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 of a company;
- “paragraph” means a paragraph of the Fourth Schedule to the Act;
- “remuneration” means remuneration as defined in paragraph 1;
- “section” means a section of the Act;
- “the Act” means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This BGR provides clarity on the employees’ tax consequences of income earned by an NED, as well as the effect those employees’ tax consequences could have on the prohibition against deductions by office holders under section 23(m).

This BGR should be read in conjunction with BGR (VAT) 41, which deals with the VAT consequences of amounts earned by NEDs.

2. Background

Since the so-called statutory tests contained in paragraph (ii) of the exclusions to the definition of “remuneration” were amended in 2007,¹ there has been uncertainty over whether the amounts payable to an NED are subject to the deduction of employees’ tax. In the 2016 Budget,² the Minister of Finance announced that this matter will be properly investigated. These investigations have culminated in SARS issuing this BGR.

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¹ By section 54(1)(d)-(g) of the Taxation Laws Amendment Act 8 of 2007.
² See Annexure C: Additional tax policy and administrative adjustments to the Budget Review 2016, issued by National Treasury on 24 February 2016, on page 164 “Taxation of non-executive directors’ fees”.
3. **Discussion**

3.1 **The concept of a non-executive director**

An NED is not defined in the Act. The King III report\(^3\) states that crucial elements of an NED’s role are that an NED –\(^4\)

- must provide objective judgment independent of management of a company;
- must not be involved in the management of the company; and
- is independent of management on issues such as, amongst others, strategy, performance, resources, diversity, etc.

In this context, “independence” does not have the same meaning as it does under the locatio conductio operis of the common law.\(^5\) It simply means “the absence of undue influence and bias…”\(^6\)

For purposes of this BGR, SARS considers an NED to be a director who is not involved in the daily management or operations of a company, but simply attends, provides objective judgment, and votes at board meetings.

3.2 **Are the amounts paid to non-executive directors remuneration?**

SARS accepts that the nature of the duties of an NED mean that NEDs are not common law employees. The only way that an NED would be subject to employees’ tax is if the so-called statutory tests apply. These tests provide that, notwithstanding that an amount may have been paid in respect of services rendered to a person carrying on an independent trade, the recipient is deemed to be an employee if two requirements have been satisfied: the “premises” test; and the “control or supervision” test. The tests operate as follows:

(a) Under the “premises” test, the services must be performed mainly at the premises of the client. “Mainly” in this context means a quantitative measure of more than 50\%.\(^7\)

(b) Under the “control or supervision” test, either control or supervision must be exercised over one of the following:

(i) The manner in which the duties must be performed; or

(ii) The hours of work.

It is only if both tests are satisfied, (that is, both the premises test, and the control or supervision test) that the recipient is deemed to not be carrying on an independent trade, and will thus be receiving “remuneration” for employees’ tax purposes. If only one of these tests is satisfied, or neither, the deeming rules will not apply.

If an NED is not deemed to be an employee, and is not a common law employee, the amounts payable to such NED will not be “remuneration”.

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4. Annex 2.3 to Chapter 2 of King III.

5. For more information on this concept, see Annexure C to Interpretation Note 17 (Issue 3) dated 31 March 2010 “Employees’ Tax: Independent Contractors” available on the SARS website www.sars.gov.za.

6. Definition of “Independence” in the Glossary of Terms to King III.

7. Sekretaris van Binnelandse Inkomste v Lourens Erasmus (Eiendoms) Bpk 1966 (4) SA 434 (A).
It has been suggested that payment made by a company to an NED for time spent in preparation for board meetings, for example, payment of an hourly rate for a specified number of hours before each meeting, creates a form of control or supervision over the hours of the NED.

This is an incorrect application of the control or supervision test. The mere fact that there is a contractual nexus regulating the number of hours for which preparation time may be billed, does not mean that the control or supervision is being exercised over the hours during which an NED’s duties are performed. Such payments will not satisfy this test. This rule does not apply to non-resident independent contractors.

3.3 The prohibition against deductions for office holders

Section 23(m) prohibits the deduction of certain expenses for employees and office holders. Two of the important triggers for this section to come into operation, are that –

- the expenditure, loss or allowance must relate to an office held; and
- the taxpayer must derive “remuneration” in respect of that office.

Directors are holders of an office.8 Accordingly, if they receive “remuneration”, section 23(m) will operate to prohibit certain deductions. However, if they do not receive remuneration, section 23(m) will not apply and the ordinary rules for the deductibility of expenditure, losses or allowances will apply.9

4. Ruling

For purposes of determining whether an NED receives “remuneration”, it is accepted that such NED is not a common law employee. It is further accepted that no control or supervision is exercised over the manner in which such NED performs his or her duties, or the NED’s hours of work.

The director's fees received by an NED for services rendered as an NED on a company’s board, are thus not “remuneration”, and are not subject to the deduction of employees' tax.

It is further accepted that because the amounts received by an NED are not “remuneration”, the prohibition under section 23(m) will not apply in respect of such fees.

This ruling does not apply in respect of non-resident NEDs.

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

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8 Secretary for Inland Revenue v Somers Vine 1968 (2) SA 138 (A).
9 See Interpretation Note 13 (Issue 3) dated 15 March 2011 “Deductions: Limitations of Deductions for Employees and Office Holders” for more information.
4. **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.

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**Executive: Legal Advisory**

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**SOUTH AFRICAN REVENUE SERVICE**