional amount that may not be actually received ultimately.

e) Introduce a threshold

Recognise that small business companies and close corporations are in reality limited partnerships which are not subject to the provisions, by introducing a threshold. (PricewaterhouseCoopers)

The Fourth Schedule does not provide for thresholds for employees employed by other entities defined to be employers. The introduction of such a system will set a precedent which may lead to requests from other groups of employees to get the benefit of a similar threshold.