

INTERPRETATION NOTE: NO. 88

DATE: 19 February 2016

ACT : INCOME TAX ACT NO. 58 OF 1962
SECTION : SECTION 11(nA)
SUBJECT : TAX DEDUCTION FOR AMOUNTS REFUNDED

Preamble

In this Note unless the context indicates otherwise –

- “**IRP5**” means an employees’ tax certificate;
- “**SDL**” refers to skills development levies as determined in the Skills Development Levies Act, 1999;
- “**section**” means a section of the Act;
- “**the Act**” means the Income Tax Act No. 58 of 1962;
- “**UIF**” refers to unemployment insurance fund contributions as determined in the Unemployment Insurance Contributions Act, 2002; and
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance and clarity on the tax implications of amounts that were included in a person’s taxable income,¹ and subsequently refunded.

2. Background

A person may receive remuneration and other similar amounts (for services rendered or to be rendered, or by virtue of employment or the holding of any office) which subsequently have to be refunded, often because of contractual obligations not having been fulfilled or due to an overpayment which was previously subject to tax. These amounts can include, for example, paid maternity or sick leave benefits, or retention bonuses, which are often refunded by the person in a subsequent year of assessment. The amounts refunded may qualify for an income tax deduction in the hands of the person under section 11(nA).

Before the introduction of section 11(nA), there was no provision in the Act under which amounts that were included in taxable income in a previous year of assessment could be reversed or claimed as a deduction. A deduction could not be claimed under

¹ As defined in section 1(1).

section 11(a),² because a refund of an amount is not an expense incurred in the production of income. The initial payment made to, for example, an employee, is taxable when it is received, yet the employee does not qualify for a tax deduction or an adjustment to remuneration when amounts are refunded. Section 23(m), at that stage, also limited the types of expenses an employee could deduct. This overall result violated basic tax principles because the employee was effectively taxed, even though no net enrichment arose.³ Section 11(nA) was enacted to overcome this inequity. Section 23(m), which is a prohibitive deduction section, was also amended so as not to apply to deductions allowable under section 11(nA).⁴

3. The law

The relevant sections of the Act applicable to amounts refunded are quoted in **Annexure B**.

4. Application of the law

4.1 Section 11(nA) deduction

Section 11(nA) was introduced into the Act with effect from 1 January 2009. Section 11(nA) will apply where –

- any amount (including any voluntary award);
- received or accrued;
- in respect of services rendered or to be rendered;
- or by virtue of any employment or holding of any office;
- as was included in the taxable income of that person;
- is refunded by that person.

Amount (including a voluntary award)

The term “amount” is not defined in the Act. Based on case law, “amount” would include not only money, but also the value of any form of property, whether corporeal or incorporeal⁵. In the context of section 11(nA) the word “amount” is limited to money (see discussion on “refunded” for more detail).

A voluntary award is a gratuitous amount, paid without any obligation to do so.

Received or accrued

An amount will only be “received” by a person as envisaged in the Act if the person receives it on his or her own behalf and for his or her own benefit.⁶ An amount “accrues” to a person when the person is entitled to it and when the person’s right to the amount is

² *ITC 1823* (2006), 69 SATC 226.

³ Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008.

⁴ For further information on the application of section 23(m), refer to *Interpretation Note No. 13, Deductions: Limitation of Deductions for Employees and Office Holders*.

⁵ *Lategan v CIR* 1926 CPD 208-209; *CIR v People Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A).

⁶ *Geldenhuis v CIR* 1974 (3) SA 256 (C), 14 SATC 419.

unconditional.⁷ An amount is included in a person's gross income in the year in which it is received by him or her or the year in which it accrues to him or her, whichever comes first.⁸ In the context of section 11(nA), the person is normally in receipt of an amount prior to it being refunded. The fact that an amount was paid in error is irrelevant, the amount was actually received by the person.

In respect of services rendered or to be rendered

The words "in respect of" mean that there has to be a causal relationship between the amount received and the services rendered.⁹ In other words the amount would not have been received had the services not been rendered. An amount refunded will accordingly only fall within the ambit of the section 11(nA) if it has been received by or accrued to a person for services rendered or to be rendered, or in respect of or by virtue of employment or the holding of an office.

Employment or the holding of an office

The "holding of an office" generally flows from an appointment (such as the President of South Africa, Ministers in the Cabinet, Judges, directors of companies, etc.) whereas "employment" normally refers to an employer-employee (master-servant) relationship.¹⁰

Taxable income

Taxable income represents the amount remaining after taking into consideration allowable exemptions and deductions, and including all amounts to be included or deemed to be included under the Act.¹¹ If an amount is, for example, exempt from tax, it could never be included in taxable income.

Refunded

The word "refunded" is not defined in the Act, and it therefore becomes necessary to examine its general dictionary definition. The Collins English Dictionary¹² defines "refund" as –

"to give back (money), as when an article purchased is unsatisfactory;
to reimburse (a person)".

The Oxford English Dictionary¹³ defines the word "refund" as follows:

"Pay back (money), typically to a customer who is not satisfied with goods or services bought;
A repayment of a sum of money."

⁷ *Lategan v CIR* 1926 CPD 203, 2 SATC 16; *Ochberg v CIR* 1933 CPD, 6 SATC 1.

⁸ *SIR v Silverglen Investments (Pty) Ltd* 1969 (1) SA 365 (A), 30 SATC 199.

⁹ *Commissioner for Inland Revenue Appellant v Crown Mines Ltd Respondent* 1923 AD 121; *De Villiers v CIR* 1929 AD 229.

¹⁰ Interpretation Note No. 13 (Issue 3) dated 15 March 2011 "Deductions: Limitation of Deductions for Employees and Office Holders".

¹¹ Definition of "income" and "taxable income" in section 1(1).

¹² www.collinsdictionary.com/dictionary/english/refunded [Accessed 19 February 2016].

¹³ www.oxforddictionaries.com/definition/english/refund?q=refunded [Accessed 19 February 2016].

The Merriam-Webster Dictionary¹⁴ defines “refund” as –

“to return (money) in restitution, repayment, or balancing of accounts”.

The word “refund” as defined in the various dictionaries clearly indicates that a repayment of an amount of money is envisaged. The return of an asset is not a repayment of an amount of money.

Section 11(nA) permits a person to claim, as a deduction, any amount refunded by him or her, in the year of assessment that the amount is refunded, but only if that amount was previously included in his or her taxable income. The amount that would have been used to determine that person’s taxable income on receipt of such income would have been the *gross* remuneration, and not the net amount received from the employer (namely, the amount after tax). The deduction will be limited to the amount that has been refunded (be it the gross or net amount or even a partial refund) in accordance with terms laid down in the contract between, for example, the employer and the employee.

Example 1 – Gross amount paid recovered from the employee

Facts:

G, an employee of XYZ, receives a retention bonus of R50 000 in year 1. Employees’ tax of R20 000 (assuming a tax rate of 40%) was deducted by XYZ and paid over to SARS. The amount paid into G’s bank account for the retention bonus was R30 000, after tax. In year 2, G does not meet the contractual obligations relating to the retention bonus paid and repays the bonus received in year 1.

Result:

G will be entitled to claim the R50 000 as a deduction on assessment in year 2 under the provisions of section 11(nA).

G will effectively be out of pocket by R20 000 after repaying the R50 000 to the employer (because only R30 000 was originally paid into G’s bank account). SARS will take into account the full R50 000 in calculating G’s taxable income on assessment when G claims a deduction under section 11(nA).

Example 2 – Section 11(nA) deduction

Facts:

In the 2014 year of assessment, X (aged 36) was granted paid sick leave of 45 days. In January 2015, the employer rejected 30 days of sick leave and required X to pay back R20 000 for the 30 days leave regarded as excessive (unpaid leave). X’s total income (before any deductions) for the 2015 year of assessment was R240 000. The employer withheld employees’ tax of R35 055,50.

¹⁴ www.merriam-webster.com/dictionary/refund [Accessed 19 February 2016].

Result:

In the 2015 year of assessment, X would be entitled to a deduction of R20 000. X's tax liability on assessment will be determined as follows:

	R
Income	240 000,00
Less: Section 11(nA) deduction	<u>(20 000,00)</u>
Taxable income	220 000,00
Normal tax on R220 000 [R31 419 + 25% of (R220 000 – R174 550)]	42 781,50
Less: Primary rebate	<u>(12 726,00)</u>
Net normal tax due	30 055,50
Less: Employees' tax withheld by employer	<u>(35 055,50)</u>
Refund due to X	<u>(5 000,00)</u>

Example 3 – Section 11(nA) deduction*Facts:*

In January 2014, employer B granted and paid employee C (aged 25) a bursary that was subject to tax and that did not qualify for exemption under section 10(1)(g). The agreement was such that C would remain in the employer's employment for a minimum of one year following the year of study. C resigned on 15 December 2014. As C had been in breach of contract (in that C did not remain in employment for at least one year following the year of study) C was required to pay back R60 000 for the bursary received and did so on 31 January 2015. C's total income for the 2015 year of assessment was R360 000, before any deductions. The employer withheld employees' tax of R69 421.

*Result:***2014 year of assessment**

C's tax assessment will remain as is.

2015 year of assessment

The employer will make no adjustment to C's IRP5 relating to the amount refunded. C will be entitled though, to claim a deduction under section 11(nA) on assessment.

C's IRP5 would show income of R360 000 and employees' tax of R69 421. On assessment, C will be entitled to claim a deduction of the R60 000 that was refunded to the employer.

	R
Income	360 000
Less: Section 11(nA) deduction	<u>(60 000)</u>
Taxable income	300 000
Normal tax on R300 000 [(R55 957 + 30% of (R300 000 – R272 700)]	64 147
Less: Primary rebate	<u>(12 726)</u>
Net normal tax	51 421
Less: Employees' tax already paid	<u>(69 421)</u>
Refund due to C on assessment	<u>(18 000)</u>

4.2 The amount that qualifies for deduction on assessment

The deduction allowed under section 11(nA) is limited to amounts previously included in taxable income. If, for example, an amount of R100 000 (in the form of a sign-on bonus) was included in taxable income, but an employee is required to refund that amount and R12 000 interest charged by the employer, the amount of R12 000 will not qualify for deduction under section 11(nA). The deduction would thus be limited to R100 000.

The deduction can only be claimed in the year in which it is actually refunded. It can create or increase an assessed loss,¹⁵ and will not be ring-fenced.

4.3 Documentation required to prove that an amount was refunded

In order to claim a deduction under section 11(nA), satisfactory proof must be provided to show that the amount was previously included in taxable income and subsequently refunded. All relevant information and documentation are required in the event that SARS conducts a compliance verification or audit.¹⁶ It is acceptable for an employer to provide a letter, similar to the sample included in **Annexure A**. Should the amount be refunded over an extended period (for example, two or more years of assessment), the employer must provide two or more letters – one reflecting the amounts refunded in Tax Year A and another reflecting amounts refunded in Tax Year B, and so on.

SARS will also take into consideration documentation such as bank statements and payslips when assessing whether an amount was refunded. The onus of proving that an amount was included in taxable income and then refunded lies with the person.

A person who wishes to claim the deduction on assessment must record the amount in the field on the ITR12 (which is the annual income tax return for individuals) dealing with deductions. For more information on the completion of income tax returns, see to the *ITR12 Comprehensive Guide*, available on the SARS eFiling website www.sarsefiling.co.za.

4.4 UIF and SDL consequences for the employer

There is no provision for the refund of UIF and SDL if amounts against which levies and contributions have been determined, are refunded to the employer. The rationale behind this approach is that both UIF contributions and SDL levies are calculated on “remuneration” as defined in the Fourth Schedule to the Act.¹⁷ Despite an amount being refunded to the employer by the employee, that amount nevertheless remains “remuneration” that has been received by or has accrued to the employee and that has been paid or is payable by the employer. The recovery of this amount does not result in a reduction in the remuneration received or accrued in that particular year of assessment, but merely results in the employee being entitled to a deduction of that amount under section 11(nA) in the year that the recovery takes place. As a result of

¹⁵ As permitted under section 20.

¹⁶ As provided in section 31, read with section 40 of the Tax Administration Act No. 28 of 2011.

¹⁷ Section 3(4) of the Skills Development Levies Act, 1999 refers to a “leviable amount” based on “remuneration” as defined in the Fourth Schedule to the Act. Section 6 of the Unemployment Insurance Contributions Act, 2002 refers to UIF contributions based on “remuneration” as defined in the Fourth Schedule to the Act.

this, no change will be made to the leviable amount for SDL purposes or to the remuneration for UIF purposes on amounts subsequently recovered from the employee by the employer.

5. Conclusion

Amounts, which have been received by or accrued to a person, for services rendered or to be rendered (or which have been received or accrued, or by virtue of any employment or the holding of any office), may subsequently be refunded by that person. The Act permits a deduction of the amount repaid in the year of assessment during which the amount is refunded. This has the effect of reducing the person's taxable income on assessment, or creating or increasing an assessed loss.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE

Annexure B – The law

Section 11(nA)

11. General deductions allowed in determination of taxable income.—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

- (nA) so much of any amount, including any voluntary award, received or accrued in respect of services rendered or to be rendered or any amount received or accrued in respect of or by virtue of any employment or the holding of any office as was included in the taxable income of that person and is refunded by that person;

Paragraph 2(f) of the Seventh Schedule to the Act

2. 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—

- (f) a debt (other than a debt for purposes of the payment by the employee of any consideration in respect of any qualifying equity share contemplated in section 8B to comply with the minimum requirements of the Companies Act or the payment of any securities transfer tax payable in respect of that share, or a debt in respect of which a subsidy is payable as contemplated in subparagraph (gA)) has been incurred by the employee, whether in favour of the employer or in favour of any other person by arrangement with the employer or any associated institution in relation to the employer, and either—
 - (i) no interest is payable by the employee in respect of such debt; or
 - (ii) interest is payable by the employee in respect thereof at a rate of lower than the official rate of interest; or

Paragraph 2(h) of the Seventh Schedule to the Act

2. 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—

- (h) the employer has, whether directly or indirectly, paid any debt owing by the employee to any third person (other than an amount in respect of which item (i) or (j) applies), 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: Provided that where any debt owing by the employee to the employer has been extinguished by prescription the employer shall be deemed to have released the employee from his or her obligation to pay the amount of such debt if the employer could have recovered the debt owing or caused the running of the prescription to be interrupted, unless it is shown to the satisfaction of the Commissioner that the employer's failure to recover the debt owing or to cause the running of the prescription to be interrupted was not due to any intention of the employer to confer a benefit on the employee; or

Paragraph 11 of the Seventh Schedule to the Act

11. (1) The cash equivalent of the value of the taxable benefit derived in consequence of the grant of a loan to an employee in the circumstances contemplated in paragraph 2 (f) shall be the amount of interest that would have been payable on the amount owing in respect of the loan in respect of the year of assessment if the employee had been obliged to pay interest on such amount during such year at the official rate of interest, less the amount of interest (if any) actually incurred by the employee in respect of the loan in respect of such year.

(2) For the purposes of this Act—

- (a) a portion of the said cash equivalent shall be deemed to have accrued to the employee—
- (i) where interest on the loan in question becomes payable by the employee at regular intervals, on each date during the year of assessment on which interest becomes so payable for a portion of such year;
 - (ii) where interest on the loan in question becomes payable by the employee at irregular intervals or where interest on the loan is not payable by him, on the last day of each period during the year of assessment in respect of which any cash remuneration becomes payable by the employer to the employee; and
- (b) the said portion shall be determined by calculating interest at the official rate of interest for the portion of the year referred to in subparagraph (2) (a) (i) or the period referred to in subparagraph (2) (a) (ii), as the case may be, and deducting therefrom so much of the amount of interest (if any) payable by him on the loan as relates to the said portion of a year or the said period, as the case may be: Provided that where the official rate of interest has been altered with effect from any date, any cash equivalent which is under item (a) deemed to have accrued to the employee on any date falling before the date on which such interest rate was so altered shall be determined as though such rate of interest had not been so altered.

(3) With the consent of the Commissioner a different method of calculation of the said cash equivalent or portions thereof may be employed if the Commissioner is satisfied that such method achieves substantially the same result as the methods provided in subparagraphs (1) and (2).

(4) No value shall be placed under this paragraph on the taxable benefit derived in consequence of—

- (a) the grant by any employer to his employee of any casual loan or loans if such loan or the aggregate of such loans does not exceed the sum of R3 000 at any relevant time; or
- (b) the grant by any employer to his employee of any loan for the purpose of enabling that employee to further his own studies.

(5) Where any amount, being the cash equivalent as determined under the provisions of this paragraph, of the value of a taxable benefit derived by any taxpayer in consequence of a loan granted to him, has been included in such taxpayer's taxable income in any year of assessment, such amount shall for the purposes of section 11 (a) of this Act be deemed to be interest actually incurred by him in that year of assessment in respect of the said loan where such amount, had it been actually incurred as interest, would have been incurred by the taxpayer in the production of his income.

Paragraph 13 of the Seventh Schedule to the Act

13. (1) The cash equivalent of the value of the taxable benefit derived by reason of the payment of any amount by an employer in the circumstances contemplated in paragraph 2(h) shall be an amount equal to such amount and the cash equivalent of the benefit to an employee by reason of his release from the obligation to pay an amount owing, as contemplated in the said paragraph, shall be an amount equal to the amount that was owing.

(2) No value shall be placed under this paragraph on the value of any taxable benefit derived by reason of the fact that an employer has paid—

- (a)
- (b) subscriptions due by his or her employee to a professional body, if membership of such body is a condition of the employee's employment;
- (bA) insurance premiums indemnifying an employee solely against claims arising from negligent acts or omissions on the part of the employee in rendering services to the employer; or
- (c) any portion of the value of a benefit which is payable by a former member of a non-statutory force or service as defined in the Government Employees Pension Law, 1996 (Proclamation No. 21 of 1996), to the Government Employees' Pension Fund as contemplated in Rule 10(6)(d) or (e) of the Rules of the Government Employees Pension Fund contained in Schedule 1 to that Proclamation.

(3) Where—

- (a) in consideration for the grant by any employer (hereinafter referred to as the former employer) to an employee of any bursary, study loan or similar assistance, the employee assumed an obligation to render services to the former employer for an agreed period;
- (b) in consequence of the employee having terminated his services with the former employer before the expiry of the said period and having taken up employment with another employer (hereinafter referred to as the present employer), the employee thereupon became liable to pay an amount to the former employer;
- (c) such amount was paid to the former employer on the employee's behalf by the present employer; and
- (d) the employee has in consideration for such payment by the present employer assumed an obligation to render services to the present employer for a period which is not shorter than the unexpired portion of the period during which he had been obliged to render services to the former employer,

no value shall be placed under this paragraph on the value of any taxable benefit derived by reason of the payment referred to in item (c).