PAYROLL COMPLIANCE

by Ron Warren, CA(SA)

When considering the great range of topics that fall under the heading of "Payroll compliance" and the fact that I have just over an hour in which to cover them, I decided to rather deal with "Payroll non-compliance". I have accordingly selected 12 areas of non-compliance that I come across often in the process of supporting a computerised payroll system, and in queries from readers of *Payroll World*, a quarterly magazine edited by me and published by LexisNexis, devoted to matters that are of interest to the payroll community.

1. Accrual versus payment of remuneration

The Fourth Schedule to the Income Tax Act deals with all matters relating to employees' tax or PAYE. For ease of reference, I will use the term PAYE in these notes to refer to all elements of employees' tax (including both SITE and PAYE).

It is stated quite clearly in the Fourth Schedule that PAYE must be deducted by an employer from remuneration paid to an employee when the income accrues or is paid to the employee. How one could possibly deduct PAYE from an accrual before it is paid to the employee remains a mystery that I have often asked SARS to explain, without any luck.

However, let us ignore that mystery today, and deal with the much more practical problem of income that accrues in one tax year, but is only paid to the employee in the following tax year. Again, for ease of reference, I will refer to the tax year in which the remuneration accrues as "tax year 1" and the tax year in which the payment for this remuneration is made and PAYE is deducted as "tax year 2".

Examples of such remuneration are –

- overtime worked in one month which is paid to the employee in the following month;
- a production bonus paid monthly in the following month;
- a petrol card given to an employee which is regarded as part of a travel allowance, for which the account from the petrol card supplier is only received in the month after the employee has been paid for that month;
- a guaranteed annual bonus that is calculated on the basis of the number of months worked by the employee for the year to date, but paid annually.

I am sure that you can think up many other examples from your experience, and that virtually all employers have such a problem.

What is the problem here? The income accrues to the employee when the work is performed and the employee is unconditionally entitled to payment. Almost by definition, all remuneration accrues before it is paid. This is of no legal consequence except when accrual occurs in tax year 1 and payment occurs in tax year 2.

When that happens, SARS requires the PAYE deducted in tax year 2, but which accrued in tax year 1, to be reflected on the monthly EMP 201 as being in respect of the month in which it accrued (say February 2010) and not when it was paid (say March 2010). The fact that it was physically impossible to calculate the remuneration amount before

PAYE for February was payable (Friday 5th March 2010) is not taken into consideration by the Fourth Schedule.

Thus, when making payment to SARS of this PAYE (by 7th April 2010), you should make out two EMP 201's – one with the payment period shown as 201002 for the remuneration relating to tax year 1, and the other with a payment period of 201003 for the normal remuneration for March. Of course, you should also split the SDL and UIF paid accordingly! And to top it all, SARS expects you to make out an amended tax certificate in due course for tax year 1, adding the accrued income for that year to the income previously reported for that year.

This is so nonsensical that most employers don't do it, and include the tax year 1 remuneration with the tax year 2 remuneration. But you should be aware that you are breaking the law, and could theoretically be subjected to penalties should you suffer an over-zealous PAYE audit.

This matter has been discussed on many occasions with SARS by the Payroll Authors' Group, and is still under discussion. Suggestions have been made as to how the problem can be satisfactorily income, but this requires a change to the law of accrual, which will not be easy to achieve.

2. *Private versus business use of an employee's private car*

You are all aware, I am sure, that travel between an employee's place of residence and place of work is deemed to be private travel. Any reimbursement made by the employer to the employee for such "private travel" is fully taxable.

But what if the employee on occasion leaves home to go direct to a customer whose office is, say, 50 kilometres from the employee's house, whereas the employee's normal place of employment (office) is only 10 kilometres from his/her residence? Is the employee entitled to reimbursement for 50 kilometres (or even 50 – 10 = 40 kilometres) for this trip? The answer is that the employee is not entitled to any reimbursement at all, as the full 50 kilometres represent travel from home to place of work.

In the construction industry, it is not uncommon for the construction to take place in the bundu, with the nearest liveable accommodation for employees many kilometres away. I have been made aware of cases where such hotel accommodation is only available 100 kilometres away from the place of work. The employer makes a bakkie available to the employee to perform his/her duties on site, and as a matter of practical necessity allows the employee to use the bakkie to also travel between place of residence (the hotel) and place of work (construction site). That travel between "home" and place of work is a taxable fringe benefit.

This is another aspect of the law that has been under discussion between the Payroll Authors' Group and SARS for many years, with no resolution being reached. The problem is to accurately define a set of circumstances so precisely that it can't be abused.

3. *The R2,92 default rate for kilometres reimbursed*

Where an employee is reimbursed for kilometres travelled, such reimbursement is not subject to PAYE if the reimbursement rate is not greater than the rate allowed by SARS.

The **Budget 2010/2011 Tax pocket guide** published by SARS (and the past such guides) say the following in this connection –

"*Alternative to the rate table:*

- *Where the distance travelled for business purposes does not exceed 8 000 kilometres per annum, no tax is payable on an allowance paid by an employer to an employee up to the rate of R2,92 cents per kilometre, regardless of the value of the vehicle.*
- *This alternative is not available if other compensation in the form of an allowance is received from the employer in respect of the vehicle."*

It really is a pity that SARS puts out such incorrect information in a document like this. It is not in accordance with the rules published in the *Government Gazette* in which the rate table is published, nor is it in accordance with the *Employer's Guide* published on SARS web site.

The wording in the *Government Gazette* in which the rates are published reads as follows –

"Where –

(b) the distance travelled in the vehicle for business purposes during the year of assessment does not exceed 8 000 kilometres, ... ; and

(c) no other compensation in the form of a further allowance or reimbursement is payable by the employer to that recipient,

that rate per kilometre is, at the option of the recipient, equal to R2,92 per kilometre."

There is no statement there, as there is in the tax pocket guide, of "regardless of the value of the vehicle". Thus, this is a concession in favour of the employee – if the rate per kilometre calculated from the table of rates is less than R2,92 per kilometre, the employee can elect to be paid at R2,92 per kilometre (always assuming, of course, that the employer is prepared to pay this rate). If the calculated rate per kilometre is above R2,92 that higher rate may be paid, also free of PAYE.

In my case, I drive a car whose cost exceeds R400 000 and I don't do very much private travel, as I live around the corner from my office. Because of this low annual mileage, my cost per kilometre from the official table works out at about R10 per kilometre, so I claim R9 per kilometre for all business travel, just to be on the safe side.

4. Annual COIDA return

For many years now, the Minister of Labour has published an annual notice fixing the maximum annual rate of remuneration above which earnings are not subject to COIDA. The new rate is always specified as being applicable as from 1st April of the year, except last year when the applicable date was specified as 1st July.

In blissful ignorance of his Minister's official notice (or in contempt at its stupidity?), the COIDA Commissioner ignores the effective date specified in the *Gazette* and specifies that the new rate applies from 1 March every year when he issues the annual form of

return W. As 8 to be made by employers for COIDA assessment purposes. This is because the year of assessment thankfully is the same as the tax year of assessment.

I believe that employers in general normally accept this discrepancy (it is only 1 month, after all), and complete their returns for the 12 months covering March to February each year.

However, the difference last year was 4 months – the old maximum earnings limit applied up to 30th June 2009, and the new limit came into effect from 1 July 2009. In some cases, applying the new limit for the whole year would increase the annual premium payable materially.

The COIDA Commissioner stuck to his normal practice of specifying that the new limit applied from 1 March 2009, which is of course quite illegal. The payroll for which I am responsible catered for the earnings to be split in accordance with the gazetted dates, which were the legally prescribed dates. However, because I know some employers are scared of upsetting the authorities (why?), the payroll allowed the employer to make a choice as to whether to obey either the COIDA Commissioner or his boss, the Minister of Labour.

To make matters worse, the COIDA Commissioner asked for details of employees per month, for three separate periods –

- those making up the estimate of earnings for the 2010 assessment year, made in the 2009 return;
- those included in the actual earnings for the 2010 assessment year, made in the current return; and
- those making up the estimate of earnings for the 2011 assessment year made in the current 2010 return.

This was bad enough, not having given any notice of this never before asked for detail to enable employers to keep the data, but a condition was added that the first estimate above was to be based on the new earnings limit that only came into force on either 1 July 2009 or 1 March 2009! In case you don't follow the impossibility of obeying this completely daft instruction –

- The estimate of earnings that was made in the 2009 return (first bullet above) for the coming 2010 year of assessment was based on the then annual earnings limit of R214 305, and employers were required (in 2009) to estimate the earnings not exceeding that limit that they would be paying in the forthcoming 2010 year of assessment.

- They were now being asked to effectively recalculate that estimate, based on the new earnings limit of R239 172 applicable from either 1 July 2009 or 1 March 2009.

If anybody managed to perform this impossible calculation, I would really like to hear how they did so!

It is truly unbelievable that such incompetence and stupidity should be tolerated by us, and that some of us even made an attempt to do the impossible. I firmly believe that when such idiotic returns are requested, employers should refuse to obey. I cannot believe that any court would uphold a penalty that might be raised by a government

department for non-submission of a return that it was physically impossible to complete.

5. *Independent contractors*

The definition of "remuneration" in the Fourth Schedule to the Income Tax Act was changed with effect from 1 March 2007 as respects the concept of a person carrying on a trade independently. If a person is deemed to be carrying on a trade independently, the "remuneration" paid to that person is excluded from the definition of remuneration, and is therefore not subject to the deduction of employees' tax.

Prior to 1 March 2007, a person was not deemed to be carrying on a trade independently –

- if he is subject to the control or supervision of any other person as to the manner in which his duties are performed or to be performed or as to his hours of work; or

- if the amounts paid or payable for his services consist of or include earnings of any description which are payable at regular daily, weekly, monthly or other intervals.

From 1 March 2007, a person is not deemed to be carrying on a trade independently –

- if the services are required to be performed mainly at the premises of the person by whom such amount is paid or payable or of the person to whom such services were or are to be rendered; ***and***

- the person who rendered or will render the services is subject to the control or supervision of any other person as to the manner in which his or her duties are performed or to be performed or as to his hours of work.

(There is a further proviso that the person will be deemed to be carrying on an independent trade if he employs 3 or more employees full time for the purposes of his trade, which is not material for our purposes here.)

Note the ***and*** which I have emphasised before the last bullet above. This means that ***both*** conditions must be satisfied before a person is deemed not to be carrying on a trade independently.

However, Interpretation Note number 17 (issue 2) dated 9 January 2008 which interprets this bit of the Fourth Schedule has got itself very confused! It repeats what I have said above (using slightly different language) but then goes on to add another paragraph which was left over (presumably in error) from the previous version of the interpretation note.

That extra paragraph says that the person shall not be deemed to be carrying on a trade independently if the worker is subject to the supervision of any other person as to the manner in which the duties are or will be performed, or as to the hours of work. This provision is not in the Fourth Schedule.

The interpretation note repeats this error (using different wording) a bit later on, where it uses the word ***any*** instead of ***and***.

So, if you believed the interpretation note, you would deem a person to be an independent contractor, whereas in terms of the Fourth Schedule the person would not be an independent contractor.

6. Net of tax remuneration

When an expatriate accepts employment in South Africa, some employers offer them a "net of tax" package. In other words, the employee is guaranteed a take home pay of Rxxx (which the employee can compare with the take home pay they would have earned in their home country).

This is perfectly legal, provided the employer treats the tax paid on behalf of the employee as a taxable fringe benefit (payment of the employee's debt). There is a slight problem in doing this calculation, in that this fringe benefit in turn attracts more tax, which the employer must allow for in the calculation.

SARS has published a very good **Guide on the Taxation of foreigners working in South Africa**, last updated in July 2009, in which they give a formula that can be used to calculate the tax on the tax paid by the employer, so as to arrive at the correct fringe benefit. Unfortunately, this calculation results in the incorrect amount of tax, which I have pointed out to SARS on a couple of occasions but which they have ignored.

The problem arises when the fringe benefit calculated according to the SARS formula pushes the total earnings into the next tax bracket, which means that a further "tax on tax" must be calculated on the earnings falling in the higher bracket. It is not difficult to do this, and I published an expanded formula in issue 1/2010 of *Payroll World*. If anyone requires a copy of this formula, I would be happy to supply it to them.

If you are calculating expatriate tax on the basis of the SARS formula, you are probably under-taxing the employee and understating the payment of debt fringe benefit on the tax certificate you issue to the employee.

The fact that SARS "accepts" the use of their incorrect formula is immaterial – SARS is not above the law! A tax calculation must be performed in accordance with the provisions of the Income Tax Act, and SARS is bound by those provisions.

7. FIFA World Cup paraphernalia

The following notice was published by SARS on 10th June 2010. By the time this conference is held, the proposed legislation will no doubt have been passed.

> ***"Pretoria, 10 June 2010** – In view of the importance of the 2010 FIFA World Cup for South Africa, its people and for nation building, draft legislation released today proposes a **once-off de minimis exemption of R750** on 2010 FIFA World Cup related items provided by employers to their employees.*
>
> *The exemption will only apply to 2010 World Cup related goods, such as T-shirts, jerseys and similar clothing, and match tickets. It will be effective for individual taxpayers for the 2010/11 tax year.*

The proposed exemption is also in support of employers that have encouraged their employees to wear FIFA World Cup T-shirts and jerseys, particularly on what has become known as 'Football-Friday', to show their support for South Africa's hosting of the 2010 FIFA World Cup."

I wonder how many of you have ensured that the excess value over R750 of the paraphernalia given to your staff was in fact taxed?

8. *Subsistence allowances*

Quite a few years ago, legislation was passed that made it (almost) impossible for a subsistence allowance to be paid as part of an employee's gross remuneration package. The final nail was the provision that a subsistence advance not utilised and accounted for by the employee or refunded to the employer within one month of being given to the employee would become taxable remuneration.

However, I have found many employers ignoring this law. When advised that it is illegal, they invariably tell me that they have checked with their auditors, who confirm that what they are doing is quite legal. I have never yet been given the opportunity to speak to the quoted auditors!

This seems to be an accepted practice for labour brokers who supply IT staff to their customers. I would suggest to SARS that they might make up some of their current deficit by performing PAYE audits on such labour brokers.

Please accept my assurance that such practices are illegal, and will cost you a lot of money should you suffer an audit. Just because your competitors are doing it (and even if your auditors say it is OK) does not make it legal.

9. *Travel allowance as part of a total package*

I receive a great deal of correspondence as editor of *Payroll World*, and much of this correspondence deals with travel allowances. I am asked what percentage of a total package can be safely taken as a travel allowance, whether a desk-bound employee can have a travel allowance if on a total package, how to calculate an acceptable travel allowance, etc.

My answer is always the same – how an employee is paid has no relevance as to whether or not they are entitled to a travel allowance.

Only if an employee does use his/her private car for business purposes (excluding travel to and from home) is he/she eligible for a travel allowance. To calculate the amount of the travel allowance, do what SARS does at the year end – multiply documented business kilometres travelled by the official rate per kilometre, which in turn depends on the total kilometres travelled in the car in a year (to arrive at the fixed cost per kilometre).

It is not a difficult concept to grasp. If an employer does not satisfy itself that the travel allowance paid to an employee is justifiable, then any such allowance paid leaves them at risk in the event of a PAYE audit.

10. UIF contributions by foreigners

Ever since the new UIF Act and UIF Contributions Act came into force in 2002, the UIF authorities have misinterpreted those Acts as they apply to foreigners. They maintained that the Acts did not apply to foreigners, even though there was only one circumstance mentioned in the Acts where this was true – a non-resident (whether a foreigner or a South African citizen) working under contract in South Africa who was obliged in terms of his contract or by law to return to his country of residence on completion of his contract was not liable for UIF contributions.

What happened in many cases was that a foreign man (usually) got a job in South Africa, and his spouse or partner came with him. The spouse/partner also took up employment, and became liable to pay UIF contributions. In due course the spouse became pregnant, and claimed a maternity benefit from the UIF.

The invariable reaction from the UIF was that the spouse should not have paid UIF contributions, and they should claim a refund of those contributions from their employers. SARS, on the other hand, who are responsible for the administration of the UIF Contributions Act, correctly said that such a refund would be illegal, as the foreign women were liable for contributions.

The root cause of the problem was a UIF regulation (not the UIF Act itself) which specified that a person had to present an SA bar coded identity document before they could claim benefits. The foreigner or spouse did not have such a document, and so could not claim a benefit, even though they had paid their UIF contributions each month. This injustice was brought to the notice of the UIF authorities time and again over the years, but they did nothing about it.

Eventually, the wording of the regulation in question was changed last year to include any valid document of identity, including foreign passports or similar documents. Once this had been gazetted, the UIF changed their minds about the liability of foreigners for UIF (although the changed regulation did not affect this liability in any way), and I have had stories related to me where employers have been instructed to make payment of UIF contributions for foreigners going all the way back to 2002. My advice to those who have been told this is to ignore this rubbish – although they are liable for those past contributions, they were instructed by the UIF at the time that they were not liable, and were entitled to rely on such "official" instructions.

In future, I hope you will all obey the unchanged law that has been in force since 2002 – the nationality of a person has no bearing on their liability for UIF. All that has changed is that they and their families can now claim benefits, provided they have some acceptable means of identification.

11. Can over-deducted PAYE be refunded to an employee by an employer?

A very interesting question came up some time ago, asking whether it was permitted to make a refund of over-deducted PAYE to an employee who earned more than the SITE limit. The person who made the enquiry stated that they could find no such prohibition in the Income Tax Act, including the Fourth Schedule to the Act.

I, and everybody else I asked in the payroll industry, was convinced that such refunds could not be made. One could only make a refund of over-deducted tax to a SITE only taxpayer, and then only at the end of a tax period.

I perused the Fourth Schedule, looking for something that specified that a refund of tax could not be made to an employee, and came across paragraph 29 where I found what I was looking for. It reads as follows –

> *"No refund of any amount of employees tax or provisional tax shall be made to the taxpayer concerned otherwise than as provided in paragraph 11B or 28 in such circumstances as may be determined by the Commissioner in any deduction tables prescribed by him under paragraph 9."*

Paragraph 11B deals with SITE refunds, which we know about, and paragraph 28 deals with the setting off of employees' tax and provisional tax against assessed tax.

I then looked at the **AS-PAYE-05 Guide for Employers iro Employees Tax – March 2009** (the deduction tables referred to in section 29) on the SARS web site, and performed a search on the word "refund". In section **11 SITE**, the third bullet reads as follows –

> *"Paragraph 11B(5)(a) of the 4th Schedule prescribes that the employer is obliged to refund the excess deducted to the employee where the employees' tax required to be deducted at the end of a tax period consists solely of SITE and the total amount of tax actually deducted exceeds such SITE required to be deducted. However, where the employees' tax required to be deducted does not consist solely of SITE, the excess deducted must be shown as PAYE on the IRP 5 / IT 3(a) and the employer is not permitted to refund the PAYE to the employee."*

So our gut feel that there was an instruction as to not refunding anybody other than a SITE only taxpayer proved to be correct!

I understand that there is one payroll supplier at least who allows the employer to choose whether or not to make such non-SITE refunds of employees' tax. This is definitely unlawful.

12. Payment for annual leave taken within 3 months of an annual bonus being paid

In a *Government Gazette* dated 23 May 2003 the Minister of Labour published some rules as to what must be included and excluded from "remuneration" when payment is made for annual leave.

The schedule in that notice is applicable not just to payments for untaken leave on termination of employment, but also to payment for annual leave when it is taken. The remuneration of employees who earn overtime, commission or other fluctuating payments must include the average of those fluctuating payments over the 13 weeks prior to the leave being taken (or shorter period if they have not been employed for 13 weeks). It is this enhanced rate that must be used to pay for annual leave, and not just the "basic" rate of pay.

Payment for annual leave does not have to include the value of payments in kind that the employee continues to receive while on leave. Items such as pension or provident fund contributions and medical aid contributions will continue to be paid by the employer while the employee is on leave, and therefore do not require to be added to the leave pay.

However, the Minister's notice makes the bald statement that the value of bonuses to which an employee is entitled must be included in leave pay, without excluding a

normal annual bonus that an employee receives each year, whether leave is taken or not. This is manifestly unfair to the employer, and is an error in the Minister's notice.

It is my opinion that payment for annual leave taken should not be increased by the value of the annual bonus that was paid to the employee at the normal bonus payment time, even though that bonus might have been paid during the 3 months prior to leave being taken. Labour law and regulations must be interpreted so as to give a fair result to both the employer and the employee, regardless of the strict legal interpretation of the actual wording.

Those of you using payroll systems provided by a payroll systems supplier will probably find that they obey the Minister's notice to the letter, and therefore overpay employees for annual leave taken within 3 months of the annual bonus being paid. This is wrong, and you should insist on your payroll supplier correcting the leave pay calculation.

I will end on that controversial note!