

BINDING GENERAL RULING (VAT) 41 (ISSUE 2)

DATE: 4 May 2017

ACT : VALUE-ADDED TAX ACT 89 OF 1991
SECTION : PROVISIO (iii) TO THE DEFINITION OF “ENTERPRISE” IN SECTION 1(1) AND SECTION 23(4)(b)
SUBJECT : VAT TREATMENT OF NON-EXECUTIVE DIRECTORS

Preamble

For the purposes of this ruling –

- **“BGR”** means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- **“NED”** means a non-executive director;
- **“non-resident”** means a person that is not a “resident of the Republic” as defined in section 1(1) of the VAT Act;
- **“remuneration”** means remuneration as defined in paragraph 1 of the Fourth Schedule to the Act;
- **“section”** means a section of the VAT Act;
- **“the Act”** means the Income Tax Act 58 of 1962;
- **“VAT Act”** means the Value-Added Tax Act 89 of 1991 and
- any other word or expression bears the meaning ascribed to it in the VAT Act.

1. Purpose

This BGR deals with the VAT treatment of the activities conducted by NEDs and clarifies whether those activities fall within the ambit of proviso (iii)(aa) or proviso (iii)(bb) to the definition of “enterprise” in section 1(1).

This BGR must be read in conjunction with BGR 40, which provides clarity on whether director’s fees for services rendered by NEDs fall within the definition of “remuneration” in the Fourth Schedule to the Act.

2. Background

It is stated in BGR 40, that as a result of certain amendments in 2007 to the exclusions contained in the definition of “remuneration” in the Fourth Schedule to the Act, some uncertainty developed as to whether the amounts payable to an NED are subject to the deduction of employees’ tax. This uncertainty also extends, by implication, to the application of proviso (iii) to the definition of “enterprise” in section 1(1) which excludes the activities of an employee, but includes the activities of a so-called “independent contractor”.

The question therefore arises as to whether NEDs should be regarded as –

- employees or deemed employees under the Fourth Schedule to the Act so that their income is subject to employees' tax; or
- independent contractors that may be liable to register for VAT if their fees for services rendered exceed the VAT registration threshold of R1 million in any consecutive period of 12 months; or
- being subject to both employees' tax and VAT.

3. Application of the law – employee or independent contractor?

The courts have highlighted a number of factors to be taken into account to distinguish between an employment contract (employee) and a contract for services (independent contractor). However, as there is no absolute test which can be applied to distinguish between the two types of contract, for the purposes of this BGR and proviso (iii) to the definition of "enterprise" –

- an employee is a person who commits his or her productive capacity to another person (the employer) in terms of an *employment contract*; and
- an independent contractor is a person who commits his or her labour to the recipient (employer) to produce a given result in terms of a *contract for services*.

The VAT treatment of employees and independent contractors is dealt with in proviso (iii) to the definition of "enterprise" in section 1(1).

Proviso (iii)(aa) to the definition of "enterprise" refers to the services rendered by a person (employee) to an employer under an *employment contract*. This is a reference to the services of a so-called "common law employee". The effect is that such services can never qualify as an enterprise activity. As such, the employee cannot register for VAT and will not charge VAT on any salary, wages, commission or similar amount which is paid or payable by the employer in that regard.

Proviso (iii)(bb) to the definition of "enterprise" refers to the services rendered by an "independent contractor" to the employer (recipient) under a *contract for services* in circumstances where such enterprise is carried on independently of the recipient. In other words, the activities of the service provider show the hallmarks of an independent business (enterprise) activity carried on by that person as opposed to the services rendered by an employee under an employment contract. In addition, even if a person is an employee as contemplated in proviso (iii)(aa), that person is not necessarily prevented from conducting enterprise activities outside of the employment contract as contemplated in proviso (iii)(bb). In such a case, that person may be liable to register and charge VAT in respect of such enterprise activities carried on independently.

The fact that certain independent contractors such as labour brokers or personal service providers are *deemed* to earn "remuneration" under the Fourth Schedule to the Act does not affect the independent nature of that person's activities for VAT purposes. It is therefore incorrect to conclude that an independent contractor must be regarded as an employee for VAT purposes merely because that person's income is deemed to be "remuneration" which is subject to employees' tax under the Fourth Schedule to the Act. The income earned by NEDs does not, in any event, fall within

the ambit of those deeming provisions. However, an NED may voluntarily request that employees' tax be deducted from any directors' fees which are paid to him/her.

Similarly, the fact that a non-resident NED earns "remuneration" under the Fourth Schedule to the Act does not affect the independent nature of that non-resident NED's activities under proviso (iii)(bb) to the definition of "enterprise" and any potential liability for that person to register for VAT in the Republic. However, the focus of attention in such cases will be on how the NEDs services are rendered. For example, a non-resident NED will be carrying on an enterprise if the services are physically performed in the Republic on a continuous or regular basis, or if the services are conducted on a continuous or regular basis through a fixed or permanent place in the Republic.

Section 23(4)(b) provides that if a person has not applied for registration in terms of Chapter 3 of the Tax Administration Act 28 of 2011, that person is regarded as a vendor with effect from the date on which that person first became liable to be registered. However, when considering the circumstances of a particular case, the Commissioner may exercise a discretion to determine a later date from which the person concerned should be a vendor, as may be considered equitable in the circumstances.

4. Ruling

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011.

4.1 VAT treatment of non-executive directors

It is concluded in paragraph 3.2 of BGR 40 that an NED is not considered to be a common law employee. This is based on the view that the services must be supplied independently and personally by the NED. Any director's fees paid or payable to an NED for services rendered in that capacity is therefore not regarded as "remuneration". It follows that for VAT purposes an NED is treated as an independent contractor as contemplated in proviso (iii)(bb) to the definition of "enterprise" in section 1(1) in respect of those NED activities.

4.2 Liability of non-executive directors to register and account for VAT

An NED that carries on an enterprise in the Republic is required to register and charge VAT in respect of any director's fees earned for services rendered as an NED if the value of such fees exceed the compulsory VAT registration threshold of R1 million in any consecutive 12-month period as provided in section 23(1). This rule applies whether the NED is an ordinary resident of the Republic or not.

An NED may also choose to register for VAT voluntarily under section 23(3) if the value of such fees does not exceed the compulsory VAT registration threshold prescribed in section 23(1).

NEDs that are already registered as vendors, but have neither levied VAT nor accounted for output tax in respect of any fees earned as an NED, must start charging and accounting for VAT on such fees by no later than 1 June 2017.

4.3 Equitable date of registration

Any NED that carries on an enterprise in the Republic and has exceeded the R1 million compulsory VAT registration threshold as contemplated in **4.2** that has not registered for VAT as at the date of this BGR must apply for registration by no later than 1 June 2017. The effective date of such registration (liability date) as determined by the Commissioner under section 23(4)(b) in such cases must be no later than 1 June 2017.

5. Period for which this ruling is valid

This ruling applies from 1 June 2017 until it is withdrawn, amended or the relevant legislation is amended. Any ruling or decision issued by the Commissioner which is contrary to this BGR is hereby withdrawn with effect from 1 June 2017. To the extent that this BGR does not provide for a specific scenario relating to an NED, a vendor may apply for a VAT ruling or VAT class ruling in writing by sending an e-mail to **VATRulings@sars.gov.za** or facsimile to 086 540 9390. The application should consist of a completed VAT301 form and must comply with the provisions of section 79 of the Tax Administration Act, excluding section 79(4)(f) and (k) and (6).

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