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GMS Flash Alert

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South Africa - Tax Treatment of Tax Compliance Services Provided to Employees

The Supreme Court of Appeal ("SCA") of South Africa has confirmed that tax compliance services provided to an employee at the cost of the employer constitute a taxable fringe benefit in the hands of the employee.[1] Accordingly, the costs incurred by the employer in the rendering of the service must be included in the employee's taxable income.

WHY THIS MATTERS

The new tax treatment will affect employers that have expatriate employees who are tax equalised or tax protected, since the employer, accordingly, is liable to bear the tax cost in the host location – this would now include the tax in respect of the tax compliance service benefit. This fringe benefit will increase the cost to the employer of seconding an employee to South Africa, and could have the same impact on a business traveler to South Africa, if the trip gives rise to a South Africa tax filing obligation.

In the case before the SCA, only the completion of a South African tax return in the context of an inbound expatriate employee was considered. However, when applying the court's rationale, the same principles could be applied to home country tax compliance services.

Context

Many employers engage with service providers to assist with the preparation and submission of their employees' personal income tax returns. This is most prevalent in the case of organisations wanting to mitigate the risk of non-compliance by their executive employees and multinational organisations with an active expatriate employee population.

Non-compliance by directors of a company holds both a reputational risk as well as a commercial risk for the employer as the company may not be able to obtain tax clearance if one of the directors have not complied with their tax obligations.

Often, in order to simplify matters for employees going overseas and to make the choice of taking an international assignment more appealing, multinational organisations will offer the services of a tax service provider to their expatriate employees, an international assignment-related cost that they bear. Moreover, in the majority of cases, the expatriate employees are tax equalised or tax protected and the employer is therefore liable to bear the tax cost in the employee's host location. With this decision by the SCA, the tax cost would now include the tax in respect of the tax compliance service benefit.

Case Background

The case before the SCA dealt with a multinational organisation with expatriate employees inbound to South Africa. The expatriate employees were tax equalised and, accordingly, any tax liability which became due and payable in South Africa would be for the employer's expense. In the interest of helping to ensure that the correct amount of tax (for which the employer was liable) was paid to the South African Revenue Service ("SARS"), a service provider was appointed to prepare and file the employees' South African personal income tax returns.

A Free or Cheap Service

Tax returns for expatriate and executive employees have often been provided on the basis that this service that is offered can help to manage the employer's financial and reputational risks and therefore is ultimately for the benefit of the employer. Where any service has been rendered to an employee at the expense of an employer and no consideration has been given by the employee, a free or cheap service taxable benefit must be accounted for.

Reliance has been placed on commentary[2] that the use of a free or cheap service must be wholly private or domestic and if used partially for the business or affairs of the employer would not be a taxable fringe benefit.

Court Ruling

The SCA has held, however, that the service does not have to be exclusively for the benefit of the employee in order to fall within the ambit of the fringe benefit provisions.

Accordingly, though there may be a peripheral advantage to the employer in having the expatriate employees' compliance matters attended to by a designated service provider, the service is ultimately provided in order to assist the employees in meeting their personal obligations to SARS, resulting in a taxable fringe benefit.

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Value of the Benefit

The value of the fringe benefit is the actual cost incurred by the employer in the rendering of the service.[3] Determining the cost of the service may become problematic where the employer has agreed bundled fees which incorporate a number of services, some of which may be for the exclusive benefit of the employer. Another layer of complexity may be added where the service contract has been signed internationally and there are additional costs (for example co-ordination fees for central offices) added to what is ultimately billed to the employer.

Actions by Other Countries

It is notable that countries like the United Kingdom[4] and the United States of America[5] have rules in place to address the value to be placed on a service of this nature and how the employer's expense for the rendering of this service is to be treated for tax purposes. The U.S. recently provided clearer guidance than was previously available, generally requiring

an imputed benefit amount based on the amount actually paid by the employer to the service provider. This simplifies the process of determining what cost relates to the benefit derived by the employer versus that of the employee.

Timing of the Accrual

An additional complexity, which makes it difficult for employers and the individuals receiving the service, is the timing thereof. For example, where 2019 tax returns are submitted by the service provider, these are submitted long after the end of the tax year, and thereafter invoiced, directly or indirectly, to the employer. At the point at which the employer pays the costs, the expatriate employee may no longer be working in South Africa. It is possible that the local employer will not even be aware of the costs being incurred as a result.

What about Past Tax Years?

One big question on many people's minds, is what about past tax years? The prevailing practice was not to treat this as a taxable benefit. Are individuals and employers now potentially exposed for past tax years, or will this only apply going forward?

Considerations for Employers, Employees, and Service Providers

- South African resident employers need to process a taxable benefit through the payroll and must account for employees' tax withholding in respect of the benefit, where relevant.

- Employees need to include the cost of tax compliance services provided at the expense of their employer in their taxable income declared to SARS – either reported on the IRP5, or declared as additional foreign-paid remuneration paid by a foreign employer on submission of the annual income tax return.

- Employers and service providers may wish to look again at the way their service agreements are structured in order to carve out services provided for the exclusive benefit of the employer so that the employee is not subject to tax on services from which they derive no benefit.

FOOTNOTES:

1 *BMW South Africa (Pty) Ltd v The Commissioner for the South African Revenue Service* (1156/18) [2019] ZASCA.

2 D Davis *et al Juta's Income Tax,* Volume 3, Schedule 7.

3 Paragraph 10 of the Fourth Schedule to the Income Tax Act, No 58 of 1962.

4 See ITEPA 2003(3)(a). For further guidance from HMRC, click here. Please note, there is no specific legislative reference to the taxation of tax preparation or accountancy fees; these are taxed as a benefit-in-kind on the basis that this is an amount paid by the employer on the individual's behalf. Generally, the full amount of the amount paid by the employer is taxable in the United Kingdom; however, HMRC has agreed by exception that for tax-equalised assignees a deemed amount can be reported on the basis that the individual needs to file a return due to their assignment.

5 For relevant rules and pronouncements, see U.S. Internal Revenue Code sections 61(a)(1) and 132(d), U.S. Treasury regulation section 1.61-21(b)(2), IRS Chief Counsel Advice 201810007.

Contact us

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