South African Reward Association

Budget Update 2012

Tax Law Changes 01 March 2012

Action List for 2012

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Landscape

- 1999/2000 = 579 Pages
- Since then = 1,868 Pages
- 2011: Tax Law Amendments 135 pages
- 2011 Response Documents from SARS 110 pages and Explanatory Document on Amendment Act 185 pages
- Tax Administration Bill (National Assembly) 204 pages
- 2012 contained 12 proposals impacting on remuneration and payroll professionals

Budget 2012
Standard Tax Changes

- 18% to R160,000, and rebate is R11,440
- Means tax free limit is now R63,555.56
- 40% after R617,000
- Dividends tax (15%) and Capital Gains Tax (13.3% effective)
- Medical credits for member plus dependant #1 from R216 to R230 (then R144 to R154 for additional dependants)

Budget 2012
Standard Tax Changes

- Travel Allowance claim schedule (your travel allowance calculators must be updated)

- Employer housing exemption increased to -

Current thresholds 2011/12	Proposed thresholds 2012/13
R59 750	R63 556

- Subsistence increased to R303 deemed expended per night away

Budget 2012
Travel Allowance Comparable

- R3.05 cents increased to R3.16 cents per kilometre (code 3703)
- Decision each employee must make:

  TAX-FREE REIMBURSEMENT vs. TRAVEL ALLOWANCE?

- Do not fear the calculation !

Budget 2012
National Health Insurance

•Implemented from 2012/13 over 14 year period

•Funding:

- Increase VAT rate
- Payroll tax on employer (note – employee excluded)
- Surcharge on taxable income of individuals

Budget 2012
My Recommendation

- There are no changes or planning which can be done now

- Become involved with consultative process

  - SARA Employee Benefit Committee

  - Research and Submissions *(20% rule, tax-free life cover, pension changes)*

  - There is genuine information gathering by National Treasury

  - Direct link with decision makers

  - Keep employees informed

Medical Aid Credit System

- 4th Effective Change in past 10 years

- Philosophical reason – Rand value of tax relief should be the same for different tax brackets

- Makes no difference whether employer or employee contribution

Medical Credit Example 40%

Medical Aid Example - 40%

	Old	New
Salary	10 000	10 000
Medical Aid	1 000	1 000
Relief	-720	n/a
Taxable Income	10 280	11 000
Tax Thereon (before rebates)	-4 112	-4 400
Personal Rebate	953	953
Medical Aid Relief	n/a	230
Take-Home	**6 841**	**6 783**

Example Explained

Difference Explained

	Old		New
Take Home	6 841		6 783
Difference In Take Home	**-58**	**per month**	
<u>Reason:</u>			
Relief Before	720		
Tax Rate	40%		
Effective Relief	288		
Tax Relief Now	-230		
Difference	**58**		

Medical Credit Example 18%

Medical Aid Example - 18%

	Old	New
Salary	10 000	10 000
Medical Aid	1 000	1 000
Relief	-720	n/a
Taxable Income	10 280	11 000
Tax Thereon (before rebates)	-1 850	-1 980
Personal Rebate	953	953
Medical Aid Relief	n/a	230
Take-Home	**9 103**	**9 203**

Example Explained

Difference Explained

	Old		New
Take Home	9 103		9 203
Difference In Take Home	**100**	**per month**	
<u>Reason:</u>			
Relief Before	720		
Tax Rate	18%		
Effective Relief	130		
Tax Relief Now	-230		
Difference	**100**		

Summary at Member Level

Medical Credit Summary

Tax Rate	Member and 1st Dependent			Additional Dependents		
	Old	New	Effect	Old	New	Effect
18%	130	230	100	79	154	75
25%	180	230	50	110	154	44
30%	216	230	14	132	154	22
35%	252	230	-22	154	154	-
38%	274	230	-44	167	154	-13
40%	288	230	-58	176	154	-22

Summary of Number of Members

Medical Credit - Take Home Impact

Tax Rate	Number of Medical Aid Members					
	1	2	3	4	5	6
18%	100	201	276	350	425	500
25%	50	100	144	188	232	276
30%	14	28	50	72	94	116
35%	-22	-44	-44	-44	-44	-44
38%	-44	-87	-100	-114	-127	-140
40%	-58	-116	-138	-160	-182	-204

Budget 2012
Retirement Reform

- Effective 01 March 2014
- Employer pension, provident and retirement annuity contributions are taxable income for employee
- Employee deduction:

Below 45	Above 45
Employment / Taxable Income	
22.50%	27.50%
R250,000	R300,000

Budget 2012
Retirement Reform

- Minimum threshold of R20,000 to ensure low income earners can claim larger deduction:

  - Below 45: R88,888 x 22.5% = R20,000
  - Over 45: R72,727 x 27.5% = R20,000

- Example – employee earning R60,000 per year will be allowed to contribute 33% (regardless of age) as R60,000 x 33% = R20,000

Budget 2012
Retirement Reform - Other

•Non-deductible contributions (in excess of the thresholds) will be exempt from income tax if, on retirement, they are taken as either part of the lump sum or as annuity income. Measures to address some of the complexities of defined benefit pension schemes will be considered. These amendments will come into effect on 1 March 2014.

•A rollover dispensation similar to the current retirement annuity contributions will be adopted to allow flexibility in contributions for those with fluctuating incomes.

•Contributions towards risk benefits and administration costs within retirement savings will be included in the maximum percentage allowable deduction.

•Lump sum withdrawals upon retirement from pension and retirement annuity funds are restricted to a maximum of one-third of accumulated savings.

Budget 2012
False Terminations

- Employees cannot withdraw funds from employer-provided retirement schemes before retirement unless an employee terminates employment with that employer. In some instances, employees terminate their employment solely to gain access to employer-provided retirement funds.

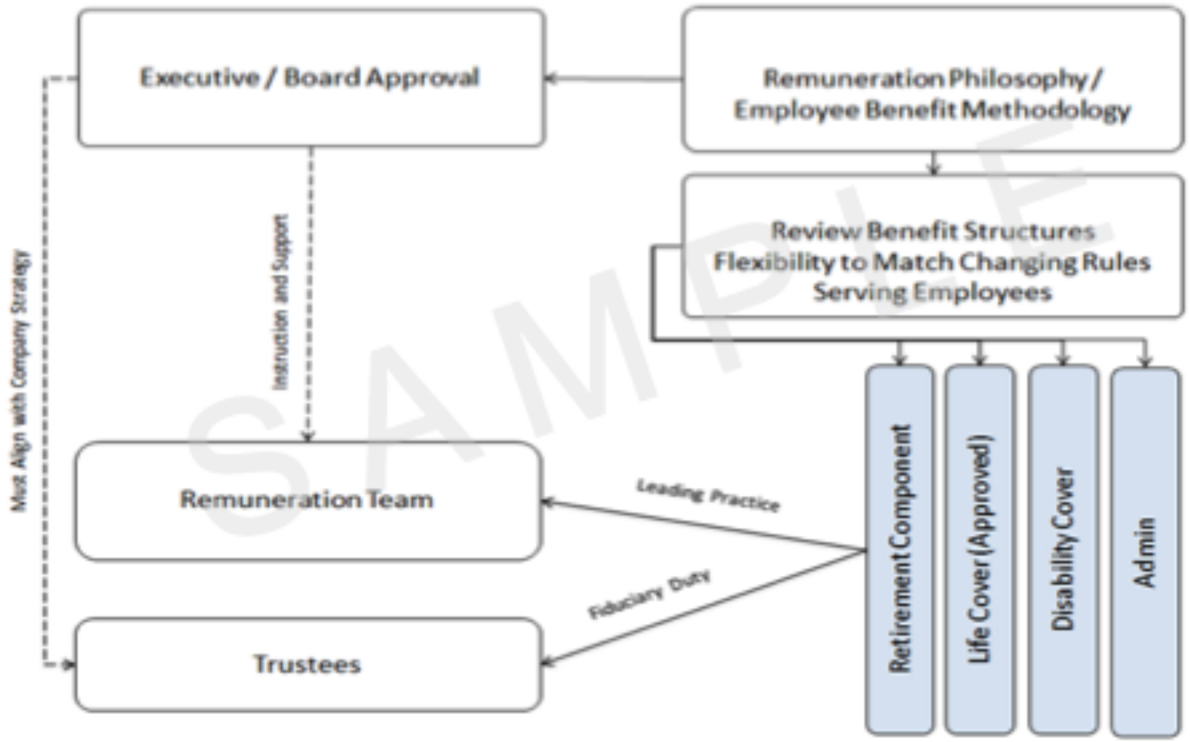
- In the most circumstances, employees quit employment only to be rehired by the same employer shortly thereafter.

- Access to withdrawal under these artificial circumstances will no longer be permitted.

Budget 2012
Pension Changes

- What you should do now:
  - Determine your remuneration philosophy / methodology
  - Executive approved
  - Confirm / educate with trustees
- What you <u>cannot</u> start doing now:
  - Change to fund rules
  - Change provident to pension fund
  - Start messing about with contribution percentages
  - Start consultative or change process with employees

Retirement Changes



Budget 2012
Likely Future Best Practice

- Cost neutral conversion to TGP (cost to company), otherwise
  - You compute contributions on “basic salary”, but tax relief on higher of employment or taxable income.
  - Law gives capped limits, and you are either under or over those limits.
  - No flexibility to align remuneration with new rule

- Re-look at flexibility of contributions, if you are not on already:
  - Flexing employer / employee percentages
  - “Approved” life cover, with flexibility
  - The admin is fully managed by calculation tool

Budget 2012
Tax Ombudsman

- During 2012, South Africa will establish a dedicated ombud for tax matters.
- The office is intended to provide taxpayers with a low-cost mechanism to address administrative difficulties that cannot be resolved by SARS.

Budget 2012
Fringe Benefit Values

•In certain cases, the Income Tax Act prescribes the use of a formula to calculate the value of a fringe benefit to be taxed in the hands of the employee (for example, housing and company vehicle).

•However, in these cases, it is sometimes possible for the employer to determine or obtain the actual cost of providing the fringe benefit to the employee (for example, actual business and private kilometres travelled by an employee using a company vehicle, and employers that provide rented vehicles to their employees as "company vehicles").

•To create a better match between the employees' tax withheld and the tax calculation on assessment, it is proposed that, where possible and practical, the employer be allowed to use actual cost to determine the value of the fringe benefit for the employee.

Budget 2012
Employer Insurance for Contingent Liabilities

- In 2011, the taxation of employer-provided insurance was rationalised. One of the aims of this rationalisation was to ensure that deferred compensation policies are not disguised as key person insurance.

- One unresolved issue relates to the purpose for which genuine key person insurance is intended. Insurance to cover against operating losses due to the loss of an employee clearly should be deductible for an employer if desired.

- On the other hand, deducting premiums for insurance to purchase ownership interests of an employee-shareholder or to repay the allocation of debt guaranteed by an employee-shareholder is questionable.

- These issues will be resolved in 2012 or 2013

Budget 2012
Offshore Pensions

- There are currently a number of anomalies in the tax treatment of lump sum and annuity pay outs from South African or foreign retirement funds, depending on whether a South African resident or a non-resident receives the pay out.

- An important factor is whether the services that relate to the pay out were rendered in South Africa or elsewhere.

- The issue will receive due consideration during the course of 2012 and 2013.

Changes Effective 01 March 2012 Employee Insurance

- Introduction of sub-paragraph 2(k) into the Seventh Schedule

  (k) the employer has during any period made any payment to any insurer under an insurance policy directly or indirectly for the benefit of the employee or his or her spouse, child, dependant or nominee.

Changes Effective 01 March 2012
Section 12C

- Section 12C effective 01 March 2012

- Expenditure incurred by an employer during a year of assessment in respect of any premiums payable under a policy of insurance directly or indirectly for the benefit of an employee or his or her spouse, child, dependant or nominee.

- Deemed to have been paid by that employee.

- Where an appropriate portion of any expenditure cannot be attributed to the employee for whose benefit the premium is paid, the amount of that expenditure in relation to that employee, then total expense divided by the number of employees.

Problem Statement on Insurance

- Law drafting problematic
- Consultative Process – Accident policies:

Response: Accepted. The legislation will be extended to include short-term insurance that covers injury, disability or death of an employee (or a director of the employer). <u>However, a carve-out will be created for employer-policies exclusively aimed at providing cover against accidents arising out of (and in the course of) an employee's employment and resulting in personal injury, illness or the death of the employee.</u>

Approved vs. Unapproved

- Approved: No fringe benefit tax on contributions, then on pay out taxed according to table in Second Schedule. Trustees consider all dependants and determine allocation.

- Unapproved: Fringe benefit on contributions (after-tax contributions) and then on pay out tax free. Funds go to nominated beneficiary in policy.

Approved = No Fringe Benefit Tax

- National Treasury Response: Accepted. The proposed amendments were not intended to alter the tax treatment of approved group life schemes. This position will be clarified in the legislation.

- It was not clarified in legislation, but reconfirmed in Explanatory Memorandum (retirement fund is beneficiary)

Types of Unapproved

- Design Attributes:
  - Employer normally policy holder
  - Beneficiary of the policy:
    - Employee
    - nominees of the employee

- Unapproved life cover – policy pays to nominated beneficiary and not to trustees who decides on dependants.

- Disability Cover:
  - Capital Disability Benefit
  - Severe Illness Benefit
  - Dread Disease
  - Trauma schemes

Types of Unapproved

- Other types of unapproved plans:
  - Funeral Cover
  - Spouse’s Cover
  - Global Education Protector
  - Related type benefits
- Impact on Employee remuneration:
  - Taxable as a fringe benefit from 01 March 2012 onwards
  - Pay out to employee / nominee is tax-free

Unapproved: Income Continuation

- Type of Insurance Policy which
  - it covers that person against the loss of income as a result of:
    - Illness
    - Injury
    - Disability
    - unemployment
  - The amount payable under the policy is taxable income

= Taxable as a fringe benefit

= Deemed to be an employee contribution under 12C

= Employee gets deduction under 23(m)(iii)

Unapproved: Income Continuation

- In-and-out provision

Tax Computation

Taxable Income Before	10 000
Disability Fringe Benefit	1 000
	11 000
Deduction (Employee Income Protection)	-1 000
Taxable Income Now	**10 000**

- Tax neutral for employee

- Additional disclosure on payroll and tax claim on personal tax return

- End of Year Tax filing & what certificates must be issued?

Unapproved: Income Continuation

- Types of policies
    - Income Continuation Benefit (ICB) Schemes
    - Permanent Health Insurance (PHI) Schemes
    - Total and Temporary Disability (TTD) Schemes

Accident Policies

- Types:
  - General accident policies (group life, disability etc.)
  - Specific work accidents
  - Travel insurance
  - Professional indemnity (directors / trustees)
  - Vehicle insurance
- Normally taken for employees as a group and single premium for all employees

Problem Statement

- "Carve out" under law not created
  - Should have linked 12C in Seventh Schedule to 11(w) – not done

w) expenditure incurred by a taxpayer in respect of any premiums payable under a policy of insurance (other than a policy of insurance solely against an accident as defined in section 1 of the Compensation for Occupational Injuries and Diseases Act, 1993 (Act No. 130 of 1993)) of which the taxpayer is the policyholder …

  - Technically 2(k) and 12C in full force and no limitation
  - Consider impact on travel insurance, vehicle insurances, events insurance etc.
  - Proposal – do not tax where exemption will be applied (law corrected).

Problem Statement

- "Accrual" concept not overridden
  - Intention of the Legislature

In the case of unapproved plans, the parties to whom the proceeds must be paid may vary. The policy can be structured so that the proceeds can be paid directly to the employees or to the employer. If the pay out is made to the employer, a side arrangement usually exists so that the employer is obligated to turn over the insurance proceeds (or their equivalent) to the employees.

An insurance policy can be intended directly or indirectly for the benefit of an employee. The employee can be the named beneficiary of the insurance policy. Alternatively, the employer can have an obligation in terms of the employment contract to pay the proceeds over to the employee.

Problem Statement

- Intention of the Legislature (continued)

  It is also possible that, in the absence of a formal obligation to pay over the proceeds, the established practice of the employer might indicate that the employer has the intention to benefit the employee. In each of these cases, the view is that the employer paid the premiums under the insurance policy directly or indirectly for the benefit of the employee.

- The critical point to consider:

  - Is there an unconditional entitlement to the benefit?

  - Yes – taxable income

  - Yes – no fringe benefit, but intention of the legislature (directly or indirectly)

Deferred Compensation

- Specifically taxed as fringe benefit

  Because these policies will now generate a fringe benefit for the employee, policyholders (employers) may seek to end the arrangement.

- *Pre-1 March 2012 compensation plans*

  - a legislative exit route to policyholders

  - the employer will have the option to exercise one of the following exit routes, once the policy has been made paid-up:

    - *Cede the policy:* The employer can cede the policy to the employee. In this case, <u>the value of the policy as at the date of cession will be included in the income of the employee</u>. The income will not be taxable as a "severance benefit" regardless of the circumstances of the cession.

Deferred Compensation

- *Make the policy paid-up:* The employer can elect to receive the proceeds from the policy and thereupon pay those proceeds over to the employee. The employee will be taxed on the proceeds received from the employer (and these amounts will be included within Pay-As-You-Earn withholding). Again, the proceeds will not be taxable as a "severance benefit", regardless of the circumstances of the pay out.

- Premiums paid as a fringe benefit from 1 March 2012 onwards.

- *B. Compensation plans from 1 March 2012*

All premiums paid in respect of employer owned investment policies for the benefit of employees must be included in the income of the employees as a taxable fringe benefit.

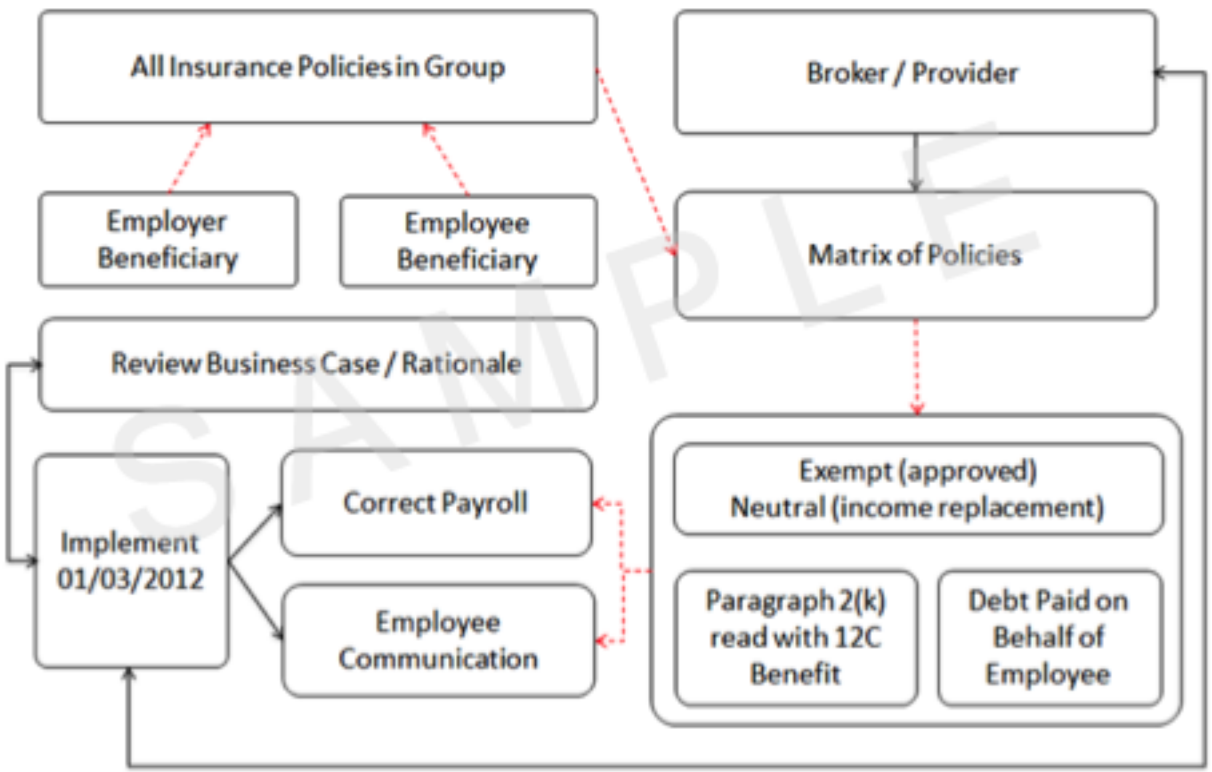
Deferred Compensation

C. Cession of compensation investment and pure risk policies

The cession of pure risk policies not generate income in the hands of the employee. This exclusion applies regardless of how the previous policyholder (i.e. the previous employer) treated the policy from a tax point of view.

Result - Continuation option not a problem

Decision Making



Example Calculator

Dividends from Share Trusts

- Dividends in respect of equity instruments are treated as ordinary revenue unless the instruments constitute an equity share or the dividend itself constitutes an equity instrument.

- The purpose of these dividend rules is to prevent taxpayers from converting high-taxed salary into low (or no) taxed dividends.

- There is a carve-back to limit the new anti-avoidance rule without re-opening pre-existing avoidance. More specifically, if the only shares held by a trust are unrestricted equity shares, those dividends will be excluded from the anti-avoidance rule.

Company Vehicle

Company Vehicle: Used 80% on Business	80%	20%
Determined Value	300 000	300 000
Fringe Benefit (as disclosed on IRP5)	126 000	126 000
Tax Inclusion	100 800	25 200
Tax Thereon (40%)	40 320	10 080
On Tax Assessment	10 080	10 080
Tax Refund	**30 240**	-
Monthly Out of Pocket (cumulative):	*2 520*	

Company Vehicle

- Company vehicle makes more financial sense where true tool of trade
- Does not make sense for executives / expatriates
- Logbooks compulsory for company vehicles (other policy adjustments are AARTO / Toll Fees)
- No logbook = incorrect financial decision and additional tax assessment (20% not taxed)

SITE Change

- R60,000 remuneration – final tax
- Low income earners with multiple sources
- 3 year phase out
- 1/3rd of additional tax 2011/12
- 2/3rd of additional tax 2012/13

SITE Example

SITE Example

	IRP5 #1	IRP5 #2
Salary	50 000	50 000
Employees' Tax	-	-
Tax Return	100 000	
Tax Thereon	7 245	
2011/12	**2 415**	1/3rd of liability
2012/13	**4 830**	2/3rd of liability

Who should submit a tax return

- Where you had more than one source of income, even where you worked on a week somewhere else or had any interest or other income.
- Where you did not work the full 12 months – this is where you will also qualify for a tax refund.
- Where your employment income equals or exceeds R120,000 for the year.
- Where you are older than 65 years.
- Where you had a retirement annuity, medical aid expenses, made donations, received a travel allowance etc. - all these will allow you to qualify for a tax refund

Assisting Employees

- IT88
- Standard communication that penalty charge automatic
- Not sorted will continue to apply

Assessed loss or taxable income for preceding year	Penalty
Assessed loss	R250
R0 – R250 000	R250
R250 001 – R500 000	R500
R500 001 – R1 000 000	R1 000
R1 000 001 – R5 000 000	R2 000
R5 000 001 – R10 000 000	R4 000
R10 000 001 – R50 000 000	R8 000
Above R50 000 000	R16 000

"Severance Benefit"

- 55 years
- Sickness, accident, injury or incapacity through infirmity of mind or body
- Retrenchment
- Grouped with Retirement Table
- 1st applied = tax directive relief
- 2nd applied = cumulative tax directive relief
- Retirement = cumulative total applied

Severance

- No more R30,000
- No more average tax rates
- Directive
- Normal tax
- When retire – appears even leave pay is exempt under retirement

Summary for 2012

- Significant changes over the coming years

- Employers of choice will know what they pay employees (total reward statements) – make every cent counts

- Make sure you know all components, otherwise:
  - Wasted spend
  - Tax risk

- Correct classification of taxable benefits / insurances

- Good time to re-look at everything “which was always done this way” – SARS has, you’d be advised too.

Questions