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The Impact of PAYE and VAT on Non-Executive Director Fees

Introduction

In the past, non-executive directors (NEDs) were excluded from having to register for Value Added Tax (VAT). This was because the general understanding was that NEDs were not carrying on an enterprise as defined by the VAT Act. Furthermore, there was always a level of uncertainty as to whether payments to NEDs were subject to Pay As You Earn (PAYE).

However, with effect from 1 June 2017, NEDs will be required to register for VAT in certain circumstances, in terms of Binding General Ruling (BGR) 41, issued by SARS on 10 February 2017.

Compulsory registration will occur where a NED earns more than R1 million during a twelve-month consecutive period. NEDs may also register for VAT on a voluntary basis if they earn more than R50,000.00 during a twelve-month consecutive period. Once registered, NEDs can claim input VAT in respect of expenses incurred to earn directors' fees.

On 10 February 2017, SARS also issued BGR 40, which sets out the view that payments to NEDs do not constitute remuneration paid by an employer to an employee, and are consequently not subject to PAYE. BGR 40 is also effective from 1 June 2017.

The details

PAYE implications for NEDs

BGR 40, asserts that a NED is not a common-law employee and therefore, does not meet the statutory requirements of an employee for the reasons set out in more detail below:

- A NED is not involved in the daily operations or management of the entity;
- A NED simply prepares for and attends meetings and provides objective judgment and votes at such meetings;
- NEDs render services personally and independently of their clients;
- In terms of the definition of remuneration contained in the Fourth Schedule to the Income Tax Act, a NED will only receive remuneration if he / she is required to perform the services (i.e. the preparation for and attendance of directors' meetings) mainly (i.e. more than 50%) at the premises of the company, and if such services are subjected to the control and supervision of the company. It is only if remuneration is paid by an employer to an employee that PAYE must be deducted. It is unlikely that these requirements will apply to NEDs and accordingly PAYE will generally not need to be deducted; and
- Supervision relates to the way duties are performed or the number of hours over which such duties are performed.

In the light of the above, SARS is of the view that PAYE need not generally be deducted from remuneration paid to NEDs. However, it should be noted that personal service providers (PSPs) and labour brokers are treated as employees for Income Tax Act purposes and PAYE must be withheld from their remuneration. Furthermore, non-residents are deemed to be earning remuneration and thus PAYE must be withheld on their earnings.

It is therefore necessary for NEDs to establish whether they fall within the definitions of a PSP or labour broker as contained in the Fourth Schedule to the Income Tax Act.



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The details (continued)

VAT implications for NEDs

In terms of BGR 41, a NED is required to register for VAT should their taxable supplies exceed the R1 million threshold in a consecutive twelve-month period. NEDs may also register on a voluntary basis should the taxable supplies exceed R50,000.00 over the same period. Once registered, NEDs may claim input VAT on expenses incurred to earn the directors' fees.

Non-resident NEDs are required to register for VAT if:

- they physically render services continuously or regularly in South Africa or;
- they render such services continuously or regularly through a fixed or permanent place of business in South Africa.

VAT implications for companies paying NEDs remuneration

Entities that pay fees to NEDs may claim input VAT should they be carrying on an enterprise in respect of such payments. Entities not qualifying as an enterprise, e.g. Schedule One PFMA entities, cannot register for VAT and may not therefore claim input VAT. The cost of directors' fees for such entities may be higher than those registered for VAT.

Tax planning tips

NEDs should ensure that, if PAYE is not deducted from remuneration, they include such amounts for provisional tax purposes as they will be taxed thereon on assessment. This is because such remuneration falls within the definition of gross income contained in section 1 of the Income Tax Act, even though PAYE need not be deducted.

Alternatively, NEDs may consider requesting that PAYE is deducted from remuneration paid to them to avoid cash flow problems on payment of provisional tax and / or on assessment. NEDs can claim any deductions incurred in earning the remuneration in terms of section 11(a) of the Income Tax Act.

Key consideration

- NEDs should consider whether they fall within the definition of a PSP or labour broker.
- NEDs should consider whether they are required to register for VAT or alternatively whether they wish to do so voluntarily.
- Companies paying NEDs should consider whether they are entitled to claim any VAT charged by NEDs provided they are in possession of a valid tax invoice.

Contact us

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