GMS Flash Alert

2020-293 | June 23, 2020

South Africa - Commuter Flights Provided by Employers to Their Employees

Where South African-tax-resident employees are paid by a South African-resident employer and they qualify for the foreign employment income exemption, if their remuneration exceeds ZAR 1.25 million per tax year, employees' tax withholding is now required in respect of the amount exceeding ZAR 1.25 million. For South African-resident employees who do not qualify for the foreign employment income exemption, employees' tax must be withheld in respect of the total amount of remuneration payable by the South African-resident employer.

With effect from 1 March 2020, the foreign employment income[1] exemption has been limited to apply to only ZAR 1.25 million of an outbound expatriate employee's remuneration. (For related coverage, see GMS *Flash Alert* 2020-183, 20 April 2020.) Employers and employees are therefore required to consider the tax treatment of benefits which were previously exempt from tax in terms of this exemption.

WHY THIS MATTERS

The inclusion in taxable income of the cost of several flights per tax year, to and from the employees' place of employment, may result in a significant increase in the tax cost for the employees or for the employer where the employees are tax equalised. Furthermore, the benefit may be taxable both in South Africa and in another country. Where this is the case, cash-flow difficulties are likely to arise where non-tax equalised outbound expatriate employees are paid from South Africa and South African employees' tax (PAYE) is required to be withheld on a monthly basis in both jurisdictions.

Background

In terms of paragraph 10(2)(b) of the Seventh Schedule to the Income Tax Act[2] any transport services provided by an employer to its employees, in general, for the conveyance of such employees from their homes to the place of their employment and *vice versa* will have no value for tax purposes.

Binding Private Ruling (BPR) no. 158 was issued by the South African Revenue Service ("SARS") some years ago, and placed no value for tax purposes on transport services provided by the applicant to its employees to convey employees working on projects in South Africa on a rotational basis between the foreign country and the construction project sites in South Africa. In terms of this ruling, the cost of flights paid for by the employer was not treated as a taxable benefit in the hands of the employees.

The BPR expired in 2016, which meant it could not be legally relied upon any longer. However, the principles remained i.e., that the benefit has no taxable value. In the absence of anything to the contrary, it would still have been relied upon by many taxpayers whose circumstances were the same as that per the BPR. This ruling has not been renewed, and SARS has indicated in the ruling itself, that the underlying principles confirmed in the ruling are currently under review.[3]

Purpose of BPRs

BPRs are issued in favour of a specific applicant and cannot be applied in general by other taxpayers.

They determine how SARS interprets and applies the relevant tax legislation in relation to a proposed transaction. However, they do not constitute a practice generally prevailing. Nevertheless, they are published for information purposes and can be useful to other taxpayers who wish to implement similar transactions or arrangements as they provide insight regarding how SARS is likely to interpret the legislation.

The above-mentioned BPR 158 was issued on 4 October 2013 and was valid for a period of two years.

Current Context for Employers Paying for Commuter Flights

Companies that fly their employees in and out of a country on a regular basis to perform their jobs, with commuter arrangements, can incur relatively significant costs for these flights. Where they have been interpreted to be for business purposes, the no-tax-value provision as set out in the Seventh Schedule to the Act applies, and, so, they will not have been taxed in the employees' hands.

If SARS were to change its interpretation of the legislation and tax these flights, many employees, or their employers where they are tax equalised, will potentially face huge additional tax bills, as well as potential penalties and interest for periods under review.

This could have a significant impact on employees and employers who have based the tax treatment of the cost of flights paid for by the employer on the principles outlined in a BPR issued some years ago, or who have interpreted the legislation (paragraph 10(2)(b) of the Seventh Schedule to the Income Tax Act) in a similar way.[4]

So, Why a Change in Interpretation?

The rationale behind SARS' change in interpretation may be that the "no value" provision in relation to the tax treatment of transport services in paragraph 10(2)(b) of the Seventh Schedule to the Income Tax Act, was intended to apply where the benefit is provided to all employees in general, rather than to just a class of employees, such as employees on fly-in, fly-out ("FIFO"), rotational, and other commuter arrangements.

KPMG NOTE

Employers are cautioned that transport services provided to certain categories of employees (e.g., commuter fly-in fly-out assignees) should obtain confirmation from SARS regarding the taxability of such flights before treating them as exempt from tax going forward.

What Should Employers Consider Doing Now?

South African-tax-resident individuals may claim a foreign tax credit ("FTC") against their South African tax liability on foreign-sourced income for taxes proved to be payable (without a right of recovery) in a foreign jurisdiction. Historically, individuals have only been able to claim foreign tax credits when preparing their annual income tax returns, as employees' tax withholding is not regarded as a final tax. However, to alleviate the burden of double taxation on a monthly basis, an employer may apply to SARS for a tax directive in terms of paragraph 10 of the Fourth Schedule to the Income Tax Act, to vary the basis on which employees' tax is withheld in South Africa.

The tax directive application is used to agree a method with SARS to vary the basis on which the monthly employees' tax liability is calculated. An employer is required to submit an IRP3(q) tax directive application form to SARS, and once the tax directive has been issued, the employer will be permitted to take into account a potential foreign tax credit to reduce the rate of tax in South Africa for employees' tax purposes.

Note that this is not the actual granting of the foreign tax credit by SARS in terms of section 6*quat* of the Income Tax Act. The employee is still required to submit an income tax return in which the actual foreign tax credit is claimed under section 6*quat* of the Income Tax Act. The final foreign tax credit available to the individual will then be confirmed on assessment of the individual's income tax return and supporting documentation will need to be submitted in order to prove the claim.

It is important to note that this type of tax directive application will not be considered where the employee's income is not subject to tax in a foreign country and therefore not subject to double taxation, or where the foreign tax due cannot be proved to be payable.

Furthermore, the employer needs to be aware of the potential risk of under-withholding employees' tax should the employee's circumstances change, as this may affect the withholding obligation of the employer. The under-withholding of employees' tax will attract penalties and interest for the employer.

What Are the Options Where the Employee Is Paid by a Nonresident Employer?

Remuneration paid to an employee by a nonresident employer is not subject to South African employees' tax withholding. However, the employee is required to register as a provisional taxpayer and submit six-monthly provisional tax returns (Forms IRP6), together with the corresponding tax payment. Taxpayers may claim foreign tax credits when preparing their provisional tax returns in order to prevent the double taxation of their income.

KPMG NOTE

Employers need to determine whether they are comfortable with the tax treatment of their commuter flights.

Many tax service providers, including the KPMG International member firm in South Africa, can assist employers by evaluating the tax treatment applied by the employer in respect of the cost of flights for employees on FIFO, rotational, and other commuter arrangements, and advising on the options available.

To the extent such employers wish to obtain confirmation from SARS regarding the exempt tax treatment of these flights, KPMG is able to apply for a tax ruling confirming this on their behalf.

Should these flights be seen as taxable, employers will need to assess how they wish to proceed, having regard to their specific circumstances or whether they require assistance in applying for a directive to offset the FTC against additional taxable income that may arise as a result of taxable benefits creating income in excess of the ZAR 1.25 million exemption which now applies.

FOOTNOTES:

1 Section 10(1)(o)(ii), Income Tax Act No. 52 of 1962 (as amended).

2 Income Tax Act No. 58 of 1962 (as Amended).

3 LAPD-IntR-R-BPR-2014-01 – BPR 158 Transport Services Provided by an Employer for Employees.

4 Paragraph 10(2)(b) of the Seventh Schedule to the Income Tax Act.

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ZAR 1 = EUR 0.051
ZAR 1 = USD 0.058
ZAR 1 = GBP 0.046
ZAR 1 = INR 4.383

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