IN THE NEWS
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HG CHARTERED Accountants

A Remote Working Danger: Independent Contractor or Employee?

The prevalence of remote working since the start of the national lockdown in March has brought to the fore the need to distinguish between an employee and an independent contractor.

This topic has both labour and tax law implications.

Anli Bezuidenhout, a Cliffe Dekker Hofmeyr employment lawyer, said during an interview that a situation could arise where an independent contractor started working for a company, but ended up operating as an employee.

“It is important that both parties manage the relationship because the lines get blurred. Companies need to classify people correctly and manage the relationship properly,” she said.

Tertius Troost, a Mazars tax manager, said during an interview that small businesses could avoid an administrative burden if they dealt with an employee as an independent contractor.

“Small businesses battle with Pay-As-You-Earn (PAYE) tax, especially with complicated employee fringe benefits,” Troost added.

Having an employee defined as an independent contractor means that the employer would not need to pay the person either annual or sick leave or overtime pay, nor would the employer be required to make pension or medical aid scheme contributions.

In addition, an independent contractor cannot enforce a claim against the company for unfair dismissal, nor hold the employer to any of the many other employee rights provided by our labour laws.

The company would also not need to contribute on behalf of the contractor to the Skills Development Levy, Compensation Fund, and the Unemployment Insurance Fund.

Bezuidenhout said some companies like to have employees classified as independent contractors, because they then do not have to comply with the Labour Relations Act (LRA) and the Basic Conditions of Employment Act (BCEA).

Often employees agree (or pro-actively request) to be independent contractors in order to avoid PAYE and to make expense deductions against their business income.

Bezuidenhout said that individuals were often happy when companies classified them as independent contractors because that gave them flexibility.

However, the South African Revenue Service (SARS) and the Department of Labour look at the actual relationship between a company and those that work for it – it is a factual enquiry and an employer that incorrectly classified an employee as an independent contractor would be liable for the employee’s tax that the company should have deducted plus penalties and interest.

However, the employer could (at least in theory) recover the tax paid to SARS from the employee.

How tax law defines an employee versus an independent contractor

SARS requires a company to withhold employees’ tax when three elements are present, namely an employer, the payment of remuneration and an employee.

SARS also provides two tests to determine whether a person is to be regarded as an independent contractor for employees’ tax purposes.

If an employee meets both parts of the first test, then the person is an employee and any earnings paid to that employee will be subject to employees' tax.

The first part of this test is that the employee performs over 50% of the services or duties at the client's premises.

The second part of the test is whether any person controls the employee or his or her work hours.

The second test determines whether a contractor is trading independently.

Where an independent contractor rendered services to more than one client, then the contractor needed to apply these tests in respect of each client to assess whether the contractor was an employee at each engagement.

Another test is the common law "dominant impression test" that SARS applies to determine whether an employee is an independent contractor or an employee.

How to apply the common law "dominant impression" test

The "common law dominant impression grid" sets out 20 of the more common indicators.
These indicators take a detailed look at the relationship to determine if it is an employer and employee relationship or a client and independent contractor relationship.

There are three categories of these indicators, namely:

1. Near-conclusive, which relate most directly to the acquisition of productive capacity;
2. Persuasive, which relate to the control of the work environment;
3. And resonant of either an employer-employee relationship or an independent contractor or client relationship, whichever is relevant.

SARS said in an Interpretation Note that it would use the dominant impression to classify the relationship as either an employee or an independent contractor relationship.

Personal service providers, labour brokers, and expatriate employees

SARS introduced anti-avoidance measures about personal service providers or labour brokers to clamp down on those trying to avoid employees' tax.

SARS uses common law tests to determine whether a personal service provider or labour broker is carrying on an independent business.

Mazars' Troost said that tax law required that when a company engaged a personal service provider or a labour broker, without a SARS certificate of exemption, that company had to withhold PAYE as SARS deemed such a person an employee.

SARS would only issue an exemption certificate if the labour broker or personal service provider conducted an independent business, according to a SARS Interpretation Note.

A personal services company has to have at least three employees who were not family members in order to be considered an independent contractor, Troost added.

Expatriate employees working in South Africa may need to pay employees' tax on local income, subject to any double tax agreements which may be in place between South Africa and the expatriate employee's home country.

In terms of the definition of remuneration in the Fourth Schedule of the Income Tax Act, a person who is not a resident cannot qualify as an independent contractor.

A quick comparison of employee versus independent contractor

Indicative factors in determining where a person is an employee or an independent contractor, according to the South African Guild of Editors.

Employee	***Employee Independent Contractor***
Works for only one employer at a time.	*Provides services to more than one person or company at a time.*
Works the hours set by the employee.	*Sets his or her own hours.*
Usually works at the employer's place of business and uses their equipment.	*Works out of his or her own office or home and uses his or her equipment.*
Entitled to annual and sick leave.	*Not entitled to any leave.*
Often receives employment benefits, such as medical aid or bonuses.	*Does not receive employment benefits from the employer.*
Works under the control and direction of the employer.	*Works relatively independently.*
Receives a nett salary after the employer has deducted income tax and UIF.	*A provisional taxpayer and responsible for paying his or her own taxes.*

(Adapted from: S A Guild of Editors)

How labour law handles the distinction between employees and independent contractors

The major pieces of employment legislation, the LRA, the BCEA and the Employment Equity Act (EEA), apply to employees and not independent contractors.

The law defines an employee to mean any person, excluding an independent contractor, who works for another person or the government, receives remuneration, and conducts the business of the employer.

There is no statutory definition of the term "independent contractor".

As a result, several tests have evolved through case law, the presumption of employment provision in the LRA and BCEA, and the Code of Good Practice on "Who is an Employee".

To ensure that employees do not lose their labour law protections, section 200A of the LRA and section 83A of the BCEA introduced a rebuttable presumption that everyone earning under the earnings threshold of R205,433.30 a year is an employee until proven otherwise and regardless of the contract concluded, according to an article on the EE Publishers website.

An employer who disputes that an independent contractor is an employee must provide evidence about the working relationship.

NOTE FOR ACCOUNTANTS: Here is further reading about how to handle the issue of an employee versus an independent contractor:

A SARS interpretation note that explains the statutory tests and common law tests used to classify an employee **here**.

A SARS interpretation note about personal service providers and employees' tax **here**.

The Labour Relations Act **here**, the Basic Conditions of Employment **here** and the Employment Equity Act **here**, which all apply to employees.

The Commission for Conciliation, Mediation and Arbitration's employee versus independent contractor guide **here**.

Accounting Tips for SMMEs in a Rocketing Tax Future

"The avoidance of taxes is the only intellectual pursuit that carries any reward": John Maynard Keynes

While there are diverse reasons why SMMEs ultimately fail, financial mismanagement and poor performance are two of the most often-cited explanations.

A financial forecast as a tool, allows businesses to plan their finances for the future - with the consideration of their present and past performances. This implement should be mindful of the looming tax increments within the South African context, if it is to be effective in steering the company to a state of readiness and efficiency, particularly during the ongoing COVID-19 pandemic.

Being that the increases are projected to be an ongoing imposition over the next five years at least, here are some expert accounting tips for SMMEs on how to best manage future projections and targets in our volatile local tax environment.

1. ***Appropriate and timeous management of the tax predicament***

   SMMEs are advised to manage their expectations within our rocketing tax context, in order to prepare themselves in dealing with their future successes and failures. Understanding the context, timing, various tax implications and what is projected at company level is vital in preparing for the inevitable pinch on the pocket.

   The COVID-19 trial hasn't come at the best of times for our government as it can't afford to be as giving as others around the globe. There are governments that have given deferrals on payroll taxes, VAT and corporate income tax as a collective package. In South Africa, tax compliant businesses have been allowed to defer 20% of their employees' tax liabilities and a portion of their provisional corporate tax payments – ask your accountant for details.

2. ***Pick the right forecasting model for your business.***

   Picking between the right qualitative and quantitative forecasting approach should be determined by the core data of the company being dealt with. The projected tax increments should be factored in, as the overall objective is to forecast profitability and not just actual sales. For example, in the Qualitative Model, there is Trend Projection, where the accountant looks at the trajectory of what is happening at that point in time, while following the trend in the publicised increases.

3. ***Adaptability and reducing costs where applicable.***

   According to Johnny Yong, who is technical manager with the International Federation of Accountants' (IFAC) Global Accountancy Professional Support (GAPS), and Robyn Erskine, who is partner at Brooke Bird in Australia, SMEs should evolve with the times.

   "Death and taxes are the two constants in life. It is therefore not surprising for SMEs to be asking this question. In other instances, the corporate vehicle or tax structure may need to evolve as the business grows. [Accountants] can discuss this with their clients – at a certain point of the SME's evolution. Preparation (for the entrepreneur) is important to ensure long term success of the business," they penned for the IFAC website.

4. ***Charitable contributions as a means of getting tax breaks***

   This is a tool that can be achieved through manoeuvring and strategy. The South African treasury has announced tax breaks which might help soften the tax pinch.

The tax-deductible limit for donations (currently 10% of taxable income) will be increased by an additional 10% for donations to the Solidarity Fund during the 2020/21 tax year.

The bona fide donations have to be made to an approved organisation, agency, institution, or department of government listed in section 18A (1) of the Income Tax Act and there must be a receipt to prove the donation. Make sure of course that you can afford the cash outflows involved.

5. ***Planning accordingly and compliance.***

   The benefits of forecasting can never be overstated. The thoroughness of forecasting gives the organization insight into the possible future performance of the business and how to prepare.

   A specific benefit is that forecasting can lead to better accuracy in budgeting. This includes accounting for future tax spend. The complete forecast can serve as a framework for developing new strategies.

Don't be left scrambling for cover at the last hour, ask your accountant for help with this – don't let high taxes kill your business!

NOTE FOR ACCOUNTANTS: For a brief breakdown of the tax breaks by the Treasury, please follow this **link**.

For entrepreneur Matt Garrett's prophecy of the finance industry in 2030, please click **here**.

To watch the Director of Cova-Advisory, Duane Newman discussing whether the Treasury's proposal for SMEs and workers was sufficient on Business Day's platform, please click **here**.

To read Johnnie Yong and Robyn Erskine's expert piece titled Performance and Financial Management: Key Factors for Small- And Medium-Sized Entities' Survival in a Volatile Environment which was published on the International Federation of Accounts (IFAC) please click **here**.

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6 Tips for Getting the Most from Your Tax-Free Savings Account

"He said that there was death and taxes, and taxes was worse, because at least death didn't happen to you every year." (Terry Pratchett, Reaper Man)

Tax-free savings accounts (TFSAs) have been around for just over five years, and yet many people still do not know about them, are unfamiliar with the benefits or don't know how to take maximum advantage of this unique investment opportunity.

Amidst the chaos of early COVID-19 and lockdown many may not have noticed that as of 1 March 2020, the annual limit in these types of investments was increased from R33 000 to R36 000 a year with the overall lifetime limit standing at R500 000. The National Treasury introduced these investments to encourage South Africans to save and as a result there are no taxes payable on interest or dividends received, and no capital gains tax (CGT) on funds withdrawn.

Clearly with such an attractive offer a TFSA must be a part of every person's future investment strategy, regardless of their income level. So just how does one take maximum advantage of these accounts and stand to gain the most future benefit?

1. ***Long term investment***

   The real power of a TFSA is in the long-term compounding of the investments. Due to the fact that a TFSA contribution is not immediately tax deductible (as for example a retirement contribution is) the benefits only kick in later when the interest that is being achieved starts overtaking the amount that would have been saved on taxes through other contributions.

   Director of advisory services at Investec Asset Management, Jaco van Tonder says, “From a tax benefit perspective, it appears to not make sense for an investor to utilise a TFSA for an investment horizon of less than five years. This picture changes dramatically though after ten years due to the well-known compounding effect of long-term investment returns”.

   This is an important aspect for investors to consider, especially as money in a TFSA can be accessed and withdrawn at any time. While that seems attractive there is a further large catch in that once the money has been withdrawn, returning it to the account will be regarded as part of your annual contribution. What this means is that if you have invested R12 000 in the account this year, then withdraw R3000, and return it a month later, the tax man will view this as you having already invested R15 000 in that account.

2. ***Saving for retirement***

   Due to the long-term nature of a TFSA, they are commonly used as a way to save for retirement, alongside, and sometimes as an alternative to, a Retirement Annuity (RA).

   While the income tax benefits of investing in an RA still makes them an extremely attractive proposition, a TFSA has a number of other benefits, which those investing in an RA should consider. Firstly, investors can withdraw from a TFSA at any time, and there is no tax on those withdrawals, while RAs are only accessible at retirement (under normal circumstances), and, when you access them, you need to buy an annuity with at least a part (currently two-thirds) of the accumulated value.

   Further, there are absolutely no restrictions on asset allocation in the TFSA, whereas restrictions apply to RAs in terms of Regulation 28 of the Pension Funds Act, meaning the investor may have more choice as to how aggressive they want to be with that investment.

   There are however some complicated considerations which need to be taken into account, and it's not as simple as cashing in the one to buy the other. In order to protect them from creditors, RA's are excluded from a deceased person's estate, and the investor is often encouraged to nominate a beneficiary to whom the benefits will accrue after death. The nomination process for a beneficiary may come with caveats, and instances where pay-outs may not happen, but even if the pay-out is set to be made, this can involve another level of administration and difficulty for the beneficiaries who may not want to deal with two separate companies to wrap up their loved one's estate. There are, however, often tax benefits to doing so at that stage.

   The issues around which is the superior investment between an RA and a TFSA will therefore ultimately come down to your unique situation, and investment strategy, and it is highly recommended that you speak to your accountant before making the leap.

3. ***Saving for an education***

   Despite the powerful points in tip two, one need not necessarily consider a TFSA as only being an alternative to an RA. There are many other investment choices someone may need to make and one of the most important is education. If you intend on sending your children to University one day you might be thinking about starting a fund to pay for the fees. If you do not already have a TFSA think twice and examine all options closely.

   Due to the long-term nature of education savings, a TFSA is the perfect tax-sheltered way to save for your children’s education. With regular education funds, part of the withdrawal may be subject to taxation, but when it comes time to finally cash in the TFSA there are no taxes payable at all and given the long term nature of the investment a TFSA could be the ideal investment tool.

As an example, if you invest just R620 a month in a TFSA at the relatively common interest rate of 6% for a period of 10 years, you could build up almost R100 000 during this time. This sort of payment is exactly what is needed when it comes time for your child to move from school to an institution of higher learning.

4. ***Invest your lump sum as soon as possible***

   Many people wait until the end of the year to put whatever savings they have left into their TFSA as a lump sum. Sometimes they use their end of year bonuses for this same benefit. Investment strategists suggest that it is wiser to either increase your monthly contribution to as close to R3000 a month as you can, or to pay the lump sum at the beginning of the year. What this does, is allow you to enjoy a full year of tax-free growth, which can add up dramatically over the lifetime of the investment.

   A R36 000 lump sum investment on 1 March can grow by R3 600 over the year (assuming a balanced fund investment with CPI+4% return). Tax on interest, dividends, and capital gains in such a portfolio would amount to roughly R600. By rather allowing this lump sum to grow in the TFSA from day one, the investor gets to keep and further grow this R600. Compounded over time this relatively small amount can grow to make a significant difference.

5. ***Invest in growth assets***

   Like other funds, TFSAs come in many shapes and sizes. SARS currently says the following kinds of accounts can qualify as Tax free investments: Fixed deposits; Unit trusts (collective investment schemes); Retail savings bonds; Certain endowment policies issued by long-term insurers; Linked investment products and Exchange traded funds (ETFs) that are classified as collective investment schemes.

   In order to take the maximum benefit from your TFSA you should ensure that there are as many growth assets included as possible to maximise your long-term growth. Remember, no limits apply as to your asset allocation and as such you are free to make bold choices.

6. ***Don't over-contribute***

   Seeing all of the above, and realising the benefit of a TFSA, one may be tempted to invest more money into TFSAs than is legally mandated. Don't. The annual contribution limit of R36 000 per individual is strictly enforced, and any contributions in excess of this annual limit can be subject to penalty tax of 40% of the excess. There is no limit to the number of TFSAs you can have, but it is important to manage them closely to ensure that you don’t exceed your annual contribution limit. This R36 000 applies to the sum of all contributions to all your TFSAs so be very careful not to accidentally stray over the line.

While powerful, a TFSA is not a one-size-fits-all investment opportunity. Investors need to carefully evaluate their different life situations and investment strategies with reference to long-term returns and volatility measures and see how they stack up. There is little doubt that the TFSA should form some part of an overall investment portfolio, but what that role is, needs to be tailored to the individual.

Speak to your accountant to evaluate your personal circumstances and see just how you can take maximum benefit from a tax-free investment.

NOTE FOR ACCOUNTANTS: For a simple breakdown of TFSAs vs Retirement Annuities go **here**.

For SARS’ rules on TFSAs head **here**.

Employees Working Abroad: How to Avoid Double Tax

"Every advantage has its tax." (Ralph Waldo Emerson)

The purpose of the foreign remuneration exemption, which was introduced in 2000, is to provide relief from any possible double tax that may arise where both South Africa and the foreign country taxes the same income derived from employment, according to a SAICA article on the topic, written by Piet Nel (Project Director: Tax Professional Development).

Requirements to qualify for the exemption

- The employee must be a resident of South Africa, for tax purposes.
- The employee must have been physically absent from South Africa and worked outside South Africa for a period or periods exceeding 183 full days in aggregate during *any period of 12 months*.
- The employee must have been physically absent from South Africa and worked outside South Africa for a continuous period exceeding 60 full days during that *period of 12 months*.

However, due to recent legislative changes and COVID-19 travel restrictions, many employees who work on foreign assignments or abroad may not qualify for the exemption for the 1 March 2020 to 28 February 2021 assessment period, and face paying double tax.

Important changes to the exemption

- A new R1.25 million threshold applies for this 1 March 2020 – 28 February 2021 tax period, where previously, there was a full exemption for qualifying foreign sourced remuneration. The individual will, unless the foreign country doesn't impose a tax on remuneration, be liable for a double tax to the extent that the remuneration exceeds R1.25 million, explains Nel.
- Furthermore, since March 2020, employers must withhold employees' tax if the taxpayer is employed by a South African resident employer, registered as such with SARS. If not, the first provisional tax was payable on 31 August 2020 and the second payment is due on 26 February 2021.
- COVID-19 travel restrictions around the world prevented many employees from traveling to work outside South Africa to meet the 183-day requirement, and therefore they cannot qualify for the exemption. Although some international travel became possible after 31 May, many workers remain unable to travel internationally. SARS and National Treasury recently proposed some relief through reducing the required number of days abroad by the 66 days of COVID-19 alert levels 5 and 4 (27 March 2020 - 31 May 2020) in South Africa. This would reduce the required number of days abroad from 183 to 117 in any 12-month period, for years of assessment ending from 29 February 2020 to 28 February 2021. The current requirement of 60 continuous days abroad would remain unchanged.

How companies can assist their employees

Given that the proposed revised rules have been announced so late and that COVID-19 remains a threat to international travel - affecting employees' ability to accumulate even the proposed reduced number of days working abroad (117) - companies need to assist their employees to plan for their foreign remuneration tax liability.

1. ***Keep updated with ongoing changes***

   The proposed amendment of the required number of days abroad is only expected to be finalised and approved later this year. In the meantime, South Africa has announced that all international travel can resume subject to stringent health protocols.

   While this is great news, it comes at a time when a second wave of COVID-19 has sent much of Europe back into lockdown, and when South Africa is witnessing a resurgence in the number of COVID-19 cases in certain areas, which has prompted government to announce the implementation of a resurgence plan. Widespread concerns remain regarding a future return to a harder lockdown alert level, which may see travel restrictions being implemented again.

2. ***Consider the individual impact***

   Nel explains that the stipulated *period of 12 months* is not a year of assessment, but any *period of 12 months* starting or ending during the year of assessment. It is also not a requirement of the relevant section of the Income Tax Act that the 12-month cycles run consecutively.

   As a result, whether an employee qualifies for the exemption will depend on when their specific 12-month cycle starts, as well as how much time was spent outside South Africa before and after the lockdown. There may also be double tax agreements in place with specific countries that could affect an employee's tax position.

   Cross-border employees, unable to work during the lockdown, should prudently consider when their new 12-month cycle should start. Those who continued earning remuneration from foreign employers while working remotely from South Africa will see their full income taxed in South Africa.

   It is possible to get credit for foreign tax to provide relief where a double tax arises. The Income Tax Act allows for foreign tax credits to be granted where the same amount was subject to tax, or partially so, in South Africa and in another country, but only on assessment, says Nel.

   In some instances, obtaining a tax directive may also be necessary. The law relevant to employees' tax (PAYE) doesn't allow for the foreign remuneration exemption to be taken into account by the employer on a monthly basis. SARS indicated that an employer "may at his or her discretion, under paragraph 10 of the Fourth Schedule, apply for a directive from SARS to vary the basis on which employees' tax is withheld monthly in the Republic" and that the "potential foreign tax credit is taken into account to determine the employees' tax that has to be withheld for payroll purposes."

   As Nel points out, there are also other practical implications to consider. Some benefits, which may be exempt from tax in the foreign jurisdiction, may not qualify for an exemption in South Africa. Examples of such benefits include free accommodation provided by the employer, security and travel services. It is also not clear how allowances, such as travel allowances, should be treated. Whilst SARS updated its practice generally prevailing in this respect, these issues are not clarified.

3. ***Professional tax assistance***

   In light of the ongoing changes in legislation and circumstances, and the need to consider each employee individually while taking into account the myriad factors that apply to the foreign earnings exemption, South African employers are well advised to obtain professional assistance in order to prudently assess their – and their employees' - current tax positions and how the recent changes in respect of the foreign remuneration exemption will affect their tax liability.

Your Tax Deadlines for December 2020

- 7 December – Monthly PAYE submissions and payments
- 24 December – VAT manual submissions and payments
- 30 December – Excise Duty payments
- 31 December – VAT electronic submissions and payments
- 31 December – CIT Provisional Tax Payments where applicable.

NOTE FOR ACCOUNTANTS: See “Important Dates” on the SARS **website**.

Thank you for your support in 2020.

Have a Wonderful Festive Season, and a Happy and Prosperous 2021.

Enjoy the Break!