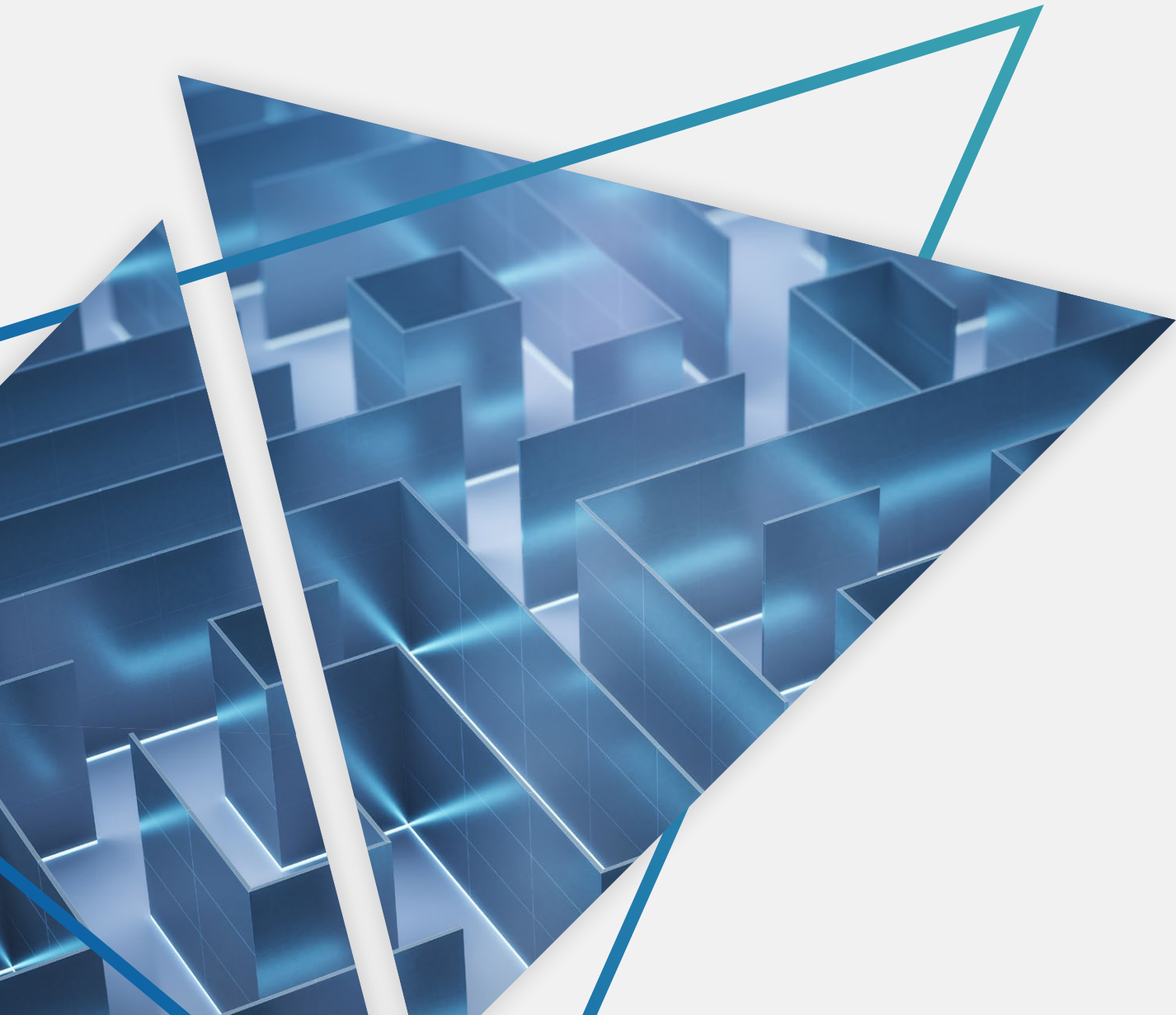


# Tax & Exchange Control

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SOUTH AFRICA

Keep abreast: reform to the employment tax incentive



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## Keep abreast: reform to the employment tax incentive

The Employment Tax Incentive Act 26 of 2013 (ETI Act) has undergone a variety of changes since its enactment, some of which have been primarily geared towards curbing perceived abuses of the employment tax incentive (ETI) by some employers. In this article, we delve into the amendments set to take effect on 1 March 2025.

The ETI is a programme aimed at encouraging employers to hire young job seekers for purposes of reducing youth unemployment. The benefit to employers who receive the incentive is that it results in a reduction of their employees' tax bill payable to the South African Revenue Service (SARS). The ETI is due to expire on 28 February 2029.

### **SARS' ongoing battle against perceived abuses**

Despite SARS' efforts to eliminate perceived abuses of the ETI, the Government has identified some employers who may have exploited weaknesses in the legislative framework, resulting in the objectives of the initiative being undermined.

Historically, SARS has raised concerns about whether some individuals appointed under ETI programmes can be considered employees who work for the employer and receive remuneration for services rendered, or if they are merely students not gaining legitimate working experience and therefore not being eligible for the ETI from a policy perspective. Amendments have therefore been made in the past to the definition of "employee" in the ETI Act to cater for these concerns.

Recently, SARS has identified arrangements adopted by some employers where the net remuneration received by employees who are engaged in an ETI programme is less than the prescribed wage under the ETI Act, due to deductions having been made on the employee's gross pay by the employer as training fees. In some cases, according to the Government, the employees do not receive any cash payment at all after deductions.

In this regard, the Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill 2024, issued by National Treasury on 1 August 2024 (Explanatory Memorandum) states that the rationale for further amendments to the ETI Act is as follows:

*"In the past three years, the Government has amended the ETI Act to curb abuse of the incentive through aggressive tax schemes. These schemes often involved training institutions claiming the incentive for students classified as employees under the ETI Act, who, however, never received cash payouts in their bank accounts. Instead, the training institutions would deduct training fees from their wages. The Government's position is that training costs should be the responsibility of the employer."*

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### What has changed?

Against this backdrop, the most recent amendments to the ETI Act in terms of the Taxation Laws Amendment Act 42 of 2024 are two-fold:

1. Tightening the definition of “*monthly remuneration*” by updating the proviso to the definition under section 1(1) of the ETI Act.
2. The insertion of a new subsection under section 5 of the ETI Act, which imposes penalties on employers who receive the ETI, even though they did not comply with the revised definition of “*monthly remuneration*”.

Both amendments will come into operation on 1 March 2025, and we unpack these amendments in further detail below.

### The effect of the amendments: What you need to know

#### Definition of “*monthly remuneration*”

The ETI can be claimed if an employer is compliant with, amongst other things, the applicable wage determinations under the ETI Act and the ETI amount is calculated in relation to an employee’s “*monthly remuneration*”.

The original definition of “*monthly remuneration*” under the ETI Act did not include a proviso. In terms of the original version, “*monthly remuneration*” was to be determined only according to the rules of “*remuneration*” outlined in the

Fourth Schedule to the Income Tax Act 58 of 1962 (ITA). This meant that “*monthly remuneration*” arguably included any amount paid (or payable) to an employee and including benefits and allowances (i.e. non-cash components). There was therefore alignment between the ETI and the employees’ tax concept of remuneration.

The definition of “*monthly remuneration*” was subsequently amended, effective from 1 March 2022, by the insertion of a proviso. The revised definition (at the time) with reference to the proviso, read:

*“Provided that in determining the remuneration paid or payable, an amount other than a cash payment to the employee after 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 stated intention of the 2022 amendment was to curb abuse of the ETI and, in particular, the explanatory memorandum at the time stated that: “*the employee must, in lieu of services rendered, receive cash remuneration*”

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from the employer". The change to the definition was clarified further in the Response Document issued by SARS and National Treasury (Response Document), in which the following was recorded:

*"Comment: The proposed amendments to section 6 of the ETI Act result in what are actually legitimate ETI claims no longer qualifying for the incentive. As a result, instances where the employer provides on-the-job training, where the employer and employee have entered into a learnership or apprenticeship programme, or where the employee is on a secondment may no longer qualify for the incentive. Consideration should rather be given to clarifying that the employee should be given a cash payment in lieu of services rendered.*

*Response: Accepted. 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 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 in the 2021 Draft TLAB [Draft Taxation Laws Amendment Bill] to reflect this intention."*

From an interpretational point of view, there was an argument that this change to the proviso ensured that the ETI would only be calculated with reference to cash payments and amounts falling within section 34(1)(b) of

the Basic Conditions of Employment Act 75 of 1997. This view was reflected in SARS Draft ETI Guide (specifically Paragraph 2.4.1 on page 14) which stated, *inter alia*, the following:

*"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 Basic Conditions of Employment Act ... This interpretation will apply to 'monthly remuneration' used throughout the ETI Act."*

Notably, however, this version of the ETI Guide was never issued in final form. There were counter interpretational viewpoints that the amendment to the definition of "monthly remuneration" only clarified that in order to qualify for the ETI, employees must receive some cash payment for services rendered, as opposed to only non-cash benefits. The argument was thus that the calculation of the ETI still took into account both cash and non-cash payments and it was only the overall eligibility for the incentive that was qualified. The Response Document lent credence to this interpretation as it specifically stated that "qualification" (i.e. eligibility) for the ETI would be impacted by whether the employee receives a cash payment.

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It may be that the Government recognised the potential ambiguity in the legislation and, pursuant to the supposed additional loopholes in the law, the proviso has now been further amended by substitution for the following wording:

*"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 adding back deductions~~ in terms of section 34 (1)(b) of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997), must be disregarded".*  
(Our underlining and strikethrough for emphasis).

According to the Government, the policy intention (as outlined in the Explanatory Memorandum) is that training costs should be the responsibility of the employer. This is potentially a further step than the amendments in 2022, which stated that training costs should "ideally" be the responsibility of the employer. The Government states further that the alleged misuse of the ETI for creating fictitious employment, primarily to exploit the incentive, contradicts the policy's intention.

From the excerpt in the Explanatory Memorandum, it appears that SARS will be scrutinising whether training fees are included in an employee's monthly remuneration and whether that should qualify for the ETI. However, notably, this is a departure from section 1(2) of the ETI Act, which requires remuneration to be determined in accordance with the Fourth Schedule to the ITA. If one considers the ITA, fringe benefits that are generally non-cash payments can constitute remuneration.

The Explanatory Memorandum suggests that SARS is specifically targeting so-called 'schemes' where training fees are deducted from employees. However, it is important to note that SARS' scrutiny will not be limited to arrangements involving training fees. Other amounts paid to employees in lieu of a cash payment could be called into question. This would mean that, if an employer pays non-cash remuneration to an employee that is ordinarily taxed in the hands of the employee (e.g. all fringe benefits), the value of the non-cash payment will potentially not form part of the ETI calculation. The employer would then have to ensure that the employee's cash component is increased to qualify for the incentive.

It is notable that the departure from the normal rules of remuneration may make the ETI less attractive and ultimately deter employers from participating in the initiative, especially where employees qualifying for the ETI generally do receive non-cash benefits as a matter of market practice. It will be interesting to see how this plays out.

### Penalties for non-compliance

The second amendment is related to the first in that an employer who is found to have received the ETI in respect of an amount that falls short of the amended definition of "monthly remuneration", will be liable to pay a penalty to SARS of 100% of the ETI received per employee, per month. This is an interesting amendment as it reflects a specific or targeted anti-avoidance rule that is aimed at specific perceived abuses identified by the Government and which type of sanction is not often inserted into legislation.

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The penalty will be in addition to other penalties that may be imposed under the ETI Act, including understatement penalties imposed in terms of the Tax Administration Act 28 of 2011. The result is that if SARS finds transgressions, it could, *inter alia*, (i) reverse the ETI initially claimed; (ii) impose a specific penalty at the rate of 100% on the ETI reversed; and (iii) impose other penalties and interest. It is far-reaching.

### Do the latest amendments align with the initial policy rationale?

It is interesting to note that the Government is targeting scenarios where there is a training component. This is because during the design of the ETI and subsequent review of it by the Government, training was identified as being critical to its success. For example, in the National Treasury Discussion Paper published in 2011 and titled: *"Confronting youth unemployment: Policy options for South Africa"*, it is specifically stated that: *"the youth employment subsidy could help to make the training of young workers more affordable to employers, particularly smaller employers."* In fact, the paper provides extensive detail of the importance of training in implementing any youth employment subsidy.

Moreover, in a paper published by the South African Reserve Bank in its August 2019 Occasional Economic Bulletin titled: *"The effectiveness of the Employment Tax Incentive"*, it is specifically stated that a training component can produce positive effects.

There is no doubt that South Africa faces an unemployment crisis, and it is accepted that there have been mixed reviews of the effectiveness of the ETI and its impact on youth unemployment levels, especially as there have been no

definitive public reports given the lack of accurate data. Moreover, it is not in doubt that abuses of incentives should be curbed. However, likewise, no public reports have expressly indicated that youth employment with a training component has resulted in outcomes contrary to the initial design of the ETI.

Given that skills development goes hand in hand with a broad range of initiatives to increase employment, there is a lingering question about where these latest amendments leave us and whether the last few years of the ETI will see its intended effect realised.

### Final comments

Although this article focuses on the challenges related to employee remuneration under ETI programmes, it is crucial to first determine whether an individual qualifies as an employee who works for the employer before discussing whether an amount constitutes monthly remuneration within the meaning of the ETI Act. This is a factual question determined with reference to the specific definition of "employee" in the ETI Act and is critical in determining whether one qualifies for the incentive.

The ETI has been under the microscope for several years now with various amendments to the legislation, which makes compliance more cumbersome. To ensure compliance with the amendments, taxpayers that participate in ETI programmes would do well to review their remuneration policies, especially their policies and procedures relating to employees in respect of which they claim ETI. The ramifications and impact of these changes may be more than initially anticipated.

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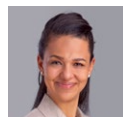
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