

DRAFT INTERPRETATION NOTE

DATE:

ACT : EMPLOYMENT TAX INCENTIVE ACT 26 OF 2013
SECTION : SECTION 1(1), DEFINITION OF “EMPLOYEE”
SUBJECT : MEANING OF “EMPLOYEE” FOR PURPOSES OF THE EMPLOYMENT TAX INCENTIVE ACT

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Preamble

In this Note unless the context indicates otherwise –

- **“Basic Conditions of Employment Act”** means the Basic Conditions of Employment Act 75 of 1997;
- **“definition of “employee”** means the definition of “employee” under section 1(1) of the ETI Act;
- **“ETI”** means employment tax incentive;
- **“ETI Act”** means the Employment Tax Incentive Act 26 of 2013;
- **“Fourth Schedule”** means the Fourth Schedule to the Income Tax Act;
- **“Income Tax Act”** means the Income Tax Act 58 of 1962;
- **“person”** means a natural person;
- **“section”** means a section of the ETI Act;
- **“TA Act”** means the Tax Administration Act 28 of 2011; and

- any other word or expression bears the meaning ascribed to it in the ETI Act.

All guides and interpretation notes referred to in this Note are available on the SARS website at www.sars.gov.za. Unless indicated otherwise, the latest issues of these documents should be consulted.

1. Purpose

This Note provides clarity on the interpretation and application of the definition of “employee” in section 1(1) of the ETI Act. The scope of this Note is restricted to arrangements entered into by parties, typically as part of a composite arrangement, in an attempt to claim the ETI for persons not meeting the definition of “employee”, specifically arrangements involving learning institutions. The Note therefore does not consider other scenarios in which the definition of “employee” is critical for purposes of claiming the ETI.

No income tax or employees’ tax implications such as fringe benefits are considered in this Note.

2. Background

The ETI Act provides for an incentive, called the employment tax incentive.¹ The aim of the incentive is to encourage employers to generate sustainable employment opportunities for young persons between the ages of 18 and 29, as well as for persons of any age in special economic zones, and in any industry identified by the Minister by notice in the *Government Gazette*. Government’s aim is the generation of sustainable employment opportunities that enjoy protection under labour law legislation.²

The incentive provided for under the ETI Act is fundamentally based on an employer-employee relationship. The ETI Act does not define “employer”. Section 3 is, however, unambiguous as to who are eligible employers. An employer is eligible to receive the ETI only if the employer is registered for purposes of withholding and paying over to SARS employees’ tax under paragraph 15 of the Fourth Schedule to the Income Tax Act. The ETI Act, however, defines “employee”.³ Beside the requirements contained in the definition, a number of criteria must be met before a person will be considered to be an employee for purposes of the ETI Act.⁴

In some instances, taxpayers become party to composite arrangements which are arguably aimed at abusing the incentive. These composite arrangements typically involve a learning institution, an organisation, and a person for a limited period of either 12 or 24 months. Under the arrangement, the organisation is responsible for paying an agreed-upon training fee to the learning institution, on behalf of that person. Contractually the parties refer to this training fee as the person’s basic remuneration. The learning institution is responsible for providing the person with training, mostly in the form of an accredited SETA⁵ training course, as well as all the lectures, and training facilities for the duration of the arrangement. In some cases, practical field training is included. Notwithstanding that an employment contract may have been entered into

¹ Section 2(1).

² *Explanatory Memorandum on the Draft Employment Tax Incentive Bill, 2013*.

³ Section 1(1).

⁴ Section 6.

⁵ A sector education and training authority established under section 9(1) of the Skills Development Act 97 of 1998.

under this composite arrangement, no work is carried out by the person for the organisation.

Under these arrangements, the person generally does not render any services to the organisation and does not obtain practical work experience. The person receives accredited education in the form of training courses through an accredited learning institution. Under some arrangements, the person may be exposed to work-based exercises and activities by another organisation (not the primary organisation) which pays only a fixed monthly fee. These fees are paid to the learning institution and not to the person.⁶ The number of persons contracted are often more than what is reasonably necessary to conduct the organisation's business.

In an attempt to curb the abuse of the ETI, National Treasury announced in the 2021 Budget Review⁷ that the definition of "employee" will be amended to specify that work must be performed under an employment contract adhering to record-keeping provisions in accordance with the Basic Conditions of Employment Act. The proposed effective date for this amendment is 1 March 2021.

This Note considers only the interpretation and application of the definition of "employee" under section 1(1).⁸ The proposed amendment by National Treasury to the definition of "employee" is not addressed in this Note.

3. The law

Section 1(1) – Definition of "employee"

1. Definitions.—(1) In this Act, unless the context indicates otherwise—
"employee" means a natural person—
(a) who works for another person; and
(b) who receives, or is entitled to receive remuneration, from that other person,
but does not include an independent contractor;

4. Application of the law

4.1 Definition of "employee"

The purpose of definitions in a statute is to define the meaning of key words and phrases frequently used in that statute. Words and phrases included in a definition clause therefore acquire, for purposes of that specific statute, technical meanings that may deviate from their ordinary meaning. Such words and phrases must be understood in accordance with the meaning ascribed by the definition clause.

In *Minister of Defence and Military Veterans v Thomas*,⁹ the Constitutional Court held that it is, as a general rule, not permissible to use the meanings attributed to words in other statutes as determinative in the interpretation of a different statute. If Parliament has defined a word used in a statute, it is taken as an indication that Parliament

⁶ See *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2021*.

⁷ Annexure C to the 2021 Budget Review details additional tax policy and administrative adjustments.

⁸ For more information on the ETI see the *Guide to the Employment Tax Incentive*.

⁹ 2016 (1) SA 103 (CC).

contemplated a special meaning assigned to the word for that statute and not an ordinary meaning.

The term “employee” is specifically defined in the ETI Act. Therefore, the definition of “employee” in paragraph 1 of the Fourth Schedule will not apply for purposes of the ETI.

Under the definition of “employee”, the person must –

- be a natural person (see **4.1.1**);
- work for another person (see **4.1.2**);
- receive or be entitled to receive remuneration from that person (see **4.1.3**); and
- not be an independent contractor (see **4.1.4**).

All four of the abovementioned requirements must be met for the person to be considered an “employee” as defined in section 1(1).

It is important to note that the ETI is an incentive. In *Western Platinum Ltd v C: SARS*,¹⁰ the Supreme Court of Appeal confirmed the well-established principle of interpretation when dealing with provisions creating tax privileges to reject a construction of such a provision that implied the extension of such class privilege and to interpret the provision strictly.¹¹

4.1.1 Must be a natural person

The definition of “employee” requires that an employee is a natural person. The phrase “natural person” is not defined in the ETI Act, and must therefore be given its ordinary legal meaning. A natural person is a human being and distinguished from a juristic person created by operation of law. *LAWSA*¹² states the following in this regard:

“Modern law distinguishes between two classes of persons: (a) natural persons; and (b) juristic or artificial persons...All human beings, irrespective of their age, mental condition or intellectual ability, are recognised as legal subjects. Every human being therefore can have rights, duties and capacities although the content of these rights, duties and capacities may vary depending on factors such as the person's mental condition and age. To distinguish them from other juristic persons humans are referred to as ‘natural persons’.”

Accordingly, a natural person is a human being, and does not include a juristic or artificial person.

4.1.2 Requirement to work for another person

The second requirement of the definition of “employee” is that the person must work for another person. The word “work” is not defined in the ETI Act and should thus be interpreted according to its ordinary meaning as applied to the subject matter with regard to which it is used.¹³

¹⁰ [2004] 4 All SA 611 (SCA).

¹¹ See also *Commissioner for Inland Revenue v D & N Promotions (Pty) Ltd* 1995 (2) SA 296 (A).

¹² DSP Cronje (updated by M Carnelley) “Different Kinds of Person” 20(1) (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 30 November 2009) in paragraph 439.

¹³ EA Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworth's at 224.

Lexico Dictionaries defines “work” as an –¹⁴

“1 Activity involving mental or physical effort done in order to achieve a purpose or result.”.

In *C: SARS v Terraplas South Africa (Pty) Ltd*¹⁵ it was held that a dictionary meaning of a word cannot govern the interpretation. It can only afford a guide. The question is what is the meaning applicable in the context of the particular document under consideration. The word “work” in the context of the definition of “employee” envisages more than just a contractual relationship between two parties involving the payment of an amount by one party to the other.

In order to obtain a greater understanding of the intention or purpose of a section or definition, it is sometimes useful to refer to the Explanatory Memorandum of an Act. The Explanatory Memorandum on the Employment Tax Incentive Bill, 2013, under the discussion on the definition of “employee”, states that it is –

“necessary to ensure that the employee referred to in the Legislation, not only provides services to the qualifying employer, but is also remunerated by that self same employer.”

By the use of the word “work”, it was envisaged that the person must provide services to the employer and must regularly assist the employer in carrying on or conducting the business of the employer for which the person is remunerated.

Legally, the essential features required to make a specific contract one of employment are, amongst others, as follows: ¹⁶

- The intention of the parties to conclude a contract of employment (true nature of relationship), also referred to as the reality test
- The existence of a relationship of authority
- The remuneration of the employee
- The rendering of personal services by the employee
- The employee being an integral part of the employer's organisation

In *State Information Technology Agency (SITA) (Pty) Ltd v CCMA and others*¹⁷ the Labour Appeal Court confirmed that the focus has finally shifted from the formal contract of employment to the existence of an employment relationship. The Labour Appeal Court identified the following as the primary criteria for the employment relationship:¹⁸

- An employer's right to supervision and control
- Whether the employee forms an integral part of the organisation with the employer

¹⁴ www.lexico.com/definition/work [Accessed 25 October 2021].

¹⁵ [2014] 3 All SA 11 (SCA); 76 SATC 377 at 385.

¹⁶ F van Jaarsveld “Criteria to Distinguish Contracts of Employment from Related Contracts” 24(1) (Third Edition Volume) *LAWSA* [online] (My LexisNexis: 30 November 2017) in paragraph 121.

¹⁷ [2008] 7 BLLR 611 (LAC).

¹⁸ At 615.

- The extent to which the employee was economically dependent upon the employer

Having regard to the definition of “employee” in the ETI Act, it does not suffice that there is a contract between the parties creating an employer-employee relationship. The factual question is whether the employee works for the employer. The facts and circumstances of each case must be considered to determine the latter. The substance over legal form will be considered when assessing an employer’s eligibility to claim the ETI.¹⁹

A person will generally not be considered to be an employee for purposes of the ETI Act if, despite having concluded a contract of employment with an organisation –

- the person performs no work for the organisation;
- the nature and extent of any work that is performed by the person is such that it does not assist the organisation in carrying on or conducting its business or is not an integral part of the organisation;
- the organisation has no or very limited supervision or control over the person;
- the person does not receive any remuneration from the organisation for the work performed; or
- the person is not entitled to the leave provisions provided under the Basic Conditions of Employment Act.

The above list is not exhaustive but does assist in determining whether a person meets the definition of “employee” for purposes of the ETI Act. Each case will be considered having regard to its specific facts.

Example 1 – Definition of “employee” not met

Facts:

On 1 March 2021, Company Z concluded an employment contract with V, a 20 year-old, for a limited period of 12 months. Company Z and V agreed to a monthly remuneration of R3 500. As a condition of the employment contract, V had to enrol at an accredited learning institution, College A, from 1 March 2021 for a monthly training fee of R3 500 for a period of 12 months. Company Z paid V’s monthly remuneration of R3 500 directly to College A as payment of the training fee. Company Z complied with payroll-related statutory requirements, namely, payments of employees’ tax, unemployment insurance fund contributions and skills development levies.

Company Z, V and College A entered into a composite arrangement. According to the agreements entered into, College A was responsible for providing V with training in the form of an accredited training course, all the lectures and training facilities for the duration of the skills, and training agreement together with practical field training. V carried on no work for Company Z which was paying V’s remuneration.

¹⁹ See *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2021*.

Result:

Notwithstanding the fact that an employment contract was entered into between Company Z and V, no work (as required by the ETI Act) was carried on by V for Company Z. V received only accredited education in the form of training courses through College A. V did not render any services to Company Z for the 12-month period. V therefore does not meet the requirement of the definition of “employee” for purposes of the ETI Act.

Company Z was therefore not entitled to claim the ETI for V.

Example 2 – Definition of “employee” met*Facts:*

On 1 February 2021, Company B, X and College Q concluded a learnership agreement registered with the Construction Education and Training Authority, for a duration of 12 months. Company B then concluded an employment contract with X, a 22 year-old, for the duration of the learnership agreement of 12 months.

Company B agreed to pay X a learnership allowance of R3 500 per month. Company B complied with payroll-related statutory requirements, namely, payments of employees’ tax, unemployment insurance fund contributions and skills development levies.

X was required to work for Company B from Monday to Friday, 8am to 5pm, with an hour lunch break each day. X was entitled to 15 days annual leave, and the other statutory leave provisions as per the Basic Conditions of Employment Act.

Company B was responsible for providing X with supervision, mentoring and coaching at work, and on the job training to enable X to competently perform the specified workplace experience required under the learnership agreement.

College Q was responsible for providing X with the necessary training resources, and course lectures for the duration of the learnership agreement. X was expected to attend lectures outside normal working hours.

Result:

X worked for Company B while under his learnership agreement, and received a learnership allowance from Company B. The learnership allowance meets the definition of “remuneration” as discussed under **4.1.3**. X, therefore, meets the requirement of the definition of “employee” for purposes of the ETI Act.

Company B may claim the ETI for X, provided that all of the other requirements under the ETI Act are met.²⁰

The qualifying learnership agreements envisaged under section 12H of the Income Tax Act must be distinguished from arrangements under which a learning institution is responsible for providing the person with training in the form of an accredited SETA training course by means of lectures, training facilities for the duration of the skills, and training agreement together with practical field training. The learnership agreements

²⁰ For more information on the ETI, see the *Guide to the Employment Tax Incentive*.

and apprenticeships are registered with a SETA, and require the person to work for the employer in a regulated environment in order to encourage skills development. Whether an employee employed under a learnership agreement qualifies for the ETI must be determined by applying the requirements of the definition of “employee” and the other provisions in the ETI Act.²¹

4.1.3 Requirement to receive or is entitled to receive remuneration

The third requirement of the definition of “employee” in the ETI Act is that the person should receive or be entitled to receive remuneration from the employer for which work is performed for. If the person works for a person, but receives remuneration from another person for the work performed, the person will not meet the requirement of the definition of “employee”.

The term “remuneration” is not separately defined in the ETI Act. Having regard to section 1(2), and read together with the definition of “monthly remuneration”,²² the term bears the meaning ascribed to it in paragraph 1 of the Fourth Schedule.²³

The word “remuneration” is defined in the Fourth Schedule as any amount of income which is *paid or is payable* to any person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, paid in cash or otherwise, and is not dependent on whether the amount is paid or payable for services rendered. The definition is subject to a number of inclusions and exclusions.

For a more detailed explanation of the inclusions and exclusions contained in the definition of “remuneration” as defined in the Fourth Schedule, see Annexure B of the *Guide to the Employment Tax Incentive*.

4.1.4 Exclusion of independent contractors

An independent contractor is specifically excluded from the definition of “employee” for purposes of the ETI. The ETI Act does not contain a definition of “independent contractor”.

The word “independent” is defined in *Lexico Dictionaries* as:²⁴

“Free from outside control; not subject to another's authority.”

The word “contractor” in turn is defined in *Lexico Dictionaries* as:²⁵

“A person or firm that undertakes a contract to provide materials or labour to perform a service or do a job.”

An independent contractor is therefore not under the control of an employer, and contracts in an independent way with persons to perform a job.

²¹ For more information on the ETI, see the *Guide to the Employment Tax Incentive*.

²² For more information on the definition of “monthly remuneration”, see the *Guide to the Employment Tax Incentive*.

²³ See section 1(2) stating that for the purposes of the definition of “monthly remuneration” in subsection (1), “remuneration” has the meaning ascribed to it in paragraph 1 of the Fourth Schedule.

²⁴ www.lexico.com/definition/independent [Accessed 25 October 2021].

²⁵ www.lexico.com/definition/person [Accessed 25 October 2021].

The current South African common law uses a “dominant impression test” to determine whether a person is considered an independent contractor or an employee. The following factors are usually considered in determining whether a person is an employee or independent contractor:

- The company controls the manner that work is done either by detailed instructions, by training, by requesting that prior approval be sought, or by instituting disciplinary steps for unacceptable performance by the person. This type of control is indicative of an employer-employee relationship.
- The company controls the work done, the environment in which the work is done by giving instructions as to the location, when to begin or stop, pace, order or sequence of work. The greater the degree of supervision, the greater the indication in favour of employee status.
- An employment contract is one of personal service (that is, the employee is at the “beck and call” of the employer). Where the company has a contractual right to insist on the personal service of a person or to object to substitution (for example, the worker substitutes his or her own employee for him or herself), or if the person may not freely hire, fire, pay or supervise his or her own assistants, an employer-employee relationship is usually prevalent.
- A reporting regime indicates that a measure of supervision exists, albeit indirect and historic in nature. The existence of a reporting regime, depending on factors such as content, detail, regularity, and obligation, can be persuasive in favour of an employer-employee relationship.
- Should the person contract away his or her right to control his or her time, even for only a portion of his or her productive hours, there is at least a persuasive indicator in favour of an employee status.
- If the company provides the office equipment or tools, stationery etc it tends to indicate a degree of dependence and lack of investment, and hence the existence of an employer-employee relationship.
- If the company provides an office or workshop or the work continually and invariably occurs at the usual place of business of the company, there is an indication of dependence, control, lack of investment, and hence, an employer-employee relationship.

The above list is not exhaustive and should be used only as a guide. For a detailed discussion on these indicators, see Interpretation Note 17 “Employees’ Tax: Independent Contractor”.

5. Record keeping

Under section 29(2) and (3) of the TA Act, any records, books of account or other documents relating to the ETI claim, must be retained and carefully preserved for a period of five years from the date of submission of the return.

In order to assist in enforcing the ETI Act, SARS may, under section 46(1) of the TA Act, request the taxpayer orally or in writing to submit relevant information and documents. SARS may, amongst other things, require the taxpayer to provide for inspection any information relating to the person for whom the taxpayer claimed the

ETI. The following information may be requested by SARS (the list is not exhaustive but rather a guide):

- Employment contract
- Job description
- Payslips
- Register of leave entitlement and utilisation
- Register of hours worked, including timecards, as well as the nature and outcome of work performed
- Training contract
- Attendance register of training

Under section 47(1) and (2) of the TA Act, SARS may require the employer or employee to meet with the Commissioner's representative for an interview to clarify issues of concern to SARS and produce for examination any documents relating to the ETI claim.

Under section 102(1)(b) of the TA Act the burden of proving that an amount is deductible or may be set off, is on the taxpayer.

6. Objection and appeal

Under section 104 of the TA Act, "a taxpayer who is aggrieved by an assessment made in respect of the taxpayer may object to the assessment". If SARS disallows the objection, the taxpayer may follow the appeal route under section 107 of the TA Act, read with the rules made by the Minister of Finance.²⁶

7. Conclusion

The definition of "employee" requires that an employee must be a person who works for another person and who receives or is entitled to receive remuneration from that person, but does not include an independent contractor.

In the context of the ETI Act, a mere contractual relationship between two parties involving the payment of an amount by one party to the other is insufficient to meet the definition of "employee" in section 1(1). The person must also work for the organisation that pays the remuneration for the work performed. The facts and circumstances of each case will be considered to determine whether the nature and extent of any work performed by the person is such that it does assist the organisation in carrying on and conducting its business and is an integral part of the organisation.

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²⁶ Government Notice 550 in *Government Gazette* 37819 of 11 July 2014.