1. Purpose

The purpose of this Interpretation Note is to incorporate previous guidelines on personal service companies, personal service trusts and labour brokers as well as the latest amendments in this field, into an interpretation note.

2. Introduction

2.1 The use of labels such as “independent contractor” and “service company” and the perception that they are acceptable means of avoiding the deduction of employees’ tax and compliance with labour legislation, necessitated the development of stronger anti-avoidance measures for employees’ tax purposes.

2.2 Interpretation Note 17, dated 28 March 2003 focuses on some of the more pertinent issues relating to independent contractors.

2.3 This Interpretation Note focuses on the so-called “incorporated” entities, and the introduction of the terms “personal service company” and “personal service trust” into the Fourth Schedule to the Act (the Fourth Schedule) with effect from 1 April 2000, the tightening of the requirements for granting an exemption certificate to a labour broker with effect from 1 July 2000, and the modification relating to the exemption requirements applicable to a labour broker with effect from 27 July 2004.

3. The law

3.1 Paragraph 1 of the Fourth Schedule

"'employee' means –

(a) any person (other than a company) who receives any remuneration or to whom any remuneration accrues;
(b) any person who receives any remuneration or to whom any remuneration accrues by reason of any services rendered by such person to or on behalf of a labour broker;
(c) any labour broker;
(d) any person or class or category of person whom the Minister of Finance by notice in the Gazette declares to be an employee for the purposes of this definition;
(e) any personal service company;
(f) any personal service trust; and
(g) any director of a private company who is not otherwise included in terms of paragraph (a);”

"'labour broker' means –

any person who conducts or carries on any business whereby such person for reward provides a client of such business with other persons to render a service or perform work for such client, or procures such other persons for the client, for which services or work such other persons are remunerated by such person;”
“personal service trust’ means –

any trust (other than a trust which is a labour broker), where any service rendered on behalf of such company to a client of such company is rendered personally by any person who is a connected person in relation to such company, and—

(a) such person would be regarded as an employee of such client if such service was rendered by such person directly to such client, other than on behalf of such company; or

(b) such person or such company is subject to the control or supervision of such client as to the manner in which, or hours during which, the duties are performed or are to be performed in rendering such service; or

(c) the amounts paid or payable in respect of such service consist of, or include, earnings of any description which are payable at regular daily, weekly, monthly or other intervals; or

(d) where more than 80 per cent of the income of such trust during the year of assessment, from services rendered, consists of or is likely to consist of amounts received directly or indirectly from any one client of such company, or any associated institution as defined in the Seventh Schedule to this Act, in relation to such client, except where such trust throughout the year of assessment, employs more than three full-time employees who are on a full-time basis engaged in the business of such company of rendering any such service, other than any employee who is a shareholder or member of the company or is a connected person in relation to such person;”

“personal service company’ means –

any company (other than a company which is a labour broker), where any service rendered on behalf of such company to a client of such company is rendered personally by any person who is a connected person in relation to such company, and—

(a) such person would be regarded as an employee of such client if such service was rendered by such person directly to such client, other than on behalf of such company; or

(b) such person or such company is subject to the control or supervision of such client as to the manner in which, or hours during which, the duties are performed or are to be performed in rendering such service; or

(c) the amounts paid or payable in respect of such service consist of, or include, earnings of any description which are payable at regular daily, weekly, monthly or other intervals; or

(d) where more than 80 per cent of the income of such company during the year of assessment, from services rendered, consists of or is likely to consist of amounts received directly or indirectly from any one client of such company, or any associated institution as defined in the Seventh Schedule to this Act, in relation to such client, except where such company throughout the year of assessment, employs more than three full-time employees who are on a full-time basis engaged in the business of such company of rendering any such service, other than any employee who is a shareholder or member of the company or is a connected person in relation to such person;”
3.2 Paragraph 2(5) of the Fourth Schedule

Certificate of exemption in respect of a labour broker

"2.(5) (a) The Commissioner shall on application made to him by any person who is a labour broker or who is an employee by reason of the provisions of paragraph (d) of the definition of "employee" in paragraph 1, issue to such person a certificate of exemption if—

(i) such person carries on an independent trade and is registered as a provisional taxpayer under the provisions of paragraph 17;
(ii) in the case of any such labour broker, he is registered as an employer under the provisions of paragraph 15; and
(iii) such person has, subject to any extension granted by the Commissioner, submitted all such returns as are required to be submitted by him under this Act:

Provided that the Commissioner shall not issue a certificate of exemption if—

aa) more than 80 per cent of the gross income of such person during the year of assessment consists of, or is likely to consist of, an amount or amounts received from any one client of such person, or any associated institution as defined in the Seventh Schedule to this Act in relation to such client unless that person is a labour broker which throughout the year of assessment employs more than three full-time employees—

(A) who are on a full-time basis engaged in the business of that labour broker of providing persons to or procuring persons for clients of that labour broker; and

(B) who are not connected persons in relation to that labour broker;

bb) such labour broker provides to any of its clients the services of any other labour broker; or

c) such labour broker is contractually obliged to provide a specified employee of such labour broker to render any service to such client.

(b) The certificate of exemption referred to in item (a) shall be issued in such form as the Commissioner may decide and shall be valid for such period as the Commissioner may indicate thereon.

(c) An employer shall not be required to deduct or withhold employees' tax from any remuneration paid or payable by him to any person who produces to the employer a valid certificate of exemption issued by the Commissioner under item (a)."

3.3 Section 23(k) of the Act

"23. No deductions shall in any case be made in respect of the following matters, namely—

(k) any expense incurred by—

(i) a labour broker as defined in the Fourth Schedule, other than a labour broker in respect of which a certificate of exemption has been issued in terms of paragraph 2(5) of the said Schedule;

(ii) a personal service company as defined in the said Schedule; or

(iii) a personal service trust as defined in the said Schedule,

other than any expense which constitutes an amount paid or payable to any employee of such labour broker, company or trust for services rendered by such employee, which is or will be taken into account in the determination of the taxable income of such employee;"
4. Interpretation of the legislation

By way of background, and as explained in Interpretation Note 17, the deduction of employees’ tax is dependent on three elements, namely an employer, an employee and the payment of remuneration. All three of these elements are defined in the Fourth Schedule. Employees’ tax cannot be charged where one or more of these three elements are not present. If, for example, an “employee” is removed from the equation, the person paying the remuneration has no responsibility to deduct employees’ tax. Similarly, if the term “remuneration” is removed from the equation, no employees’ tax liability arises. If remuneration is therefore paid to somebody who is not an “employee” as defined in the Fourth Schedule, or if something other than “remuneration” is paid to somebody, no employees’ tax needs to be deducted. Previously it was a popular tax saving method for employees to offer their services to their employers through the medium of private companies, close corporations or trusts. In order to discourage the use of corporate entities or trusts as intermediaries to provide personal services to a client which are, in essence, services provided in terms of a contract of employment, legislation was introduced that required remuneration payable to such a company, close corporation or trust by the client be subject to employees’ tax and which limited the available deductions from income in the determination of taxable income in respect of these entities.

4.1 Personal service company and personal service trust

4.1.1 Any company, close corporation or trust that fits the definition of a “personal service company” or “personal service trust” and which is in receipt of “remuneration” as defined in the Fourth Schedule is subject to the deduction of employees’ tax.

4.1.2 In determining whether a company, close corporation or trust is a “personal service company” or “personal service trust” and whether or not employees’ tax is recoverable from payments made to them the following steps should be taken:

a) **Determine whether or not the company, close corporation or trust is a “labour broker” as defined in the Fourth Schedule.** If it is, it remains a labour broker for purposes of the Fourth Schedule and the definitions of “personal service
company” and “personal service trust” do not apply. If it is not, proceed to the next step.

b) **Determine whether or not some or all of the receipts of the company, close corporation or trust consist of “remuneration” as defined in the Fourth Schedule.** It should be clear by now that if the receipts do not include “remuneration” as defined no employee’s tax is deductible. In this regard, it should be noted that the exclusion in the definition of “remuneration” of payments made to independent contractors applies to natural persons and does not apply to personal service companies and personal service trusts. There is no need, as a result, to determine whether the personal service company or personal service trust is an “independent contractor” for purposes of the Fourth Schedule. If remuneration is paid or payable, proceed to the next step.

c) **Determine whether the service is rendered personally by any person who is a connected person in relation to the company, close corporation or trust.** The term “connected person” is defined in section 1 of the Act and must be applied accordingly. If this is the case, proceed to the next step below. If it is not the case, the company, close corporation or trust is not a “personal service company” or “personal service trust” and (if it is not a “labour broker” as defined) it is not subject to the deduction of employees’ tax.

d) **Determine whether the company, close corporation or trust employed (or is likely to employ) four or more full-time employees throughout the particular year of assessment that are on a full-time basis engaged in rendering the service, and who are not shareholders or members of the company or close corporation, or connected persons in relation to the person who is personally rendering the service or the trust.** If this is not the case, proceed to the next step below. If this is the case (and if it is not a “labour broker” as defined) the company, close corporation or trust is not a “personal service company” or “personal service trust” and therefore not subject to the deduction of employees’ tax.
e) Determine whether one (or more) of the following is true:

- Would the person who is personally rendering the service have been regarded as an “employee” of the client if the service was rendered directly to the client and not through the company, close corporation or trust? For purposes of employees’ tax, the word “employee” is defined in the Fourth Schedule and it is therefore necessary to determine whether the person would have been an employee as defined. For example, if the person would have been a person in receipt of remuneration or to whom remuneration accrues as described in paragraph (a) of the definition of “employee”, the company, close corporation or trust is a “personal service company” or “personal service trust”, as the case may be. Following the example through, the test must also include a reference to the definition of “remuneration” (because of its reference in paragraph (a) of the definition of “employee”), which excludes payments made to common law independent contractors. If the person rendering the service would have been regarded as an independent contractor under the common law (refer to Interpretation Note 17), the person would not have been regarded as an “employee” in the absence of the company, close corporation or trust.

- Is the person who is personally rendering the service, or the company, close corporation or trust, subject to the control or supervision of the client as to the manner in which, or hours during which, the duties are or are to be performed? The test is the same as the one used in exclusionary subparagraph (aa) of the definition of “remuneration” in the Fourth Schedule. In simple terms, if the client prescribes the hours during which the service is to be rendered, or if the client supervises or controls the activities of the person rendering the service or the activities of the company, close corporation or trust, the test is positive.
Do the amounts (remuneration) paid or payable in respect of the services consist of or include earnings of any description that are payable at regular daily, weekly, monthly or other intervals? The test is the same as the one used in exclusionary subparagraph (bb) of the definition of “remuneration” in the Fourth Schedule. As explained in Interpretation Note 17, this test would be satisfied if a right to demand payment on a regular basis is present, regardless of when the payments are actually collected.

Does more than 80% of the income of the company, close corporation or trust from services rendered consist of or is likely to consist of amounts received from any one client, or from any associated institution in relation to the client? In simple terms, if more than 80% of the income of the company, close corporation or trust consists (or is likely to consist) of income from only one client, the test is positive. The reference to “income” in the test is a reference to “income” as defined in section 1 of the Act. It is necessary to isolate the income received for the services rendered from the income received in respect of other activities of the company, close corporation or trust.

The following is an example:

Company A is in receipt of R100 000 for the year of assessment, of which R90 000 is “income” as defined in section 1 of the Act. R50 000 of the R90 000 represents income for services rendered. Of the R50 000, R42 000 (i.e. more than 80% of R50 000) was earned from services rendered to one client and the test is therefore positive in respect of the company.

4.2 Labour broker

4.2.1 A labour broker that is a company without an exemption certificate is subject to employees’ tax at a rate of 34%.

4.2.2 The requirements to be met before an exemption certificate may be issued to a labour broker have, as was indicated above, been strengthened in 2000 and modified in 2004. Paragraph 2(5)(a) of
the Fourth Schedule prohibits an exemption certificate to be granted where:

a) more than 80% of the gross income of the labour broker during the year of assessment consists of, or is likely to consist of, amounts received from any one client of the labour broker or from an associated institution of the client, unless the labour broker employs more than three full-time employees who are on a full-time time basis engaged in the business of that labour broker and who are not connected persons in relation to the labour broker; or

b) the labour broker provides to any of its clients the services of another labour broker. In this regard, it is important to note that this requirement does not preclude a labour broker from acquiring an employee from another labour broker for purposes of providing the employee to a client. Where, for example, labour broker A is requested by a client to provide a particular type of employee that it does not possess, and labour broker A acquires this employee from labour broker B to become an employee of labour broker A and forwards the employee to the client in the normal way, labour broker A would not be penalised by this requirement because employee A is provided to the client as an employee of labour broker A. This requirement is applicable where, for example, a client is permitted to hire an employee of labour broker B through labour broker A; or

c) the labour broker is contractually obliged to provide a specified employee of the labour broker to the client. This requirement is applicable where, for example, the client prescribed or required employee A to render the service. This requirement is not applicable in circumstances where an employee of the labour broker was chosen by name as a result of a *bona fide* selection process based on the requirements of the client, and specified as such in the eventual contractual agreement.

The following is an example:

The client requires an information technology auditor. Labour broker A conducts a selection process to determine the most suitable employee to render services for the client. Ms. A is selected by labour broker A and in the contract...
4.2.3 It is important to note that the requirements for granting an exemption certificate still include the requirements that were operative prior to the introduction of the new requirements. From a practical point of view, however, it is easier to test the labour broker against the new requirements before attempting to classify the labour broker as either dependant or independent.

4.2.4 With the exception of amounts paid to employees for services rendered, section 23(k) of the Act prohibits the deduction of all expenses incurred by a labour broker in respect of which a certificate of exemption has not been issued.

4.3 Decision chart
The legislation relating to the definition of “employee” in the Fourth Schedule can diagrammatically be illustrated as follows:
Is the person falling under paragraph (a) or (b), (c), (e) or (f) of the definition of “employee”? 

The person is an (a) type of employee in receipt of remuneration

Is the person resident in RSA?

Yes

No

Is control or supervision or regular payment present as envisaged by paragraph (ii)(aa) or (bb) of “remuneration”? 

No

Yes

Apply the grid

Dominant impression that of an independent contractor? 

Yes

No

Not subject to employees’ tax

The person is a (b) type of employee in receipt of remuneration

The person is a (c) type of employee in receipt of remuneration

Is the labour broker registered for employees’ tax purposes and are all returns up to date?

No

Yes

Any of the following present?: 
- Gross income more than 80% from any one client or associated institution and employs less than 4 full-time employees who are engaged in the business of the labour broker and are not connected persons to the labour broker; or 
- Provides the services of any other labour broker; or 
- Contractually obliged to provide services of specified employee?

No

Yes

Apply the grid

Dominant impression that of an independent labour broker? 

Yes

No

Not subject to employees’ tax (issue exemption certificate)

The person is an (e) or (f) type of employee in receipt of remuneration

Is the person also a labour broker as defined?

Yes

No

Apply the grid

Not subject to employees’ tax

Subject to employees’ tax
5. The effect of the legislation

5.1 A personal service company or personal service trust as defined in the Fourth Schedule is an “employee” for purposes of employees’ tax. Therefore, employees’ tax must be deducted from remuneration paid or payable to a personal service company or personal service trust.

5.2 A labour broker would not be granted an exemption certificate where any one of the prohibitions mentioned in paragraph 4.2.2 above applies.

5.3 Section 23(k) of the Act affects a personal service company, a personal service trust and a labour broker without an exemption certificate. In terms of this section, any expenses incurred by a personal service company, personal service trust or labour broker without an exemption certificate, other than amounts paid or payable to employees as remuneration, are not permitted as a deduction for purposes of calculating taxable income. The Act does not make provision for the apportionment of deductions where a personal service company, personal service trust or labour broker is in receipt of more than one type of income. If a company, close corporation or trust falls within the above definitions, the provisions of section 23(k) of the Act will apply.

5.4 A personal service company, a personal service trust and a labour broker without an exemption certificate would, furthermore, not qualify as a “small business corporation” for purposes of the lower tax rates applicable to small business corporations.

5.5 A personal service company and a labour broker that is company without an exemption certificate would be subject to tax at the rate of 34%, as opposed to the normal corporate tax rate (currently of 29%). A personal service trust remains taxable at normal trust rates (not the rates applicable to special trusts).

5.6 It may become apparent, during the tax year, that a personal service company, personal service trust or a labour broker will earn more than 80% of its income from one source. To avoid this unforeseen circumstance, employers must ensure at the outset that this situation is anticipated and that the applicable employees’ tax has been deducted.

6. The effective dates of implementation of the legislation

6.1 The additional requirements, introduced in 2000, for a labour broker to obtain an exemption certificate are effective from 01 July 2000. Labour
brokers in possession of valid exemption certificates on that date will not be affected by the new requirements until their applications for the renewal of the exemption certificates. The modification to the exemption requirements, introduced in 2004, will be applicable to any application received on or after 27 July 2004.

6.2 The definitions of “personal service company” and “personal service trust” in the Fourth Schedule apply in respect of years of assessment commencing on or after 1 April 2000.

6.3 The amendment to the definition of “employee” to include personal service companies and personal service trusts is effective from 1 August 2000.

6.4 A company or trust with a year of assessment that commenced before 1 April 2000 will be affected by the amended legislation with effect from the date of commencement of its next year of assessment.

6.5 A company or trust with a year of assessment commencing on or after 1 April 2000 is affected by the amended legislation with effect from the date of commencement, but the effective date for the amendment to the definition of “employee” means that employees’ tax is not recoverable until 1 August 2000.

6.6 The limitation of expenses as envisaged in section 23(k) of the Act is effective from 1 April 2000 and shall apply to any expense (other than amounts paid to an employee and taken into account for purposes of determining the taxable income of the employee) incurred on or after this date by a personal service company, personal service trust or non-exempt labour broker.

7. Common misconceptions about the legislation

7.1 One of the areas that is typically misinterpreted is the relationship between the definition of “employment company” in section 12E(4)(b) of the Act and the definition of “personal service” in the section 12E(4)(d) of the Act on the one hand, and the definitions of “personal service company” and “personal service trust” in the Fourth Schedule. In this regard, it is important to note that the definitions of “employment company” and “personal service” were not created for purposes of determining whether or not a company or trust is a “personal service company” or “personal service trust”. For example, a company is not a “personal service company” by reason of the fact that it
provides a “personal service”, but by reason of the fact that it complies with the definition of “personal service company” in the Fourth Schedule.

7.2 The term “personal service company” is only applicable to a “company” as defined in section 1 of the Act. This means that that the term is not applicable to a natural person. The effect of the new legislation can, therefore, be eliminated by rendering the service through a natural person directly to the client. By rendering the services directly as a natural person, the normal rules relating to the status of an independent contractor or common law employee as explained in previous guidelines issued by the SARS become relevant.

7.3 Not all companies are affected by the legislation. Only companies that fall within the definition of “personal service company” are affected by the definition, and also only when those that fall within the definition are in receipt of “remuneration” as defined.

7.4 It is recommended that all users of services (employer/client) from potential labour brokers, personal service companies and personal service trusts should have policies and systems in place to correctly identify and tax these entities and individuals. A possible solution would be a questionnaire or an affidavit that could be used by the service-user at the start of the engagement or contract and regularly thereafter. This will enable the client to determine whether employees’ tax should be deducted or not.

8. Applicable tax rates

8.1 A labour broker that is a company without an exemption certificate is subject to employees’ tax at a rate of 34%.

8.2 A labour broker without an exemption certificate who is an individual or trust is subject to employees’ tax at the rates applicable to an individual or trust, as the case may be.

8.3 Should a company be a personal service company as defined in paragraph 1 of the Fourth Schedule to the Act, employees’ tax at the rate of 34% must be withheld by the client (employer) of the company.

8.4 Should a trust be a personal service trust as defined in paragraph 1 of the Fourth Schedule to the Act, employees’ tax at the rate applicable to trusts which is currently 40% (other than special trusts) must be withheld by the client (employer).
9. **General**

   The information contained in this Interpretation Note cover the main aspects associated with personal service companies, personal service trusts or labour brokers.

   

   **Legal and Policy Division**  
   **SOUTH AFRICAN REVENUE SERVICE**