**REPUBLIC OF SOUTH AFRICA**

**IN THE TAX COURT OF SOUTH AFRICA**
**(MEGAWATT PARK)**

**CASE NO: IT13775**

(1) REPORTABLE: YES / NO
(2) OF INTEREST TO OTHER JUDGES: YES/NO
(3) REVISED.

..... .....
DATE SIGNATURE

In the matter between:

**ABC (PTY) LTD** Appellant

and

**THE COMMISSIONER FOR THE SOUTH AFRICAN**

**REVENUE SERVICE** Respondent

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**J U D G M E N T**

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**KEIGHTLEY, J:**

[1] This matter concerns the income tax arrangements between the appellant, ABC (Pty) Ltd, and its expatriate employees who are seconded from their home countries to work in South Africa.

[2] More specifically, the appellant appeals against PAYE assessments raised by the respondent ("SARS") for the 2004 to 2009 tax years in respect of taxable benefits granted to these employees. The taxable benefits assessed by SARS comprised payments made by the appellant to tax consultants who performed various tax-related services in respect of the expatriate employees.

[3] The appellant contends that SARS erred in assessing these payments as falling within the definition of "gross income" in section 1 of the Income Tax Act, 58 of 1962 ("the Act") or within the ambit of paragraphs 2(*e*) and 2(*h*) of the Seventh Schedule of the Act. It requests this court to reverse SARS' assessment in this regard.

[4] The parties are agreed on the following common cause facts:

[4.1] The appellant is part of the ABC Group. It is a world-wide organization that requires its various operations throughout the world to operate on a similar basis and apply similar standards.

[4.2] As part of its global business imperative, employees of the ABC Group are required to work for short or medium term periods in foreign countries.

[4.3] These expatriate employees invariably remain residents in their own home countries and continue to submit tax returns there.

[4.4] Additional costs are incurred as a result of the ABC Group requiring employees to work in foreign countries.

[4.5] The employment relationship operates on an agreed “tax equalisation” basis, which is standard in the ABC Group.

[4.6] This entails the expatriate employee paying the exact same effective rate of tax in his or her host country as he or she would have paid had they remained in their home country.

[4.7] The expatriate employee’s employment package is determined with reference to the home country net pay.

[4.8] The appellant agrees that it will take responsibility for the payment of the employee’s tax in the host country, in this case, South Africa.

[4.9] In order to protect the interests of the appellant and the ABC group, certain payments were made to identified tax consultancy firms for services rendered in respect of the appellant’s expatriate employees.

[4.10] These employees have no choice in this regard as it is one of the conditions of their secondment.

[4.11] In November 2009, SARS addressed a PAYE Letter of Enquiry to the appellant in which it queried the payments made by the appellant on behalf of its expatriate employees. SARS was of the view that these payments created taxable fringe benefits for which the employees would be liable.

[4.12] The appellant responded by indicating that the professional fee expenses were incurred in respect of certain foreign employees for tax advice as well as assistance for the completion of their tax

returns. The appellant did not agree that these expenses were taxable fringe benefits.

[4.13] SARS issued PAYE assessments in October 2010 for the aforementioned years of assessment subjecting the payments made by the appellant to the consultancy firms on behalf of its foreign employees to fringe benefit tax in terms of paragraph (i) of the definition of "gross income" read with paragraphs (*e*) and (*h*) of the Seventh Schedule to the Act.

[4.14] On this basis, SARS estimated the employee's tax in respect of these payments to be R2,378 407.72

[4.15] The appellant objected to the assessment, and when SARS disallowed the objection it lodged the present appeal.

[5] The parties are agreed that the issues in dispute are the following:

[5.1] do the payments made by the appellant to the tax consultants fall within the ambit of paragraph (i) of the definition of "gross income" in section 1 of the Act, and, if so,

[5.2] do they fall within the ambit of paragraphs 2(*e*) or 2(*h*) of the Seventh Schedule?

[6] Section 1 of the Act defines "*gross income*" as meaning, in relevant part:

> "*(i)* …
>
> *(i)* *in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from source within the Republic,*
>
> *during such year or period of assessment, excluding receipts or accruals of a capital nature, but including, without in any way limiting the scope of this*

*definition, such amounts (whether of a capital nature or not) so received or accrued as are described hereunder, namely—*

*…*

*(i) the cash equivalent, as determined under the provisions of the Seventh Schedule, of the value during the year of assessment of any benefit or advantage granted in respect of employment or to the holder of any office, being a taxable benefit as defined in the said Schedule, and any amount required to be included in the taxpayer's income under section 8A …*"

(emphasis added)

[7] Paragraph 2 of the Seventh Schedule provides as follows, in relevant part:

"*For the purposes of this Schedule and of paragraph (i) of the definition of 'gross income' in section 1 of this Act a taxable benefit shall be deemed to have been granted by an employer to his employee in respect of the employee's employment with the employer, if as a benefit or advantage of or by virtue of such employment or as a reward for services rendered or to be rendered by the employee to the employer—*

*(e) any service … has at the expense of the employer been rendered to the employee (whether by the employer or by some other person), where that service has been utilised by the employee for his or her private or domestic purposes and no consideration has been given by the employee to the employer in respect of that service …; or …*

*(h) the employer has, whether directly or indirectly, paid any debt owing by the employee to any third person, … without requiring the employee to reimburse the employer for the amount paid or*

*the employer has released the employee from an obligation to pay any debt owing by the employee to the employer, …*"

(emphasis added)

[8] The appellant submits, in the first instance, that the appellant's expatriate employees received no benefit or advantage, within the meaning of the definition of "gross income" in section 1, through the appellant's payment of the tax consultants' fees. Accordingly, so the appellant contends, the assessment raised by SARS in this regard must fall at the first hurdle.

[9] In the second instance and in the event that the appellant's first submission is rejected, it submits that the payment of the fees does not fall within the categories of taxable benefits identified in paragraphs 2(*e*) or (*h*) of the Seventh Schedule.

[10] In support of its submissions, the appellant led the evidence of two witnesses at the hearing.

[11] The first witness was Ms M. She is currently the payroll manager for the appellant. Prior to that and during the relevant years of assessment, she was the Divisional Financial Controller. In this capacity she was responsible for dealing with the payments in respect of expatriate employees, including the invoices submitted in this regard by the various tax consultants. She testified that she was very familiar with the workings of the scheme involving expatriate employees.

[12] Ms M explained how the tax equalisation scheme worked. She testified that it meant that an expatriate employee working for the appellant would not pay any more tax than he or she would pay in his or her home country. In other words, the employee's take-home salary remained the same as it would

have been had he or she not been seconded to the appellant. According to Ms M, the effect of the tax equalisation scheme was that it does not matter to the expatriate employee whether they are registered for tax in South Africa, as the appellant is responsible for paying his or her tax. This is part of the agreement entered into between the appellant and each expatriate employee.

[13] Included in the trial bundle was an employment agreement between the appellant and one of its expatriate employees. Ms M confirmed that this was a typical example of the relevant employment agreement entered into with all expatriate employees. The agreement records that the employee's "economic employer" would be the appellant, and that it would "bear all salary costs" during the employee's assignment. Ms M testified that the salary costs included the employee's tax obligations to SARS. She understood this clause to place a contractual obligation on the appellant to ensure it paid sufficient PAYE for each expatriate employee.

[14] She further confirmed that clause 4 of the agreement dealt with taxes. It recorded that:

> "*During your international assignment you will be subject to taxation in your host country. By using the method of "Tax Equalisation" you will be treated as if you were still taxable in Germany. The calculation will be done on a yearly basis. The tax payable shall be calculated by an independent external tax consultancy entrusted with this task by ABC. The tax consultancy will also draw up your tax declarations in home and host country during your assignment*."

[15] Ms M confirmed that in terms of this agreement the employee was obliged to use the services of the tax consultant and had no choice in the matter.

[16] Ms M conceded, in both her evidence in chief and in cross-examination, that although the appellant bore the financial responsibility to carry the cost of each expatriate employee's tax, it remained the responsibility of each such employee to register for tax and to submit tax returns. In other words, Ms M recognised that in terms of the applicable tax regime (as opposed to the contractual relationship governing the employer employee relationship), employees retained tax obligations to SARS.

[17] Ms M also confirmed under cross-examination that the tax consultancy service only applied to expatriate employees. The appellant did not provide a similar service for local employees. Further, she testified that the services of the tax consultant were necessary as the tax regime was too complicated for employees to undertake. Indeed, she said that there was no-one in-house that could do the necessary calculations.

[18] The second witness for the appellant was Ms T. She is a director of JKL and head of its global mobility services. JKL is one of the tax consultants that render services in respect of the appellant's expatriate employees. Ms T signed the letter of engagement between the appellant and JKL regarding these services for the relevant years of assessment. She confirmed what Ms M had stated regarding expatriate employees being in no different position regarding tax than they would have been had they remained in their home countries. She also confirmed that the employees could not have completed their tax returns without the assistance of the tax consultants.

[19] In addition, Ms T testified that JKL's client was the appellant, rather than each individual expatriate employee. She indicated that JKL charged a flat rate for each employee. If there were any refunds due from SARS in respect

of a particular employee, she testified that the refund was paid to the appellant.

[20] Under cross-examination, Ms T was taken to the letter of engagement that described the services that JKL would render for each expatriate employee. These included registration/de-registration as a taxpayer with SARS; preparation and submission of annual income tax returns and review of annual income tax assessments; preparing letters of objection to SARS; and preparation and submission of provisional tax returns, if necessary. Ms T conceded that each of these services involved assisting employees with the obligations normally expected of them as taxpayers. However, she stated that what distinguished these employees from other employees was the tax equalisation arrangement between them and the appellant. This was why the tax consultancy services were provided to expatriate employees and not to local employees.

[21] According to Ms T, the same expatriate employees were assisted by JKL in their home country for completion of their tax returns there.

[22] Finally, when pressed under cross-examination, Ms T conceded that although JKL was engaged by the appellant the services in question were provided to each individual employee. However, she added the rider that this was done “on behalf of ABC”.

[23] The first question to consider is whether the expatriate employees received or accrued any benefit or advantage from the appellant’s payment of the tax consultancy fees.

[24] Counsel for the appellant submitted that the terms “benefit” and “advantage” should bear their ordinary meaning. He referred to dictionary definitions that

define “benefit” as meaning “an advantage”. The latter term is defined as meaning “a favouring circumstance, something which gives one a better position”.[1]

[25] Based on this, counsel submitted that in order to fit within the definition of “gross income” in section 1, the expatriate employees must be placed in a better or more advantageous position than they otherwise would have been as a result of the appellant’s payment of the tax consultancy fees on their behalf.

[26] I emphasise the underlined portion of the submission because it is critical to the appellant’s case in this regard. The appellant contends that in order to determine whether the expatriate employees are placed in a more advantageous position as a result of the services of the tax consultants their position needs to be weighed in comparison with their position had they not been seconded to South Africa. In other words, the appellant submits that it would be wrong to compare the expatriate employees in this regard (who enjoy the services of the tax consultants at the expense of the appellant) to local employees (who do not enjoy those services). Instead, says the appellant, the simple question to ask is whether the expatriate employees are placed in a better financial position as a result of the tax consultancy services than they would be without them.

[27] Taking this argument further, the appellant submits that there is no such benefit or advantage. This is because the expatriate employees’ salary and tax obligations remain the same as a result of the tax equalisation arrangement. Their position is not improved as a result of the appellant’s payments to the tax consultants.

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[1] Both definitions from the Shorter Oxford English Dictionary.

[28] The difficulty with the appellant's submission is that it assumes that the benefit or advantage must be assessed in terms of whether the employees' financial position was actually improved as a result of the tax consultant's services. However, in my view this is not the correct question to ask.

[29] The Supreme Court of Appeal has consistently held that the definition of "gross income" in section 1 of the Act:

> "includes, as explained in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), not only income actually received, but also rights of a non-capital nature which accrued during the relevant year and are capable of being valued in money"

and that

> "(t)he judgment in the *People's Stores* case tells us that no more is required for an accrual than that the person concerned has become entitled to the right in question."[2]

[30] Counsel for SARS submitted that the correct question to ask is whether the tax consultancy fee paid by the appellant in respect of the expatriate employees is a benefit for which they otherwise would have had to pay had the agreement between the appellant and these employees not provided differently.

[31] In my view, this approach is consistent with the above-cited *dicta*. As a consequence of the contractual arrangement between the appellant and the expatriate employees, the latter became entitled to the services of a tax consultant free of charge. The same benefit was not bestowed on local

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[2] *Cactus Investments (Pty) Ltd v Commissioner for Inland Revenue* 1991 (1) SA 315 (SCA) and 319G-H & 320H, cited with approval in Commissioner for South African Revenue Service v Brummeria Renaissance (Pty) Ltd & Others 2007 (6) SA 601 (SCA) at para 14.

employees. Whether the tax consultants' services actually resulted in a further benefit to the employees concerned, or to the appellant is irrelevant. The service itself, which was provided free of charge to the expatriate employees, was the benefit. It has a monetary value, and accordingly falls within the definition of "gross income" for purposes of the first issue in dispute between the parties.

[32] The next question to consider is whether the benefits are taxable under either paragraph 2(*e*) or 2(*h*) of the Seventh Schedule.

[33] As regards paragraph 2(*e*), a benefit is taxable if it is in the form of any service rendered to the employee, at the expense of the employer and where the employee has used the service for his or her "private or domestic purposes". The dispute in the present matter is whether the tax consultancy services were used for the expatriate employees' "private or domestic purposes".

[34] Both parties are agreed that this issue must be determined on the basis of a factual inquiry regarding the nature of the service rendered rather than on the basis of the intention behind the rendering of the service. In addition, the parties are agreed that if the use to which the service is put is not wholly for the employees' private use but also for the use of the employer's business, then it falls outside of paragraph 2(*e*).[3]

[35] SARS submits that if one has regard to the actual services rendered, they were plainly for the individual employees' private use. This is demonstrated by the description of the services in question. I listed these earlier. Counsel for SARS submitted that all of these services relate solely to the individual

[3] Davis et al, Juta's Income Tax, Vol 3, page Sch 7, paragraph 2-4.

tax obligations of each employee. In other words, the obligation to register as a taxpayer, to submit returns and the right to raise objections thereto are quintessential to the relationship between SARS and the taxpayer. They bear no relation to the appellant's own relationship with SARS.

[36] The appellant on the other hand, points to the contractual relationship between it and the employees. In terms of this relationship the appellant was bound to pay the employees' tax. Accordingly, so the argument continues, the services of the tax consultants were, at the very least, partially for the appellant's own business purposes. For this reason, they fall outside the ambit of paragraph 2(*e*).

[37] Both of the appellant's witnesses conceded, quite correctly, that regardless of the contractual arrangement between the appellant and their expatriate employees South Africa's tax regime gave rise to direct obligations between the employees and SARS in relation to the payment of PAYE. It is also clear from the evidence that local employees of the appellant who wished to employ the services of tax consultants to assist in complying with their tax obligations would have to do so in their private capacities, i.e. with no assistance from the appellant.

[38] As between SARS and the individual taxpayer the general purpose of tax consultancy services is to facilitate the taxpayer's individual and hence private, income tax obligations. This is what defines the nature of the service.

[39] Thus, if one has regard to the actual nature of the services rendered, it appears to me that they were for the employees' private use, i.e. to comply with the individual tax obligations of the employees vis-à-vis SARS.

[40] It may be so that as between the appellant and its expatriate employees the intention of obtaining the services was also to assist the appellant to fulfill its contractual obligations to those employees. However, as stated already, this intention is not the determinative factor. The correct approach, in my view, is to consider the nature of the service from the perspective of the tax relationship between the employees and SARS, and not from the perspective of the contractual relationship between the employees and the appellant. This private, contractual relationship cannot re-define the nature of a service.

[41] In the *Brummeria* judgment, the SCA dealt with the question of how to determine whether accruals or receipts in a form other than money have a monetary value and hence ought to be included in the definition of gross income. In this regard, the court held that:

> "*It is clear … that the question whether a receipt or accrual in a form other than money has a money value is the primary question and the question whether such receipt or accrual can be turned into money is but one of the ways in which it can be determined whether or not this is the case; in other words, it does not follow that if a receipt or accrual cannot be turned into money, it has no money value. The test is objective, not subjective. … The question cannot be whether an individual taxpayer is in a position to turn a receipt or accrual into money. If that were the law, the right to live in a house rent free, or to drive a motor vehicle without paying for it, for example, could be rendered tax free by the simple expedient of limiting the right to exercise such benefit to the recipient - which manifestly is not the case.*"[4]

(emphasis added)

[4] Above, at para 15.

[42] Applying this principle to the present case, the question of whether tax consultancy services are for private use must be determined objectively. They are manifestly for the private use of locals. Consequently, and objectively, they remain so in respect of expatriate employees as well.

[43] I point out that the position of the individual taxpayers is not adversely affected nor is the contractual relationship ignored. The effect of the approach I have adopted is simply that the appellant will be required in terms of its contractual obligations to its expatriate employees, to shoulder the additional tax burden associated with the tax consultant's fees. However, this remains a private matter between the appellant and its expatriate employees.

[44] On this basis, I conclude that SARS was correct in assessing the fees paid to the tax consultants as being taxable benefits in terms of paragraph 2(*e*) of the Seventh Schedule.

[45] This being the case, it is not necessary to consider the correctness of the assessment in terms of paragraph 2(*h*).

[46] As regards the question of costs, in terms of section 130 of the Tax Administration Act 28 of 2011, the Tax Court has the discretion to grant an order for costs in favour of a party if, among other things, the grounds of appeal are held to be unreasonable.

[47] SARS submitted that the appellant's grounds of appeal were unreasonable, and that an award for costs on an attorney and client scale ought to be granted. At the hearing, counsel for SARS persisted with a request for an order as to costs in the event of SARS succeeding, albeit on the ordinary scale.

[48] I am not persuaded that the appeal was unreasonable in any respect. This was not the kind of case where there was a clear-cut answer that was apparent from the start. In my view, the appellant was fully justified in lodging its appeal.

[49] I make no order as to costs.

[50] I make the following order:

"The appeal is dismissed."

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**R KEIGHTLEY**
**JUDGE OF THE TAX COURT OF SOUTH AFRICA,**
**JOHANNESBURG**

I agree/~~disagree~~

**CONCURRED**

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**S MAKDA**
**ACCOUNTANT MEMBER**

I agree/~~disagree~~

**CONCURRED**

_____

**P VUNDLA**
**COMMERCIAL MEMBER**

Date Heard: 29 February 2016

Date of Judgment: 29 April 2016