Payroll Authors Group of South Africa

Newsflash

No. 15 of 2022

11 March 2022

EMPLOYMENT TAX INCENTIVE ACT AMENDMENTS – CURBING ETI ABUSE

Before discussing the details of the amendments to the ETI Act (Employment Tax Incentive Act) to curb ETI abuse that are effective from 1 March 2022, I would like to thank National Treasury for their help from a policy perspective, and to thank SARS for putting up with my many emails, for their support during the past weeks, and for their clarification of the new ETI requirements.

Included in the appendix to this Newsflash is the result of our discussions with SARS in the form of an NBPO (Non-Binding Private Opinion) that was issued by SARS dated 7 March 2022.

The issuing of the NBPO was followed by an investigation by the PAGSA Exco into the practical application of the NBPO, resulting in an example of the calculation of ETI 'monthly remuneration' that is included, after approval by SARS, in a later section of this newsflash as guidance for the payroll supplier members of the PAGSA.

The correct calculation of ETI 'monthly remuneration' is of huge importance to all parties.

If 'monthly remuneration' is incorrectly calculated, the ETI amount will be calculated incorrectly, resulting in an incorrect reduction of the employer's PAYE liability on the EMP201.

Apologies to our payroll supplier members that it has taken some time to reach the point where we are now with this Newsflash. It has been a difficult time for payroll suppliers – how can you change a payroll system when you don't know what the changes are?

The challenges that payroll suppliers face with the timeous implementation of the new ETI requirements has been formally communicated to SARS by the PAGSA.

The final changes to the ETI Act were made in October/November 2021 by the Standing Committee on Finance and were published in the TLAA (Taxation Laws Amendment Act) that was issued on 19 January 2022, accompanied by a final Explanatory Memorandum that was issued a week later on 25 January 2022.

The limited amount of time available between the publication of the TLAA on 19 January 2022 and the effective date of 1 March 2022, coupled to the fact that ETI is calculated monthly, has put a lot of pressure on everybody.

Purpose of the ETI Act

The purpose of the ETI Act is to encourage employers to hire young people between the ages of 18 and 29 by subsidising their wage cost.

The ETI is therefore an employment incentive, not a training incentive.

As an aside, Government subsidises the cost of training employees in two ways that I am aware of:

1. Learnership Incentive (Allowance)

   If the studies are in the form of a SETA-provided learnership in terms of the Skills Development Act, the Learnership Incentive (as it is now called) has been available from 2001 to assist employers with these costs.

2. Bursaries and Scholarships

   Bursary schemes reduce the taxable value of the fringe benefit that results from the payment by the employer on behalf of the employee to a recognised training institution for the training of either the employee, or the relatives of the employee.

   The bursary training expenses paid by the employer on behalf of the employee are allowed as a deduction in the hands of the employer.

Background to 'ETI Schemes'

Several years ago SARS became aware of what is now referred to as 'ETI Schemes', and after investigation, the action that Treasury and SARS decided to take first appeared in the public domain in the 2021 Budget Review, as follows:

"Some taxpayers have devised certain schemes using training institutions to claim the ETI for students. To counter this abuse, it is proposed that the definition of an "employee" be changed in the Employment Tax Incentive Act (2013) to specify that work must be performed in terms of an employment contract that adheres to record-keeping provisions in accordance with the Basic Conditions of Employment Act (1997).

The Problem with 'ETI Schemes'

According to the final Explanatory Memorandum issued by National Treasury and SARS on 25 January 2022, these schemes while varying in nature, are broadly along the following lines.

"Eligible participants are recruited by a recruitment agency and employed by a participating employer for a fixed term period of 12 to 24 months.

Participating employers engage with the recruitment agency to recruit eligible participants. Contracts signed by the eligible participants indicate the receipt of remuneration while 'employed' by the participating employer.

Once 'employed', participants are trained by a training institution (over the 12 to 24 month period) and, in some cases, enrolled in Sector Education and Training Authority (SETA) accredited courses.

The training institution is contracted by the participating employer at a cost equal to the remuneration stated in the eligible participant's contract. The remuneration stipulated in the contract is paid to the training institution as opposed to being paid to the eligible participant.

In some cases, the eligible participants are exposed to work-based exercises and activities by an independent company.

The independent company is able to utilise the eligible participants for a fixed monthly fee, which similar to the remuneration, is not paid to the eligible participant.

Once the training programme is completed, the eligible participant may work for the participating employer for the remainder of the 12 to 24 month period.

In accordance with said scheme, the participating employer is then able to claim the ETI for the 12 to 24 month period that the eligible participant is supposedly 'employed' by the employer."

Intention of the Amendments to the ETI Act

Quoting further from the Explanatory Memorandum of 25 January 2022.

In order to address the above-mentioned contraventions, it is proposed that changes be made in the ETI Act to clarify that substance over legal form will be considered when assessing an employer's ability to claim the ETI.

As such, 'work' must actually be performed in terms of an employment contract and the employee must be documented in the employer's records as envisaged in the record keeping provisions contained in section 31 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997).

Further to the above, the employee must, in lieu of services rendered, receive cash remuneration from the employer.

The last (underlined) sentence of the final Explanatory Memorandum of 25 January 2022 was not in the Explanatory Memorandum issued on 28 July 2021 for public comment.

It was added to the final Explanatory Memorandum to explain the new proviso to the definition of ETI monthly remuneration in the ETI Act (discussed below) that was added by the Standing Committee on Finance just before the final TLAB (Taxation Laws Amendment Bill) was tabled in the National Assembly for approval towards the end of 2021.

The Solution to 'ETI Schemes'

The TLAA issued on 19 January 2022 made changes to the ETI Act to curb the abuse of the ETI system whereby some taxpayers have devised schemes whereby ETI is claimed in respect of individuals who do not work for them and therefore do not comply with the definition of "employee" in section 1(1) of the ETI Act.

Three areas of the ETI Act (Employment Tax Incentive Act) have been amended by the TLAA:

1. The definition of an employee
2. The definition of 'monthly remuneration'
3. The qualifying conditions of section 6.

These three changes are designed by the policymakers as a package to curb the abuse of the ETI Act and are discussed in the sections below.

The first and third changes are relatively easy to understand, but the second one - the change to the definition of 'monthly remuneration' - is problematic.

Sections of the SARS NBPO will be copied from the appendix where relevant to the discussion of the amendments that follow, but it is advisable to read through the NBPO to familiarise yourself with its contents before continuing.

The three areas of the ETI Act that have been changed are discussed in the sections that follow.

The Solution: The Definition of an Employee

The TLAA of 19 January 2022 has expanded the definition of an employee in the ETI Act by inserting the underlined wording, as follows:

'employee' *means a natural person—*

(a) who works for another person and in any other manner directly or indirectly assists in carrying on or conducting the business of that other person

(b) who receives, or is entitled to receive remuneration from that other person; and

(c) who is documented in the records of that other person as envisaged in the record keeping provisions in section 31 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997),

but does not include an independent contractor

The policy makers have looked to labour law principles to tighten up on the definition of an employee in the ETI Act.

In my opinion, the insertion of the underlined wording in subsection (a) of the definition does not contribute much towards curbing ETI abuse, but the addition of subsection (c) does go some way to ensure an employment relationship by specifying that an employee must be recorded by the employer as required by BCEA section 31.

The record keeping requirements of BCEA section 31 are not extensive and are satisfied by the employee information that is recorded in a payroll system.

In simple terms, the ETI Act defines an employee as a natural person who works for another person and receives remuneration from that other person (the employer) in return for services rendered. This is the work/reward labour principle that is at the heart of an employment relationship, and it stands strongly on its own.

Remuneration for the purpose of the definition of an employee in the ETI Act has been interpreted by SARS to be 'monthly remuneration' as discussed in a section that follows.

This is explained in the SARS NBPO section 3.3:

"Section 1(2) states that "for the purposes of the definition of "monthly remuneration" in subsection (1), "remuneration" has the meaning ascribed to it in paragraph (1) of the Fourth Schedule to the Income Tax Act".

This means that "remuneration" as defined may only be used for purposes of the definition of "monthly remuneration" under section 1(1) and nowhere else in the ETI Act." [My emphasis]

The Solution: The Definition of 'Monthly Remuneration'

The draft TLAB (Taxation Laws Amendment Bill) of 28 July 2021 that was open for comment did not propose any changes to the definition of 'monthly remuneration'.

It was only towards the end of 2021 that the definition of 'monthly remuneration' was extended by inserting the underlined wording starting from "*provided that*" (referred to as 'the proviso' in this Newsflash), as follows:

'monthly remuneration'—

(a) where an employer employs and pays remuneration to a qualifying employee for at least 160 hours in a month, means the amount paid or payable to the qualifying employee by the employer in respect of a month; or;

(b) where the employer employs a qualifying employee and pays remuneration to that employee for less than 160 hours in a month, means an amount calculated in terms of section 7(5):

Provided that in determining the remuneration paid or payable, an amount other than a cash payment that is due and payable to the employee after having accounted for deductions in terms of section 34(1)(b) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997), must be disregarded

It is this late change to the definition of 'monthly remuneration' that has caused the difficulties for payroll suppliers, coupled to wording that is not easily understood.

With the help of the SARS NBPO, the new definition of monthly remuneration is explained by breaking the definition into logical chunks and discussing these one by one.

Paragraphs (a) and (b) of the Definition

Paragraphs (a) and (b) are unchanged and their wording reflects the labour law work/reward principle "*where an employer employs and pays remuneration to a qualifying employee*" to emphasise again that there must be a legitimate employment relationship.

The difference between the two paragraphs is that paragraph (b) provides that remuneration must be 'grossed-up' if less than 160 hours are worked for the month.

The definition of 'monthly remuneration' in subsection 1 of the ETI Act definitions is followed by subsection (2):
"For the purposes of the definition of "monthly remuneration" in subsection (1), "remuneration" has the meaning ascribed to it in paragraph (1) of the Fourth Schedule to the Income Tax Act."

Therefore the 'remuneration' referred to in paragraphs (a) and (b) of the definition of 'monthly remuneration' is remuneration as defined by the Fourth Schedule, but its value can be changed:

- Firstly, by the proviso that potentially reduces the base value of Fourth Schedule remuneration,
- Secondly, by the 'grossing-up' requirement specified in paragraph (b) if less than 160 hours are worked.

Note that the requirements of the proviso must be applied first (potentially reducing the value of Fourth Schedule remuneration), before 'grossing-up' the reduced remuneration amount if necessary.

'Monthly remuneration' is therefore the value of:

- The reduced remuneration amount after applying the proviso, if 160 hours or more are worked, or
- The 'grossed-up' reduced remuneration amount after applying the proviso, if less than 160 hours are worked.

The Proviso to the Definition of Monthly Remuneration

The proviso is copied here for convenience for this section:

Provided that in determining the remuneration paid or payable, an amount other than a cash payment that is due and payable to the employee after having accounted for deductions in terms of section 34(1)(b) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997), must be disregarded

The wording of the proviso is discussed in logical chunks, starting with the preamble to the proviso.

"Provided that in determining the remuneration paid or payable …"

This means that the base amount of Fourth Schedule remuneration referred to in paragraphs (a) and (b) can potentially be reduced by the requirements of the proviso that follow this preamble to the proviso.

"an amount other than a cash payment … must be disregarded"

Fourth Schedule remuneration amounts that are not a cash payment are the taxable fringe benefits specified by the Seventh Schedule to the Income Tax Act. If there are any taxable fringe benefits, their value must be 'disregarded' when calculating the value of ETI monthly remuneration.

This much is clear but unfortunately shares and dividends are two other types of remuneration that may or may not have a non-cash value that must be disregarded.

Shares

NBPO Section 3.1.1 states that

"Non-cash amounts related to shares paid to employees should not form part of monthly remuneration" but does not go on to explain what the 'cash' and 'non-cash' amounts could be that are related to shares and that could be paid to an employee as income.

The question comes down to whether it is possible for tax certificate codes 3707, 3717, and 3718 to have either a cash or a non-cash value. After querying this with SARS, they have been investigating the complex matter of shares for quite some time, but at the time of writing had not yet reached a conclusion.

As soon as we get clarity, a Newsflash will be issued.

Dividends

NBPO Section 3.1.2 states that

"Dividends can be paid in cash or in kind (in specie [shares can be granted instead of a cash payment – Rob]). Dividends made in cash payments (which is normally the case) and not excluded from the definition of "remuneration" must be included in monthly remuneration."

SARS will still provide clarity on dividends, but as stated by the NBPO, normally dividends are a cash amount paid to the employee. This means that dividends paid in cash, if remuneration, must be included in ETI monthly remuneration.

The tax certificate codes for dividends are: 3719, 3720, 3721, and 3723.

"a cash payment that is due and payable to the employee"

NBPO Section 3.2 states that

*"Monthly remuneration is therefore limited to cash amounts paid to the employee **plus** any amount that the employer has legally deducted under section 34(1)(b) of the BCEA."* [BCEA section 34(1)(b) is explained on the next page]

The NBPO clarifies that the wording of the proviso: "*a cash payment that is due and payable to the employee*", refers to the remuneration portion of cash net pay after deductions, and not to the total cash remuneration before deductions.

In other words, the proviso essentially states that "*an amount other than (the net cash remuneration) after having accounted for deductions in terms of section 34(1)(b) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997), must be disregarded"*

Note that if "an amount **other** than (the net cash remuneration)" were to be disregarded, all that would be left would be the net cash remuneration itself. Had that been the case, the proviso would have meant that "monthly remuneration" was equal to the employee's "net cash remuneration".

However the last part of the proviso must still be considered.

"after having accounted for deductions in terms of section 34(1)(b) of the Basic Conditions of Employment Act"

In this context, "*after having accounted for*" means that instead of simply deeming "monthly remuneration" to be equal to the "*cash payment that is due and payable*" (i.e. the net cash remuneration), the "*cash payment that is due and payable*" must be increased by the value of any deductions in terms of BCEA section 34(1)(b) that were made from the employee's remuneration.

A simpler way of putting this would be to say that "monthly remuneration" means the value of the employee's net cash remuneration increased by the value of any BCEA section 34(1)(b) deductions that were made.

BCEA section 34(1)(b) states that:

(1) An employer may not make any deduction from an employee's remuneration unless—
(b) the deduction is required or permitted in terms of a law, collective agreement, court order or arbitration award.

Note that SARS cannot give an interpretation of section 34(1)(b), not because they don't want to help but because the BCEA is not administered by SARS, so the explanations of section 34(1)(b) that follow are the opinion of the PAGSA.

"the deduction is required or permitted in terms of a law"

The words "*a law*" is very wide and if effect, means "any law". This would without doubt include the Fourth Schedule to the Income Tax Act.

Therefore any deductions from remuneration that are allowed by the Fourth Schedule for the purpose of the PAYE calculations, are also deductions that are permitted by BCEA section 34(1)(b).

These deductions would be:

1. Allowable donations
2. Employee-paid contributions to retirement funds in terms of section 11F.

In addition, other deductions that are permitted by BCEA section 34(1)(b) are the payments to statutory bodies that reduce an employee's net pay, including:

1. PAYE
2. Voluntary PAYE
3. Employee-paid UIF contribution (1%).

"the deduction is required or permitted in terms of a … collective agreement, court order or arbitration award"

Hopefully these remaining types of deductions that are "*required or permitted*" by section 34(1)(b) would be familiar to the employer and should be easily recognised if they are present in the payroll.

As examples, "*collective agreements*" would include Bargaining council agreements, "court orders" would include garnishee orders, and "arbitration awards" are just that.

Summary of the Proviso

To summarise the result of the proviso, "monthly remuneration" is equal to the cash remuneration paid to the employee, increased by the value of any deductions permitted in terms of section 34(1)(b).

This is aligned with the SARS NBPO section 3.2 that states:

*"Monthly remuneration is therefore limited to cash amounts paid to the employee **plus** any amount that the employer has legally deducted under section 34(1)(b) of the BCEA."*

Application of the defined concepts of 'Remuneration' and 'Monthly Remuneration'

It is important to know when to use 'remuneration' and when to use 'monthly remuneration'.

Subsection (2) of the definitions section of the ETI Act states:
"For the purposes of the definition of "monthly remuneration" in subsection (1), "remuneration" has the meaning ascribed to it in paragraph (1) of the Fourth Schedule to the Income Tax Act."

Section 3.3 of the SARS NBPO clarifies as follows:

Section 1(2) [of the ETI Act] states that "for the purposes of the definition of "monthly remuneration" in subsection (1), "remuneration" has the meaning ascribed to it in paragraph (1) of the Fourth Schedule to the Income Tax Act". This means that "remuneration" as defined may only be used for purposes of the definition of "monthly remuneration" under section 1(1) and nowhere else in the ETI Act. [my emphasis]

Section 6(g) refers to "remuneration….in respect of a month" and thus monthly remuneration must be [used] when applying this requirement."

Section 6(g) is the qualifying test that checks an employee's "remuneration" against the R6 500 pm threshold.

Despite the use of the word "remuneration" in section 6(g), the SARS NBPO clarifies that 'monthly remuneration' as explained above (i.e. the potentially reduced remuneration amount) must be used for the R6 500 qualifying test in terms of subsection (2) of the definitions section of the ETI Act.

Lastly, ETI Act section 7 states specifically that "monthly remuneration" must be applied in the formulas to calculate the ETI amount, so there is no doubt about this.

Example of the Calculation

With reference to the proviso to "*amounts other than a cash payment*", and to BCEA section 34(1)(b) deductions that are "*required or permitted by a law*" (being the Fourth Schedule), all cash income amounts, fringe benefits, and deductions allowed by the Fourth Schedule, as well as statutory payments, can be identified programmatically by using the tax certificate codes specified by the SARS PAYE BRS.

On the other hand, labour law does not have a coding system equivalent to the SARS PAYE BRS.

Presumably, these deductions are captured by the employer in the payroll in a 'free format' manner and could include deductions in terms of:

- BCEA section 34(1)(a),
- BCEA section 34(1)(b), and
- BCEA section 34(2).

Some payrolls might have difficulty in being able to programmatically identify the BCEA section 34(1)(b) deductions that are "*required or permitted in terms of a … collective agreement, court order or arbitration award*".

In the absence of codes, this means that the employer will have to 'flag' section 34(1)(b) deductions (or alternatively 'flag' deductions that are not section 34(1)(b) deductions) in the payroll to identify them for use in the payroll's calculation of ETI monthly remuneration.

If the employer gets this 'flagging' wrong, the payroll system can do nothing about it, and monthly remuneration and the ETI amount itself will be incorrectly calculated, resulting in potentially incorrect ETI claims in the EMP201.

Alternative Methods of Calculation of ETI Monthly remuneration

After receiving the SARS NBPO, a member of the PAGSA Exco created an example of how to calculate ETI monthly remuneration that shows two alternative methods of calculation of the ETI monthly remuneration amount.

The calculation shows that it is possible to arrive at the correct ETI monthly remuneration amount of R1 750,00 (see the example) by either:

1. Using a 'top-down' calculation (Starting from 'Total remuneration' and working downwards), or
2. Using a 'bottom-up' calculation (Starting from 'Net pay' and working upwards).

The 'top-down' and the 'bottom-up' calculation options are indicated by the red arrows in the frame at the bottom of the calculation example.

Both methods of calculation are aligned with the outcome envisioned in the SARS NBPO section 3.2 of which extracts have been copied in below for convenience:

SARS NBPO Section 3.2

Non-binding private opinion:

The reason for the amendment to the ETI Act is explained in the *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2021 [that] states that the recent amendments to the ETI Act are intended to curb the abuse of the ETI where in these schemes employers "*claim the ETI in respect of individuals who do not work for them*" and the "*remuneration stipulated in the contract is paid to the training institution as opposed to being paid to the eligible participant*".

Based on the above background, the proviso to the definition of "monthly remuneration" aims to exclude non-cash payments and salary sacrifices made by an employee.

Monthly remuneration is therefore limited to cash amounts paid to the employee plus any amount that the employer has legally deducted under section 34(1)(*b*) of the BCEA.

The wording of the last sentence of the SARS NBPO implies a 'bottom-up' calculation. The "*cash amounts*" referred to would be the net pay (or take-home pay) of the employee, plus any section 34(1)(b) deductions.

This calculation is also aligned to the wording of the proviso that allows section 34(1)(b) deductions to be *added back* to the value of "a cash amount due and payable" (i.e. the net pay), in effect excluding the value of non-section 34(1)(b) deductions from remuneration that in the example below includes the training fee that is under the spotlight.

Alternatively, for a 'top-down' calculation, the new proviso to the definition of 'monthly remuneration' reduces 'monthly remuneration' by disregarding amounts other than cash payments (i.e. fringe benefits) as well as to further reduce remuneration with deductions that fall outside the scope of section 34(1)(b) of the BCEA.

Please note that the scenario used for the calculation example provides for:

1. Examples of regularly occurring income, also including exempt income amounts.
2. The deductions that are "*required or permitted*" by BCEA section 34(1)(b) are shown in three groups:
   a. Statutory payments (PAYE and UIF)
   b. Fourth Schedule deductions (allowable donations and employee retirement fund contributions)
   c. 'Other' deductions (in terms of a collective agreement, court order or arbitration award).
3. Deductions that are not "*required or permitted*" by BCEA section 34(1)(b), for example in this scenario:
   a. Loan repayment
   b. Birthday club
   c. Training costs.
4. In accordance with the intention of the policy makers, and in alignment with the SARS NBPO, the training cost of R2,500 in this example, must reduce the value of ETI monthly remuneration but depending on the method used to calculate ETI monthly remuneration, the other 'general' deductions might also reduce ETI monthly remuneration.
5. The method used to calculate ETI monthly remuneration (i.e. 'top-down' or 'bottom-up') is the decision of the payroll supplier, and will no doubt be based on your payroll's design, the information available in the payroll, the ease of change, etc.

The example is provided to clarify the calculation and to give guidance for payroll suppliers so that an informed decision can be made.

The calculation example follows on the next page.

ETI Monthly Remuneration Calculation Example

		Cash Income	Benefits	Remuneration	Exempt
3601	Basic	R4 000.00		R4 000.00	
3607	Overtime	R500.00		R500.00	
3702	Reimbursive Travel	R300.00			R300.00
3714	Uniform Allowance	R200.00			R200.00
3806	Cheap Services		R750.00	R750.00	
	Total Income	**R5 000.00**	**R750.00**	**R5 250.00**	**R500.00**
4102	PAYE	R0.00			
4141	UIF (Employee)	R52.50			
4005	Medical	R500.00			
4006	Retirement Annuity	R650.00	R1 442.50		
	Garnishee Order	R120.00	(Sec 34(1)(b))		
	Council Levies	R80.00			
	Union Fees	R40.00			
	Loan Repayment	R200.00			
	Birthday Club	R50.00	R2 750.00		
	Training Costs	R2 500.00			
	Total Deductions	**R4 192.50**			
	Net Pay	**R807.50**			

1	**Total Remuneration**	**R5 250.00**	**Total Remuneration**	18
2	Less Benefits	R750.00	Plus Benefits	17
3	**Cash Remuneration**	**R4 500.00**	**Cash Remuneration**	16
4	Less Non-Sec34(1)(b) Deductions	R2 750.00	Plus Non-Sec34(1)(b) Deductions	15
5	**Monthly Remuneration (ETI Act)**	**R1 750.00**	**Monthly Remuneration (ETI Act)**	14
6	Less Sec34(1)(b) Deductions	R1 442.50	Plus Sec34(1)(b) Deductions	13
7	**Net Pay (Cash Remuneration Only)**	**R307.50**	**Net Pay (Cash Remuneration Only)**	12
8	Plus Exempt Income	R500.00	Less Exempt Income	11
9	**Net Pay (Total Cash Payment)**	**R807.50**	**Net Pay (Total Cash Payment)**	10

The example shows that ETI monthly remuneration = **R1 750,00** for both the 'top-down' and the 'bottom-up' method.

This result has been approved by SARS as being the correct value of ETI monthly remuneration in this scenario:

We agree with the basic framework of your calculations and that the result is in line with our purposive interpretation of the proviso to the definition of "monthly remuneration". We are still not in a position to express an opinion on what constitutes deductions under section 34(1)(b) of the BCEA, but agree with the way that these deductions are treated in your calculation.

The compliance issues and suggestions mentioned in your email have been given through to the applicable staff members. We will keep them in mind as well when being asked to provide inputs for further legislative amendments.

Please let me know if you want to discuss.

Regards

Note that in the example, the value of ETI monthly remuneration that would have been R5 250 before the change to the new definition of monthly remuneration, is now R1 750 – a significant reduction in value.

I doubt that this could be part of the reason why the ETI value has been increased by up to 50% from 1 March 2022.

The Solution: Section 6 - Qualifying employees

Sections 6(a) to (g) of the ETI Act specify the seven conditions that must be met before an employee qualifies to generate the ETI for an eligible employer.

The draft TLAB of 28 July 2021 added a short proviso that applies to the whole of section 6.

Comments submitted to SCOF and the SCOF Response

Towards the end of 2021, SCOF (the Standing Committee on Finance) received comments that expressed the concern that the amendment to section 6 proposed in the draft TLAB could result in legitimate ETI claims no longer qualifying for the incentive.

Instances where the employer provides on the job training, where the employer and employee have entered a learnership or apprenticeship program, or where the employee is on a secondment, may no longer qualify for the incentive.

It was suggested that consideration should rather be given to clarifying that the employee should be given a cash payment in in consideration for services rendered.

The Standing Committee on Finance accepted the comments as being valid, and responded as follows:

The incentive is intended to apply to all legitimate arrangements where the employee is not only engaged in the activity of studying, but rather gaining valuable work experience. In the event that some of the employee's duties involve some sort of training or studying, the costs of said training or studying should ideally be borne by the employer.

To ensure that the employee's remuneration package is not solely [my emphasis] allocated to costs associated with any required training or studying, qualification for the incentive shall further be based on the employee receiving a cash payment in lieu of services rendered.

Changes will be made to the 2021 Draft TLAB to reflect this intention.

Changes to the Proviso to Section 6

To give effect to their response to the comments, SCOF extended the proviso to section 6 by adding the last portion that starts with the word "*unless*" to the final TLAB.

The wording of the final proviso in the TLAA of 19 January 2022 that has been inserted in section 6 is underlined:

Section 6. An employee is a qualifying employee if the employee—
[subsections (a), (b), (c), (d), (e), (f), and (g) i.e. the 7 x qualifying tests, are not listed here to keep it short]

*Provided that the employee is **not**, in fulfilling the conditions of their employment contract during any month, **mainly** involved in the activity of studying, unless the employer and employee have entered into a learning programme as defined in section 1 of the Skills Development Act, 1998 (Act No. 97 of 1998), and, in determining the time spent studying in proportion to the total time for which the employee is employed, the time must be based on actual hours spent studying and employed.*

Comments on the Proviso

'*Mainly*' is interpreted to mean 'more than 50%'.

The proviso specifies that "*mainly involved in the activity of studying*" (as opposed to 'mainly' providing services to the employer), must be measured "*based on actual hours spent studying and employed*".

Keeping track of these hours will no doubt add a significant administration burden on the employer's shoulders.

SARS have kindly interpreted the portion of the proviso that was added from "*unless*" to accommodate learnerships:

The way that we read the last part of the proviso to section 6, namely "*in determining the time spent studying in proportion to the total time for which the employee is employed, the time must be based on actual hours spent studying and employed"*, it does **not** apply to learning programmes as defined in section 1 of the Skills Development Act (legitimate learnership agreements).

This is also in accordance with the purpose of the amendments – to curb the training related ETI abuse. We do not want to discourage legitimate learnership agreements.

In other words, the words:
"*unless the employer and employee have entered into a learning programme as defined in section 1 of the Skills Development Act, 1998 (Act No. 97 of 1998)"*,
removes the employee from the "mainly" proviso, and the employer of the learner is not required to track the actual hours worked and studying.

However, the words:
"*in determining the time spent studying in proportion to the total time for which the employee is employed, the time must be based on actual hours spent studying and employed"*,
are applicable when the employer and employee have not entered a learning programme as defined in section 1 of the Skills Development Act.

In this case, the employer is required to track the actual hours worked and studying.

Changes to the Effective Date

The draft TLAB of 28 July 2021 proposed a retrospective effective date of 1 March 2021, which at the time was of concern to some employers (particularly those that were involved in ETI Schemes), but due to the late changes made to the draft TLAB just prior to approval by Parliament, the effective date was changed to 1 March 2022 in the final TLAA of 19 January 2022.

To allow for changes to be made to payroll systems, testing, and roll-out of the changes to employers, an effective date of 1 March 2023 would have helped enormously, but this would have delayed the curbing of ETI abuse for another year.

Impact of the ETI Changes on Tax Revenue?

The result of the latest amendments is that potentially more employees can qualify from March 2022 than what qualified in February 2022, although this will depend very much on the structure of the employee's remuneration.

This is because monthly remuneration above R6,500 in February 2022 would fail the section 6(g) test, whereas if that monthly remuneration is reduced below R6 500 from 1 March 2022 by the proviso, the employee will now qualify.

This scenario will mean less tax revenue for the fiscus.

The other scenario that is more difficult to quantify and analise, is that of an employee that qualified in February 2022 (under the 'old' requirements) and then also qualified in March 2022 (under the 'new' requirements).

In this case, the positive or negative difference to the calculated ETI amount that impacts on the fiscus depends on where the employee was positioned in the three-step formulas that calculate ETI. In March 2022 compared to February 2022, there could be more ETI, there could be the same ETI, or there could be less ETI.

This analysis will be clouded by the increase to the ETI amount by up to 50% that is effective from 1 March 2022.

One must also bear in mind that whether there is a significant change to the ETI amount calculated could depend on the employee's remuneration structure and deductions, as well as whether the employer is participating in an ETI Scheme, and the allocation of the training costs.

In Conclusion

The amendments to the ETI Act to curb the abuse of ETI are complex, difficult to understand, and administratively burdensome, but they will help to close the loophole of 'false' employment that has been exploited by some ETI schemes.

The PAGSA plan to submit a proposal to tighten up the definition of an employee in the ETI Act by deeming an individual to not be an employee under specified circumstances. To state the obvious, if there is no employee, there cannot be a qualifying employee, and if there is not a qualifying employee, there can be no ETI.

I sincerely hope that the policymakers will achieve what they wanted to achieve with these amendments to curb the abuse of ETI. Nobody wants to experience a series of further changes down the line to correct any 'unforeseen circumstances' resulting from these changes.

Lastly, be aware that Sars have made it clear that they will apply the principle of 'substance over form' when checking the validity of employer ETI claims. In other words, is the relationship a genuine employment relationship, or does the employer simply say that it is employment?

In closing, I hope that this Newsflash has clarified the complex and rather confusing amendments to the ETI Act for you.

Regards,

Rob Cooper
Chairman Payroll Authors Group of South Africa

All information provided by the PAGSA is subject to our DISCLAIMER.

SARS NON-BINDING PRIVATE OPINION: EMPLOYMENT TAX INCENTIVE ACT

Leveraged Legal Products
Corporate Income Tax

Office
Head Office

Enquiries
CITOpinions@sars.gov.za

Room
Khanyisa Building

Reference

Date
07 March 2022

www.sars.gov.za

South African Revenue Service

Khanyisa Building
281 Middel Street,
Nieuw Muckleneuk, 0181
Private Bag X923, Pretoria, 0001
SARS online: **www.sars.gov.za**
Switchboard: (012) 422-4000

Rob Cooper
Payroll Authors Group South Africa

By E-mail: [redacted]

Dear Sir

NON-BINDING PRIVATE OPINION: EMPLOYMENT TAX INCENTIVE ACT

We write with reference to various email correspondence received from you requesting a non-binding private opinion on the interpretation of the proviso to the definition of "monthly remuneration" under section 1(1), section 6(*g*) and (7) of the Employment Tax Incentive Act 26 of 2013 (ETI Act).

This letter constitutes a non-binding private opinion under section 88 of the Tax Administration Act 28 of 2011 (TA Act). This opinion does not have any binding effect upon SARS. It may not be cited in any proceedings including court proceedings other than a proceeding involving the person to whom this opinion is issued. The views contained in this letter are expressed without prejudice to any of SARS's rights contained in the ETI Act, the Income Tax Act 58 of 1962 (the Income Tax Act), and/or the TA Act.

Kindly note that the views expressed in this letter are based on the understanding of the facts (as presented in your numerous emails including all subsequent documentation submitted in support of your request) and the effects of current legislation.

This opinion is intended solely for Payroll Authors Group South Africa (PAGSA) and is not be applicable to any other parties and should not be used by any party other than PAGSA.

In this letter, unless stated otherwise –

- "BCEA" means the Basic Conditions of Employment Act 75 of 1997;
- "**monthly remuneration**" means the definition of "monthly remuneration" under section 1(1);
- "ETI" means the employment tax incentive;
- "**Fourth Schedule**" means the Fourth Schedule to the Income Tax Act;
- "**Income Tax Act**" means the Income Tax Act 58 of 1962;
- "**remuneration**" means remuneration as defined in the Fourth Schedule;
- "**section**" means a section of the ETI Act;

- **"Seventh Schedule"** means the Seventh Schedule to the Income Tax Act;
- any other word or expression bears the meaning ascribed to it in the ETI Act.

1. Request

Interpretational clarity is requested on the amendment in the Taxation Laws Amendment Act 20 of 2021 (TLAA, 2021) to the definition of "monthly remuneration" in section 1(1). The request relates specifically to the following:

1. Whether the following should be included in "monthly remuneration":
   1.1. Shares
   1.2. Dividends
   1.3. Long service awards
   1.4. Employer paid contributions
   1.5. Bursaries
2. Whether monthly remuneration should exclude the deductions under section 34(1)(*b*) of the BCEA.
3. Whether monthly remuneration should be used for purposes of section 6(*g*).
4. Whether monthly remuneration should be used for purposes of section 7.

Each request is considered seriatim below.

2. The law

The relevant sections of the ETI Act are quoted below.

> **1. Definitions.**—(1) In this Act, unless the context indicates otherwise—
>
> **"monthly remuneration"**—
>
> (*a*) where an employer employs and pays remuneration to a qualifying employee for at least 160 hours in a month, means the amount paid or payable to the qualifying employee by the employer in respect of a month; or;
>
> (*b*) where the employer employs a qualifying employee and pays remuneration to that employee for less than 160 hours in a month, means an amount calculated in terms of section 7(5):
>
> Provided that in determining the remuneration paid or payable, an amount other than a cash payment that is due and payable to the employee after having accounted for deductions in terms of section 34(1)(*b*) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997), must be disregarded;
>
> (2) For the purposes of the definition of "monthly remuneration" in subsection (1), "remuneration" has the meaning ascribed to it in paragraph (1) of the Fourth Schedule to the Income Tax Act.

> **6. Qualifying employees.**—An employee is a qualifying employee if the employee—
>
> (*g*) receives remuneration in an amount less than R6 500 in respect of a month.
>
> **7. Determining amount of employment tax incentive.—**
>
> (2) During each month of the first 12 months in respect of which an employer employs a qualifying employee, the amount of the employment tax incentive in respect of that qualifying employee, if the monthly remuneration of the employee is—
>
> ...
>
> (3) During each of the 12 months after the first 12 months that the same employer employs the qualifying employee, the amount of the employment tax incentive in respect of that qualifying employee, if the monthly remuneration of the employee is—
>
> ...
>
> (5) If an employer employs a qualifying employee for less than 160 hours in a month, the employment tax incentive to be received in respect of that month in respect of that qualifying employee must be an amount that bears to the total amount calculated in terms of subsection (2) or (3) the same ratio as the number of hours that the qualifying employee was employed and is paid remuneration in respect of those hours by that employer in that month bears to the number 160.

3. Application of the law and non-binding private opinion

The TLAA, 2021 amended the definition of "monthly remuneration" by inserting a proviso that reads as follows:

> "in determining the remuneration paid or payable, an amount other than a cash payment that is due and payable to the employee after having accounted for deductions in terms of section 34(1)(b) of the Basic Conditions of employment Act, 1997 (Act No 75 of 1997), must be disregarded".

The application of this proviso has resulted in some uncertainty and gave rise to the request for clarification of the issues below.

3.1 Whether certain amounts should be included in monthly remuneration

3.1.1 Shares

Query:

Are shares included in monthly remuneration?

Non-binding private opinion:

Non-cash amounts related to shares paid to employees should not form part of monthly remuneration.

3.1.2 Dividends

Query:

Are dividends included in monthly remuneration?

Non-binding private opinion:

Dividends can be paid in cash or in kind (*in specie*). Dividends made in cash payments (which is normally the case) and not excluded from the definition of "remuneration" must be included in monthly remuneration.

3.1.3 Long service awards

Query:

The taxable portion of the long service award is excluded from ETI monthly remuneration because it is a fringe benefit, and the non-taxable (up to R5 000) portion is not remuneration.

Therefore the full amount reported under code 3835 is excluded from ETI monthly remuneration if the long service award is granted as one or more of the available fringe benefits.

The problem is with long service awards that are paid in cash. In what sequence must the payroll allocate the R5 000 reduction if there are various types of awards that make up the total award?

Non-binding private opinion:

Paragraph 5(4) to the Seventh Schedule defines a "long service" as "an initial unbroken period of service of not less than 15 years or any subsequent unbroken period of service of not less than 10 years".

The ETI Act provides that an eligible employer may claim the ETI for 24 months per qualifying employee. Based on this, an eligible employer may not claim the ETI for an employee receiving a long service award, since long service awards are received by employees for an unbroken period of service of not less than 15 years.

3.1.4 Employer-paid contributions

Query:

Should employer-paid contributions (i.e. they are not deducted from the employee's remuneration) that are paid to medical schemes, funeral schemes, retirement funds, etc. for the benefit of the employee be included in "monthly remuneration"? These amounts result in a taxable fringe benefit being raised.

Non-binding private opinion:

Employer-paid contributions are not cash paid or payable to an employee and are not deductible under section 34(1)(*b*) of the BCEA and thus do not fall within monthly remuneration.

3.1.5 Bursaries

Query:

Does 'non-cash payments' that should be disregarded for purposes of determining "monthly remuneration" include taxable bursaries that are not specified in the Seventh Schedule as taxable fringe benefits, but are exempted in section 10(1)(*q*) of the Income Tax Act?

Non-binding private opinion:

Generally, any *bona fide* scholarship or bursary granted to enable or assist any person to study at a recognised educational or research institution is exempt from normal tax. This exemption is, however, subject to certain conditions, particularly where the scholarship or bursary is granted by an employer (or an associated institution in relation to that employer) to an employee or to a relative of such employee.

Bursaries generally constitute taxable benefits (settlement of an employee's debt, or free or cheap services) and are thus considered "an amount other than a cash payment".

However, some employers offer more to the employee as part of the bursary, such as including stipends, etc. The cash portion of the bursary to an employee will be exempt under section 10(1)(*q*) of the Income Tax Act.

A bursary received in respect of a relative will not be entirely exempt. Only a portion of the bursary will be exempt under section 10(1)(*q*) of the Income Tax Act. Where the bursary includes cash payments such as stipends, there is a possibility that the cash portion will not be exempt. Thus, a cash portion of such a bursary that is not exempt under section 10(1)(*q*) of the Income Tax Act must be included in monthly remuneration.

3.2 Whether monthly remuneration should exclude the deductions under section 34(1)(*b*) of the BCEA

Query:

In calculating the "monthly remuneration" under section 1(1) must the amount be reduced by deductions under section 34(1)(*b*) of the BCEA?

Non-binding private opinion:

The reason for the amendment to the ETI Act is explained in the *Explanatory Memorandum on the Taxation Laws Amendment Bill*, 2021 states that the recent amendments to the ETI Act are intended to curb the abuse of the ETI where in these schemes employers "claim the ETI in respect of individuals who do not work for them" and the "remuneration stipulated in the contract is paid to the training institution as opposed to being paid to the eligible participant".

In *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA), it was held that the process of interpretation involves a consideration of 1) the language used in the light of the ordinary rules of grammar and syntax, 2) the context in which the provision appears, and 3) the apparent purpose to which it is directed.

Based on the above background, the proviso to the definition of "monthly remuneration" aims to exclude non-cash payments and salary sacrifices made by an employee. Monthly remuneration is therefore limited to cash amounts paid to the employee plus any amount that the employer has legally deducted under section 34(1)(*b*) of the BCEA.

The above interpretation will apply to "monthly remuneration" used throughout the ETI Act.

We are unable to provide a list of eligible deductions for purposes to calculate the "monthly remuneration". Each deduction to be accounted for must meet the requirements under section 34(1)(*b*) of the BCEA.

3.3 Whether monthly remuneration should be used for purposes of section 6(*g*)

Query:

Qualification is checked in section 6(*g*) by testing "remuneration" against R6 500 pm. Must 'gross' remuneration still be used for section 6(*g*)?

Non-binding private opinion:

For an employee to be qualifying employee, a requirement under section 6(*g*) is that the employee "receives remuneration in an amount less than R6 500 in respect of a month".

Section 1(2) states that "for the purposes of the definition of "monthly remuneration" in subsection (1), "remuneration" has the meaning ascribed to it in paragraph (1) of the Fourth Schedule to the Income Tax Act". This means that "remuneration" as defined may only be used for purposes of the definition of "monthly remuneration" under section 1(1) and nowhere else in the ETI Act.

Section 6(*g*) refers to "remuneration….in respect of a month" and thus monthly remuneration must be used in making this determination. See **3.2** for the determination of monthly remuneration.

3.4 Whether monthly remuneration should be used for purposes of section 7.

Query:

The proviso to the definition of ETI monthly remuneration specifies various deductions under the BCEA (subject to SARS' interpretation) that reduce the value of 'gross' monthly remuneration, then 'net' monthly remuneration is used in section 7 to calculate the ETI amount.

But the definition of monthly remuneration specifies the 'less than 160-hour' gross-up rule.

The question is:

1. Must 'gross' remuneration be grossed-up', or
2. Must 'net' remuneration (i.e. after deductions) be grossed-up'?

Non-binding private opinion:

Section 7(2) and (3) make reference to "monthly remuneration" and thus in determining the ETI under section 7, monthly remuneration as defined must be used. Refer to 3.2 above for the determination of monthly remuneration. Since section 7(5) refers to an amount calculated under section 7(2) and (3) and these subsections make reference to "monthly remuneration", for purposes of section 7(5), the amount determined under the definition of monthly remuneration must also be used.

4. Standard conditions and assumptions

This non-binding private opinion is based solely upon:

- The information, documents, representations, facts and assumptions that are included or referenced in this being true and accurate.
- The tax laws, regulations, binding general rulings, and cases in effect as of the date of this non-binding private opinion. In particular, the opinion is based solely upon the interpretation and application of the tax laws, as amended and in effect as of the date of this opinion as well as any applicable regulations, general binding rulings or cases in effect, as of that date.

Should you have any enquiries regarding this letter, please email us at CITOpinions@sars.gov.za.

Sincerely

SENIOR MANAGER: LEVERAGED LEGAL PRODUCTS: TAX, CUSTOMS AND EXCISE (CORPORATE INCOME TAX)

for **COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE**