SNG Grant Thornton

Targeting the Education Sector - Risk Analysis including employee's tax

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1. Tax in the Education Sector (South Africa)

One of the common issues raised by many education institutions in South Africa is the lack of adequate funding. In this document we explore the impact of tax on the financial sustainability of higher education institutions in particular focusing on Value-Added-Tax and Employees' Tax.

2. Historic Challenges with tax compliance

Educational services are an exempt supply under section 12(h) of the Value-Added Tax Act, 89 of 1991 (the "VAT Act"). The main reason for the exemption of educational services is that many of the institutions providing educational services were government institutions and to some extent financed by the government. When value-added tax (VAT) was introduced in 1991, legislation that specified the boundaries of primary, secondary, and higher education was not in place at the time and it was difficult to distinguish between the various educational spheres. As a result, the Value-Added Tax Committee (VATCOM) appointed by then Minister of Finance recommended at the time that the supply of educational services should be exempt from VAT, like the previous general sale tax treatment(GST). The exemption aimed to alleviate the financial burden as well as additional risks and compliance costs associated with VAT accounting and compliance. However, over the years, the activities of institutions providing educational services have changed drastically and a reduced number of institutions are wholly subsidized in terms of government subsidies. To aid government grants and increase income, these institutions have increased their taxable activities considerably. Furthermore, privately owned, and semi-subsidized institutions are accountable for their own costs and are not provided any or limited support from government.

As the term educational services is not defined in either the VAT Act or in the various Acts referenced in section 12(h), it remains to argue that "educational services" can only be termed or defined in terms of what it includes. Thus, while "educational services" have not been specifically defined in the VAT Act, it is nevertheless clear that services, covered by the referenced Acts, is included in the definition. If the taxable supplies of an educational institution exceeds R1 million per annum they will be obliged to register for VAT and declare output tax on their taxable supplies. No VAT is charged on exempt supplies made by organizations and they cannot claim input tax credits on their purchases or only a portion is recoverable through the application of an apportionment ratio. The details of the exemption are complex for educational institutions and the mixture of supplies that are rendered by these institutions creates even more difficulties.

Numerous educational institutions within South Africa conduct an enterprise with the rendering of taxable supplies in addition to the provision of educational services. Such additional activities, provided by the educational institute qualifies for and is VAT registered, are taxed at the standard rate.

This in turn has created complications in administering the VAT Act, whereby these service providers are then required to carry out an apportionment calculation of VAT on their mixed supplies. This practice is inefficient and not cost effective. Furthermore, the ease of compliance, which was the basis of implementing the exemption, is diminished, as registration for VAT purposes is unavoidable.

Some of the other challenges faced by the Education Institutions are the rising costs of education and the reduced funding from government which results in most educational institutions increasing their activities, which fall outside of the s12 - section 12. Consequently, these institutions must register for VAT and must apportion the VAT that cannot be wholly attributed to either taxable or exempt supplies. Most of these institutions are not equipped to handle these complex apportionment ratio calculations. The formula proposed by the South African Revenue Service (SARS) in claiming input tax credits, is highly complex. In addition, new apportionment ratio calculations often require change in use adjustments creating additional complexity.

It has always been the intention of the South African VAT legislation that the financial burden fall on the end consumer. However, due to the Government and the sector, attempts to keep the cost of education as low as possible to encourage further education, institutions are funding the VAT cost associated with the supply of exempt educational services from internal resources. In order to alleviate the financial and administration burden associated with VAT accounting, Universities South Africa (USAf), formerly known as Higher Education South Africa (HESA) on behalf of the sector was invited to give a presentation to the Davis Tax Committee on a possible VAT reform for the sector.

Following the presentation, a formal request was submitted proposing VAT reform for the sector, whereby the supply of educational services is made taxable at a reduced rate, like the current treatment of long-term commercial accommodation. This would have the effect of placing the sector in a VAT-neutral position in which the output tax payable on tuition fees would be funded by the additional input tax deduction that would become available and not by increasing tuition fees. Not only would the VAT cost be reduced but managing the VAT risk in the sector would become a much easier task.

In the 2015 National Budget Speech, the definition of educational services was raised as well as the VAT treatment of numerous expenditures. It was reported that the Davis Tax Committee is currently revising these VAT implications and that its conclusions will aid possible changes.

Since these developments are on-going and not yet finalised, the Education Institutions must abide by the current VAT legislation. We highlight below certain risk areas that we caution the Institutions on.

3. VAT Risks Identified in the Education Sector

Supplies made by Education Institutions

Education Institutions primarily supply educational services which are exempt from VAT in terms of s12 - section 12. These Institutions have however expanded their services to obtain funding/revenue from other sources. One income stream that has become a material source of revenue for most higher educational institutions is research income in its various forms. **Under current legislation tuition fees, accommodation fees and some state-funded research grants have no VAT implications. This therefore implies that all other income received by the Education Institutions is likely to be a taxable supply**.

One of the most common misconceptions by the Education Institutions not required to register for VAT purposes simply because they are an Education Institution. This is not correct!

All other income streams must be considered individually. Compulsory VAT registration will kick in should the R1 million threshold be met. SARS can go back 5 years or more, depending on the circumstances, to assess an entity's VAT liability. This liability would likely include penalties and interest, could have a significant impact on the business of the Education Institution.

VAT on Imported Services

Imported services are particularly relevant in the library environment and typically include subscriptions to international journals and databases. In addition, institutional membership fees to international bodies, accreditation fees and international software licenses will also fall within the ambit of imported services.

In terms of section 7(1)(c), VAT is levied on the supply of imported services by a person. The VAT must be paid, in terms of section 7(2), by the recipient of the imported services. The term imported services is defined in section 1(1) as a supply of service made by a supplier who is not a resident, or carries on a business outside of the Republic, to a recipient who is a resident of the Republic to the extent that the services are not used or consumed in the Republic for the purpose of making taxable supplies. This therefore implies that Education Institutions that acquire imported services from a foreign supplier for final consumption must account for VAT at the standard rate to the extent that the services are used or consumed for purposes other than making of taxable supplies.

It is also important that institutions implement procedures to ensure future compliance with the imported services provisions of the VAT Act. In this regard the new legislation governing the VAT registration of foreign suppliers of electronic services (discussed below) will have the effect that some of the subscriptions to international journals and databases will be subject to VAT at the standard rate. This therefore implies that the imported services legislation will not apply.

The time of supply is the earlier of the invoice or payment date. Presumably, the invoice date will be before the payment date and therefore the invoice value should be used when calculating the liability. The difference between the invoice value and the actual payment is exchange gains or losses and should not have a VAT implication.

VAT on Electronic Services

The Original Regulations came into effect on 1 June 2014. These have since been updated. The intention of the Updated Regulations which came into effect on 1 April 2019 is to substantially widen the scope of services that qualify as electronic services, so that all services supplied for a consideration (subject to a few exceptions), which are provided by means of an electronic agent, electronic communication or the internet, are electronic services and must be charged with VAT at the standard rate.

The term "electronic services" is defined in section 1 of the VAT Act to mean "electronic services" as prescribed by the Regulation. The Regulation states that an "electronic service" is a service which is listed in the Regulation and is supplied by means of an "electronic agent", "electronic communication" or the "internet" for a "consideration". In terms of the Regulation, electronic services includes, inter alia, a subscription service to any blog, journal, magazine, newspaper, games, internet-based auction service, periodical, publication, social networking service, webcast, webinar, web site, web application and web series.

By virtue of foreign suppliers providing electronic services in South Africa, it is highly possible that they would have created a VAT presence in South Africa and subsequently applied for VAT registration as suppliers of electronic Services. This therefore implies that Education Institutions will not have to account for VAT Output on Imported Services however the normal VAT rules will apply. This therefore means that the institutions can claim VAT on the supplies received from such foreign suppliers.

VAT Apportionment

The principle of the VAT system is that VAT incurred on the acquisition of goods and/or services by a vendor in the course or furtherance of making taxable supplies should not be a cost to a vendor unless specifically provided for in legislation. The exception provided for in section 12 of the VAT Act envisages that VAT incurred to make exempt supplies will not qualify as input tax.

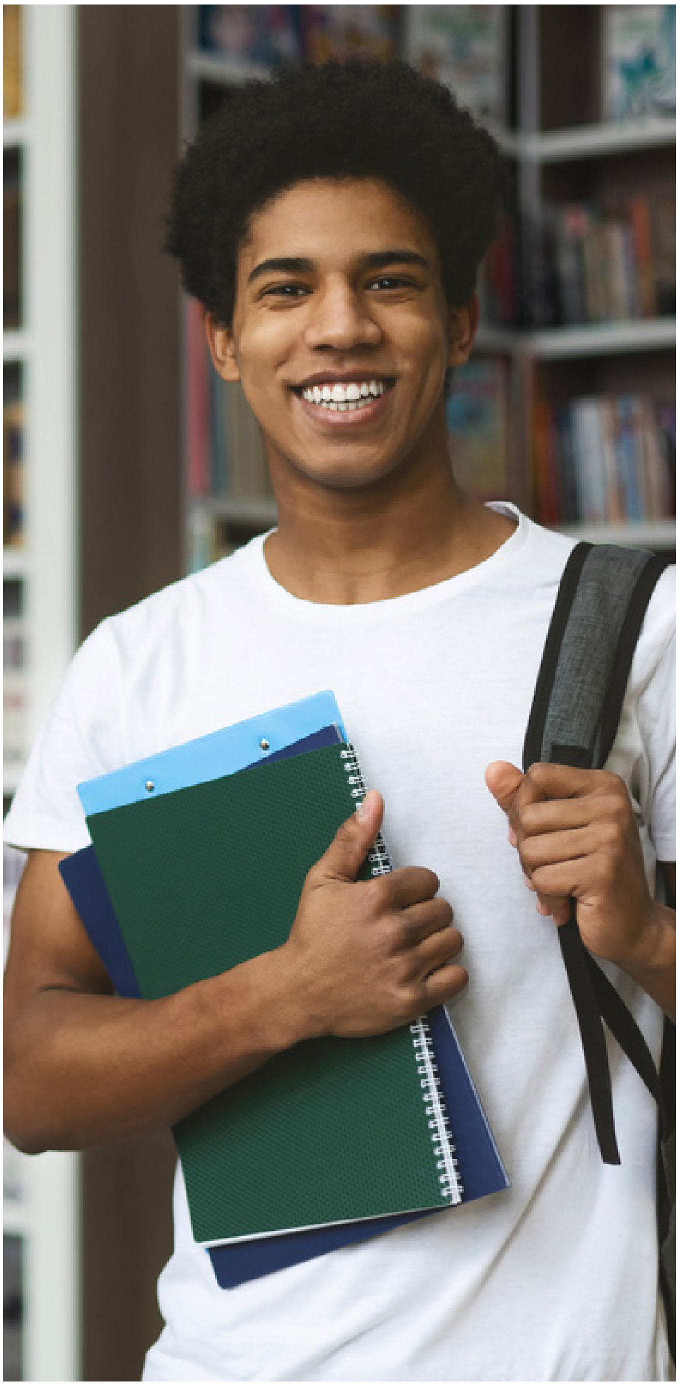
In the instance that a vendor makes both taxable and exempt supplies, it is required to determine the extent to which the goods or services are used, consumed, or supplied while making taxable supplies. In this regard, the determination of the extent to which input tax may be deducted is regulated by the provisions of section 17(1) of the VAT Act. Most Education Institutions primarily provide exempt educational services and are or may be required to register for VAT as they also provide taxable supplies (standard and zero-rated supplies) in addition to the exempt and other non-taxable supplies. As a result, Education Institutions are required to apportion VAT in respect of those expenses that are not acquired wholly to make either taxable or exempt supplies.

BGR 16 (issue 2) prescribes the method to be used in determining the ratio contemplated in section 17(1).The turnover-based method is the only approved method for determining the "extent" of taxable supplies, as required in terms of section 17(1) of the VAT Act. Therefore, this method must be applied in the absence of a vendor requesting the use of another method and SARS approving such other method.

Further to the above, proviso (i) to section 17(1) of the VAT Act contains the so-called "de minimus rule" that provides for the intended use of goods or services where it equates to 95% or more for the making of taxable supplies to be wholly for the purposes of making taxable supplies (i.e. 100%). This means that vendors, whose non-taxable supplies exceed 5% of total supplies, must calculate an apportionment ratio to apply to the VAT paid in respect of goods and services acquired for a dual purpose. However, vendors whose non-taxable supplies do not exceed 5% of its total supplies may claim a full input tax credit in respect of the tax paid relating to goods and services acquired for a dual purpose.

In circumstances where the turnover-based method is inappropriate because it produces an absurd result, proves impossible to use, or does not yield a fair approximation of the extent of taxable application of the enterprise's VAT-inclusive expenses, the vendor must approach SARS to obtain consensus on an alternative method which yields a more accurate result.

SARS issued a VAT Class Ruling (VCR) - Binding Class Ruling to Universities South Africa (USA), formerly known as Higher Education South Africa (HESA) to assist universities in properly classifying their services and calculating the input tax deduction in respect of goods and services acquired for the purpose of making taxable supplies. In terms of the VCR, the recovery rate on overhead expenses is limited to 12.5%. SARS approved a varied input tax method as an alternative apportionment method.



Research Activities

Research is also a defined focus area in which Education Institutions are now contracted by private entities for various types of research and consulting services. The VCR focussed on the following type of research activities:

Applied research: means a project which is primarily directed towards a specific practical aim or objective and should result in the application of new knowledge into a process or product, or the transfer of existing knowledge into a new process or product, for the benefit of the donor or for the immediate purpose of commercialising the product.

Basis research: means experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any application or use in view.

Research grants: means any appropriation of funds by an organ of state within the Republic for the purpose of research where the involvement or development of students is a requirement or condition.

SARS further ruled that research projects entered will partly meet the requirement contained in the definition of enterprise at the point when the research activity can be defined as “applied research”.

The VCR also applies to assets of capital nature (with a value of less than R1 million) which were purchased for research purposes. To the extent that the asset is applied for a mixed purpose the apportionment percentage applicable to research activities will apply.

Where an asset of capital nature is acquired for a mixed purpose and the purchase price exceeds either R1 million or the applicable percentage is not appropriate, this asset will be subject to a special apportionment method which must be approved by the Commissioner for the SARS.
The following percentages shall apply to calculate input tax in relation to research activities:

Type of research	Input tax treatment
Basic	None
Applied	50% input tax deductible
Contract (student involvement)	50% input tax deductible
Contract (no student involvement)	100% input tax deductible

Although the directive was given only to members of USAF as per the VCR, the definitions and application can serve as a guide to what SARS may be open to allow to Education Institutions who approach SARS for an alternative method of apportionment.

Change in use adjustment

In the event that capital goods or services are acquired, a vendor is required to estimate the percentage of taxable use in order to deduct input tax as soon as possible after acquisition or importation, despite the fact that the goods or services will be used, consumed or supplied during the subsequent tax periods. Where input tax has been deducted based on an estimate which does not reflect the actual taxable use, an adjustment must be effected. If the input tax deducted exceeds the input tax that should have been deducted, as the taxable use of the goods or services has decreased, an output tax adjustment must be made. Alternatively, where the input tax deducted is less than the input tax which should have been deducted, as the taxable use of the goods has increased an input tax adjustment must be reflected.

A vendor who acquires capital goods or services wholly or partly for the purpose of consumption, use or supply in the course of making taxable supplies, and subsequently reduces the taxable application or use of such goods or services, shall be deemed, in terms of section 18(2), to make a taxable supply to the extent that there is a decrease in the application or use of such goods or services in relation to its application. The value of the supply is determined by applying the formula as set out in section 10(9), subject to the provisions of that section.

Capital goods or services acquired or applied partly for the purpose of use, consumption or supply in the course of making taxable supplies shall be deemed to be supplied to the vendor in terms of section 18(5) to the extent that there is a subsequent increase in the taxable use of the goods or services.

The provisions of section 18(2) read with section 10(9), and section 18(5) are only applicable to capital goods or services where the change in use of such capital goods or services where the change in use of such capital goods or services exceeds 10%. The proviso to section 18(2) and (5) provides that an adjustment does not have to be made in the following instances:

- The capital goods or services have an adjusted cost of less than R40 000 (excluding tax).
- The capital goods or services costs less than R40 000 (excluding tax); or
- The capital goods or services were deemed to be supplied in terms of section 18(4) and the amount, being the lesser of the adjusted cost to the vendor of acquisition, manufacture, assembly, construction or production of those goods, was less than R40 000 when the goods or services were deemed to be supplied to such vendor.

According to the VCR, SARS ruled that an adjustment is to be made at year end in terms of section 18(2) and (5) in respect of all capital goods applied for mixed purposes. In calculating the adjustment, determine the difference between the apportionment ratio for the current and previous financial year (the adjustment percentage) and, insofar as the difference exceeds 10%, apply the adjustment percentage to the VAT paid on the acquisition of capital goods.

VAT on exchange transactions/Barter transactions

The VAT Act does not define a barter transaction. According to the VAT guide for vendors (VAT 404), a barter transaction occurs when goods or services are exchanged for other goods and/or services. Payment of the consideration may also be partly in money, and partly in goods and/or services exchanged. According to section 10(4) of the VAT Act, to the extent that payment is not in money, the consideration is the open market value (OMV) of goods and/or services received. In terms of this section, the value of a supply is deemed to be the open market value of that supply where:

- The charge is lower than the open market value of the supply;
- The parties are connected persons; and
- The recipient is not entitled to a full input tax deduction.

The definition of connected person is defined in Section 1 of the VAT Act.

SARS in its Interpretation Note 67, that considered the definition of a “connected person” in terms of the Income Tax legislation considered the term “control”. The Interpretation note states that control “refers to de facto control and not shareholder control”. SARS further states that “de facto control is generally but not necessarily held and exercised by the board of directors.” The note states that the facts and circumstances of each case should be considered and that the influence of controlling individuals may significantly impact whether the parties are controlled by the same person.

It will have to be analysed if the Institutions are considered to be a connected person to other entities (sister companies and non-sister companies) it contracted to. The definition of consideration in the VAT Act provides that consideration includes any payment made, whether in money or otherwise, it may be voluntary or not and may take the form of any act or ‘forbearance’ (that is, failure to act), in respect of the supply of goods or services.

Other common VAT Risks

As VAT is a transactional type of tax, there are a lot of risks that can be identified based on the vendors’ activities and transactions. One would need to analyse the risk on a transaction by transaction basis.

The below factors however tend to be some of the contributing factors associated with non-compliance when it comes to VAT. These are, but not limited to:

- Duplicate expenditure
- Inadequate risk assessments/identifiers
- Adequate process not followed
- Late filing of returns and not responding to SARS queries on time
- Poor record keeping
- Lack of VAT knowledge or not utilising skilled personnel
- Claiming input VAT on prohibited expenditure

The solution to all the above, we believe can be obtained in the use of VAT Analytics which we have highlighted the benefits and proposed solutions below.

4. Interest and penalties for non-compliance

Late payment penalties

Section 39(1) of the VAT Act provides as follows:

"If any person who is liable for the payment of tax and is required to make such payment in accordance with the provisions of section 14, 28 (1) or 29, fails to pay any amount of such tax within the period for the payment of such tax specified in the said provisions, the Commissioner must, in accordance with Chapter 15 of the Tax Administration Act, impose a penalty equal to 10 per cent of the said amount of tax."

Section 213 of the TAA, in turn, provides as follows:

"If SARS is satisfied that an amount of tax was not paid as and when required under a tax Act, SARS must, in addition to any other 'penalty' or interest for which a person may be liable, impose a 'penalty' equal to the percentage of the amount of unpaid tax as prescribed in the tax Act." (Own emphasis)

The use of the word "must" in both section 39(1) of the VAT Act and section 213 of the TAA indicates that SARS does not have a discretion as to whether or not to impose a late payment penalty – SARS is obliged to impose such penalty.

Interest

In terms of Section 39(1)(a)(ii) "where payment of the said amount of tax is paid on or after the first day of the month following the month during which the period allowed for payment of the tax ended, interest on the said amount of tax, is calculated at the prescribed rate (but subject to the provisions of section 45A) for each month or part of the month in the period reckoned from the said first day. "

Interest is not a penalty but constitutes compensation for the time value of money. Therefore, tax legislation does not generally provide SARS with the discretion to waive interest.

Section 39(7)(a) of the VAT Act does however provide the Commissioner with a discretion to remit, in whole or in part, the interest imposed where the failure on the part of the vendor to pay the VAT amount timeously was **due to circumstances beyond the vendor's control** (i.e. external, unforeseeable, unavoidable or in the nature of an emergency, such as an accident, disaster or illness which resulted in the person being unable to make payment of VAT when due). Interest is levied on late tax payments to prevent vendors from delaying the payments of tax to the detriment of the State, and to ensure that it is compensated for the use of money due to the State. It is for this reason that the discretion of SARS to remit interest imposed is limited to circumstances where the taxpayer had no control over the failure to pay the VAT when it became due.

Interest will therefore be imposed if there is a late payment of VAT.

The TAA came into operation on 1 October 2012 except for certain provisions relating to the calculation of interest. Section 187(3)(e) that provides for interest to be levied on a percentage-based penalty, the 10% late payment penalty, is still to be proclaimed.

Interest to be levied on any understatement penalty as provided for in section 187(3)((f) had been proclaimed by the Proclamation that was issued 14 September 2012.

The effect of the above is that interest is currently not being levied on any late payment penalty but is levied on any understatement penalty from the effective date of the tax understated.

Understatement penalties

If SARS finds that there was an understatement by Education Institutions, the Education Institutions will have to pay the understatement penalty as provided in section 222(2) of the TAA in addition to the underlying tax due for the applicable tax period.

"Understatement" is defined in section 221 as "…any prejudice to SARS or the fiscus because of –

(a) a failure to submit a return required under a tax Act or by the Commissioner;
(b) an omission from a return;
(c) an incorrect statement in a return;
(d) if no return is required, the failure to pay the correct amount of "tax"; or
(e) an 'impermissible avoidance arrangement'."

If the incorrect statements in the Institution's VAT returns resulted in any prejudice to SARS or the fiscus, there will be an understatement as defined. Where there is an understatement, SARS has no discretion as to whether to impose an understatement penalty. Section 223(1) of the TAA contains the understatement penalty table which SARS must use when it imposes the understatement penalty:

Item	Behaviour	Standard case	If obstructive, or if it is a 'repeat case'	Voluntary disclosure after notification of audit or criminal investigation	Voluntary disclosure before notification of audit or criminal investigation
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	'Impermissible avoidance arrangement'	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

In its analysis, SARS must first establish whether the taxpayer's conduct should be regarded as a standard case, a repeat case, a voluntary disclosure after notification of an audit or if the taxpayer approached SARS voluntarily before receiving a notification of audit. SARS must then determine how to classify the taxpayer's behaviour as prescribed in the table (i.e. whether the behaviour comprises a substantial understatement, reasonable care not taken in completing return, no reasonable grounds for tax position taken, impermissible avoidance arrangement, gross negligence or intentional tax evasion). Once the behaviour has been established, SARS must levy the applicable understatement penalty percentage.

In terms of section 221 of the TAA, a substantial understatement means a case where the prejudice to SARS or the fiscus exceeds the greater of five per cent of the amount of tax properly chargeable or refundable under a tax Act for the applicable period, or R1 million.

If there is not a "substantial understatement", as defined, SARS can classify the Institution's behaviour as any one of the remaining five behaviours (based on the circumstances in which the understatement arose).

5. Remedies/Solutions to correct errors

Option 1: Voluntary Disclosure Programme (VDP)

Firstly, it is not compulsory for any vendor to exercise the relief measures offered by the VDP or Voluntary Disclosure Programme.

The purpose of the VDP is to enhance voluntary compliance. It aims to encourage taxpayers to come forward on a voluntary basis to regularize their tax affairs with SARS and avoid the imposition of understatement penalties and administrative penalties.

A VDP application is because of a VAT default. A default may be defined as the submission of inaccurate or incomplete information to SARS, or the failure to submit information or the adoption of a 'tax position', where such submission, non-submission, or adoption resulted in—

(a) the taxpayer not being assessed for the correct amount of tax;
(b) the correct amount of tax not being paid by the taxpayer; or
(c) an incorrect refund being made by SARS.

To ensure validity of a VDP application, a disclosure must:

- Be voluntary;
- Involve a "default", which is defined in section 225 of the TAA, as 'the submission of inaccurate or incomplete information to SARS, or the failure to submit information or the adoption of a 'tax position', where such submission, non-submission, or adoption resulted in an understatement'. The default must not have occurred within five years;
- Be full and complete in all material respects;
- Not result in a refund due by SARS; and
- Involve a behaviour where understatement penalties can be levied

If the taxpayer elects to do a VDP, SARS would waive any administrative penalty as well as the understatement penalty, since this is voluntary. However, the taxpayer will still be liable for interest on the default amount.

The VDP is only applicable where an application relates to a VAT liability. Where an application results in a refund, such a vendor will not qualify for a VDP.

Benefits –

- It waives all understatement penalties;
- It waives all administrative penalties; and
- Exemption from criminal prosecution.

Cons -

- Once submitted, it is regarded as binding, and the taxpayer may not object in the future.

Option 2: A reduced assessment- Section 93 (1)

SARS may make a reduced assessment if the taxpayer successfully disputed the assessment under Chapter 9 of the TAA or SARS is satisfied that there is a readily apparent undisputed error in the assessment by SARS or the taxpayer in a return.

Option 3: Additional assessment- Section 92

If at any time SARS is satisfied that an assessment (with VAT being a self-assessment tax, the return submitted by the taxpayer is the original assessment) does not reflect the correct application of a tax Act to the prejudice of SARS or the fiscus, SARS must make an additional assessment to correct the prejudice.

Should a taxpayer not elect to submit a VDP, penalties (late payment and understatement) and interest will be levied.

Other guidance

Included in the 10 important principles as stated in the SARS VAT 404 SARS Guide for Vendors (updated and issued on 12 December 2019), it provides as follows – "If you have underpaid VAT as a result of a mistake, report it to SARS as soon as possible, rather than leaving it for the SARS auditors to detect. You can make a request for correction on eFiling if you file your returns electronically."

The SARS External Guide for Completing the Value-Added Tax (VAT201) declaration, also states the following under section 9-Request for Correction: "Vendors have the ability to revise a previously submitted VAT201 Declaration, whether it is for the current tax period or a prior tax period, amounts under Part A (i.e. Output tax) can be increased or decreased, however amounts under Part B (i.e. Input tax) can only be decreased on the VAT201 Declaration to reflect the correct VAT liability."

Furthermore, in terms of section 25(2) of the TAA "A return must contain the information prescribed by a tax Act or the Commissioner and be a full and true return". It is important to note that a "return" as defined in the TAA "means a form, declaration, document or other manner of submitting information to SARS that incorporates a self-assessment, is a basis on which an assessment is to be made by SARS…"

In terms of section 234 of the TAA, there will be criminal offences relating to non-compliance with the tax Acts. This relates to a person who wilfully and without just cause –

(j) fails or neglects to disclose to SARS any material facts which should have been disclosed under this Act or to notify SARS of anything which the person is required to so notify SARS under a tax Act.

(p) fails and neglects to withhold and to pay to SARS an amount of tax as and when required under a tax Act.

6. Tax Analytics

In today's fast moving economy, institutions are increasingly challenged to meet their multiple tax obligations around the world, often using limited resources. Challenges include the large number and different type of transactions performed. Tax authorities are also becoming more sophisticated in their methods and frequency of auditing companies. These trends make managing indirect taxes more important than ever. Managing indirect tax requires proper knowledge of and control over:

- Data quality
- ERP set-up issues
- Supply chain visibility
- VAT risk monitoring
- Partial manual reporting processes
- Cash flow management
- Performance measurement

In South Africa's heightened regulatory environment, especially in the Education sector, many tax functions struggle to strike the right balance and, out of necessity, have largely expended their tax resources on compliance activities. Tax functions that focus on these activities to the exclusion of all others may feel trapped in an endless set of tasks with limited ability to focus on creating value and managing tax risk and handling large quantities of data that need to be analysed. The solution we utilise is able to access the data at source and independently analyse large volumes of transactions across the Institutions entire data population (e.g. data files, spreadsheets and reports) without using sampling techniques, which can increase the risk of undetected errors/variances.

Our approach, which has been developed through leveraging the benefits of data analysis techniques, provides the Education Institutions with the ability to monitor tax outcomes on a continuous, real time basis. This approach can be customised to any business and is instrumental in improving the overall effectiveness and quality of the management of your transactional and income tax risk. This is achieved by applying a suite of proven data analytics that will assist you in managing tax in your organisation. You will be able to manage risk, save time and improve efficiency by using pre-built automated analytics rather than extracting and analysing data manually or on an ad-hoc basis, which can prove to be ineffective at times.

The benefits are that you will gain insight into your tax-related financial data and highlighting areas of process weakness and control ineffectiveness that can be remediated to avoid future tax risks. By releasing senior management to spend more time on strategic tax management matters, this approach will enable the tax function to maximise the value added to the Education Institution. You will be able to manage risk, save time and improve efficiency by using pre-built automated analytics rather than extracting and analysing data manually or on an ad-hoc basis, which can prove to be ineffective at times.

7. Employees' Tax

Introduction

The 2018- 2019 annual report issued by the Auditor General has identified the following key issues that impose a risk relating to human resources on higher educational institutions:

- Payments made to education and training employees without proper approval employees tax risk. The department might not be withholding employees' tax and paying it to SARS on the payments made
- Payment of shift allowance to CET employees.
- Fraudulent payment made to employees
- Outdated Human Resources policies and financial system's responsible for capturing payments to employees
- Poor controls in relation to leave capturing
- Payments in respect of leave.
- Overall policies and procedures in place to ensure monthly, quarterly, annual financial and performance reports may not be complete and up to date
- Employee records not properly kept, no system in place to store large volumes of information received from Tvets
- Recurring findings regarding monthly reconciliation of employee benefits
- Payments to employees not properly authorised (CET employees)
- Backdated payment to employees without enough support
- Validity of learners funded through community based skills development initiatives
- Travel claim duplication,

The above risks identified may have an impact on the withholding of employees tax by the institutions of higher learning.

The tax law requires:
All employers to withhold tax and pay it over to the tax authorities within 7 days after the end of the month during which the amount was deducted or withheld. They have an obligation to ensure that the correct amount of employees' tax is calculated and paid over to SARS within the specified period as stipulated by the Commissioner of SARS.
At the end of each tax period, the employer is obliged to issue each employee with an employees' tax certificate [IRP5/IT3 (a)] which reflects, amongst other details, the employees' tax deducted.

In addition to employees' tax there is a compulsory levy for the purposes of funding education and training. This levy is governed by the Skills Development Act, 1998. It is called Skills Development Levy (SDL) and is payable by employers on a monthly basis. The amount payable is 1% of the leviable amount (taxable income). There is another compulsory contribution to fund unemployment benefits. This levy is called Unemployment Insurance Fund and it's governed by the Unemployment Fund Act. The employer and employee are liable for the contribution.

For employees' tax to be payable three elements must be present: there must be an **employer**, paying **remuneration** to the **employee**.

The employer must determine the employment relationship to be able to classify the employee correctly in order to determine the correct rate which must be applied to deduct employees' tax from the remuneration of the specific employee. Below we detail areas where higher education institutions might need to engage tax specialists to determine whether an employer-employee relationship exists and whether amounts paid qualify as remuneration.

Third-party service providers

As a general principle, whether an employee is classified as an independent contractor or employee might impact the employer's obligation to withhold and pay taxes as detailed above. Where a third-party service provider is not correctly classified the higher education institution might be under-declaring tax where the third party should have been declared as an employee of the institution.

Independent contractor is not defined in the Income Tax Act, however the definition of remuneration brings some on issue of independent contractor. The definition of remuneration in terms of the Fourth Schedule of the Act excludes payments made to a person carrying on a separate trade from the employer. Therefore, an independent contractor is not an employee, any amounts accrued to or received by an independent contractor are not subject to employees' tax. The independent contractor will be taxed according to the individuals tax tables.

In order to classify whether a person is an independent contractor, two tests are applied; the statutory test and common law test. In practice the statutory test is considered first, if the requirements of the of the statutory test are satisfied, the common law dominant impression test is applied.

SARS issued the interpretation note 17 (Issue 4) on the 14th of March 2018 to give more clarity to employers on the classification of independent contractors. In determining the statutory test, the following should be taken into account:

- Residency status of the independent contractor, if the person is a non-resident, that person cannot be an independent contractor.
- If services are performed mainly at the premises of the person paying for or requesting the service and the service provider is subject to the control and supervision as to the manner in which the duties are performed or to the hours of work
- If the person rendering the services is subject to the control as to the manner in which the duties are to be performed or hours of work
- Except if the person throughout the year of assessment employs 3 or more employees who are full time in rendering the service on behalf of the person, other than connected person to such person.
- Supervision and control are only factors indicating employment.
- If the person is told when to start work and how to work, it could not be said that the employer has the control on his hours of work, and he would not be carrying on an independent trade

- In addition, if the employer controls the manner in which the employee has to work at the employer's premises, this means the person is not carrying on a trade independently and thus cannot be called an independent contractor

Common Law Test:

- The common law dominant impression test is an analytical tool that is designed for application in the employment environment to establish the dependence or independence of a person rendering the service.
- In making an evaluation a number of indicators are used. These indicators are grouped into three categories:

1. Near conclusive indicators, such as the manner of control.
2. Persuasive indicators, such as whether or not the worker is receiving instructions or supervision.
3. Resonant indicators, such as who provides the tools of the trade

Risk:

- The correct classification of a relationship as either employee or independent contracting is important as a result of the differences in tax treatment.
- An employer is in the best position based on the facts and actual situation to evaluate whether an individual is an independent contractor or an employee
- The decision on whether a person is an employee or independent contractor impacts on the employer's obligation to deduct employees' tax
- An employer who has incorrectly determined that a person is an independent contractor is liable for employees' tax that should have been deducted, as well as interest and penalties

What can institutions do to mitigate the risk

- Proper assessments and controls should be in place to ensure that the employer in this case, the Higher Education is able to identify this category of employees correctly for employee's tax purposes.
- We will work with the procurement and payroll department to develop a control process that can be implemented by the employer for proper analysis
- Recommend and oversee the implementation of the system
- Test effectiveness of the process implemented
- Improve any gaps noted during testing
- Where payments have been made already to the Personal Service Provider / employee without withholding employees tax, we will recommend approaching SARS through the Voluntary Disclosure Program (VDP)
- We will recommend that management submits a Voluntary disclosure application (Vda) to SARS.

8. Employee Benefits

Employee benefits are governed by the Seventh Schedule to the Income Tax Act. An obligation is placed on the employer to correctly determine the cash equivalent of the value of a taxable benefit for employees' tax purposes.

Insurance risk products

The taxation of insurance premiums contributions made by the employer is governed by paragraph 2(k) of the Seventh Schedule to Income Tax Act.

In terms of the abovementioned paragraph, a taxable benefit arises if an employer makes any payment to any insurer under an insurance policy directly or indirectly for the benefit of an employer or spouse, dependent, child or a nominee.

The paragraph does not apply to policies arising solely out of and in the course of employment of the employee such as an accident policy where a pay-out is in respect of an employee injured at work. The premium that the employer pays is not regarded as a taxable benefit.

However, some employers overlook this tax benefit and therefore do not tax it accordingly. Failure to withhold employees' tax may result in the payment of interest and penalties.

Bursary

Institutions often award bursaries and scholarships, to its employees (lecturers and general employees of the institutions) or to relatives of employees.

These are bona fide scholarships or bursaries to enable or assist a person to study at a recognized university or institutions.

These bursaries or scholarships are exempt in terms of section 10(1)(q) of the Act. The section outlines that where a bona fide bursary or scholarship is granted to any person to study at a recognized educational or research institute that bursary will be exempt from tax. The bursary or scholarship granted to an employee will be exempt from tax provided that the employee agrees to repay the employer if that employee fails to complete the course of study for reasons other than ill-health, death or injury.

In the case where the bursary or scholarship is granted to an employee's relative the exemption will not apply under the following conditions:

- If the employee's remuneration for that year of assessment is in excess of R600 000 and
- In the case of any such relative, during the year of assessment, exceeds-
  - o R20 000 in respect of grade R to twelve or a qualification to which an NQF level from 1 and including 4 has been allocated in accordance with the National Qualifications Framework Act, 2008 and
  - o R60 000 in respect of a qualification to which an NQF level from 5 up to and including 10 has been allocated in accordance to chapter 2 of the National Qualification's Framework Act 2008

However, in terms of the above mentioned section, employers are allowed to redirect a portion of their employees' remuneration towards school fees in the form of a bona fide scholarship or bursary in the form of a salary sacrifice, thereby effectively reducing the tax liability of the employee.

New Amendment

It is proposed that the exemption in respect of a bona fide bursary or scholarship granted by the employer to the relatives of the employee as contemplated in paragraph (ii) of the provisos to section 10(1)(q) and section 10(1)(qA), should only apply if that bona fide bursary or scholarship granted by the employer is not restricted only to the relatives of the employee, but is an open bursary or scholarship available and provided to members of the general public; and

It is proposed that the requirement that the applicability of the exemption is dependent on the fact that the employee's remuneration package is not subject to an element of salary sacrifice, be reinstated.

It is further proposed that, as a means of further encouraging employers to grant bursaries to relatives of employees without subjecting such bursary to an element of salary sacrifice, that the employer deduction in relation to said bursaries is only afforded if the bursary to the employee's relative is not subject to an element of salary sacrifice.

The new amendment is effective from 1 March 2021

Accommodation

Paragraph 2(d) of the Seventh Schedule of the Income Tax provides that a taxable benefit shall be deemed to have been granted where the employer has provided the employee with the residential accommodation either free of charge or for a rental consideration which is less than the value of such accommodation as determined by paragraph 9 of the seventh schedule of the Act.

The value to be placed on the benefit is the greater of:
Any rent payable by the employer and other expenditure in respect of the accommodation, or
An amount determined according to the formula (A-B) X C/100X D/12

Educational institutions normally provide its employees with employer owned houses / flats. These employees may pay a monthly rental which is lower than the prevailing market value. In such case the employer may fail to withhold an appropriate employees' tax.

Advances

Some payments may be made to the employees outside the payroll system. Some of these payments may be in the form of advances. The advances may be for travel, entertainment and subsistence.

Section 8(1)(a)(i) of the Income Tax Act provides that all allowances and advances paid by a "principal" to a "recipient" must be included in the recipient's taxable income to the extent that they are not expended for travelling on business; or for accommodation, meals and incidental costs while such office holder or employee is obliged to spend at least one night away from his or her usual place of residence as a result of business or official purposes; or by reason of the duties attendant upon public office.

Section 8(1)(a)(ii) provides that in limited circumstances a reimbursement or advance must not be included in taxable income as otherwise required by section 8(1)(a)(i) the reimbursement or advance was or must be expended by the recipient on instruction of the principal in the furtherance of the principal's trade; and the recipient must produce proof to the principal that the amounts were wholly and actually expended for this purpose.

Subsistence allowances are generally not subject to employees' tax. However, if a subsistence allowance or advance is paid or granted to an employee during any month, and that employee had not spent the anticipated time away from his or her usual place of residence on business by the end of the month following the month in which the allowance or advance was paid or granted, it will be subject to employees' tax if the employee has not refunded such amount to the employer. This ensures that subsistence allowances or advances are not used as a form of salary structuring by employers and do not result in employees receiving a tax-free allowance.

Risk in respect of employee benefits:

- The incorrect payment of employees poses a huge financial risk for companies as the wage bill can constitute over 50% of operating expenses. Poor controls can also lead to fraud and therefore strict controls regarding the payment of salaries need to be in place. Employers can also be found in contravention of legislation if the incorrect amounts of tax or other statutory deductions are not paid over correctly.
- Improper procurement of goods and services
- Improper HR practices, e.g. improper appointment or placement of staff, or improper accounting for bonuses or research grants, etc.
- Fraudulent payments, e.g. payment of ghost employees and payment to fraudulent/ non-existent suppliers
- Improper claims, e.g. overstated/ invalid travel & subsistence claims
- Improper payment of financial aid, e.g. via payment to non-NSF-registered students, or overpayment of financial aid to students
- Failure to determine the cash equivalent of the employee benefits may results in an employer not withholding the correct employees' tax
- This may result in the levying of interest and penalties by SARS

Solutions in respect of employee benefits:

- A review of the entire payroll process needs to be conducted and where gaps are identified, systems need to be put in place to correct them. A detailed blueprint for payroll processing needs to be developed and adhered to, which includes more than one person signing off the payroll. A remuneration policy needs to be developed which outlines how tax, overtime and any other payments are to be made i.e. leave. A remuneration policy will guide salary decisions and ensure that remuneration is equitable and fair as required by the Employment Equity Act.
- HR Policies should be reviewed to ensure compliance with current legislation and best practice i.e. leave policy. This will include the following:
  - We will review the payroll documentation including: remuneration structuring policy documents to determine whether the provisions of the Income Tax Act have been complied with;
  - We will examine all benefits and allowances provided to employees and the PAYE treatment thereof. Further, we will ensure the correct application of human resources, remuneration policies and practices
- Where the discrepancies have been identified we will bring such to the attention of management and quantify the error
- Where actual or suspected irregularities are identified, it is important that they be promptly investigated and resolved. Our Forensics team will be on hand to determine, inter alia: whether there is an irregularity, what legislation or policy has been breached, the parties responsible for such irregularity, whether a loss has been suffered by the institution or the State, and recommendations (e.g. civil or criminal action, improvements to controls, etc.). The team's use of digital forensics tools allows the extraction of evidence from electronic devices such as cellphones, tablets and computers to aid the investigation process.
- In the cases where there is a liability to SARS we will recommend approaching SARS through the Voluntary Disclosure Program (VDP)
- We will recommend that management submits a Voluntary disclosure application (Vda) to SARS.

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