

Human Resource Services

# HR Quarterly

Sharing good practice\*

August 2009



\*connectedthinking

PRICEWATERHOUSECOOPERS 

# Contents

Executive Reward – a look into the future . . . . .	4
UIF and foreign employees . . . . .	12
PAYE non-compliance - avoiding unpleasant surprises! . . . . .	14
Pension and provident fund membership . . . . .	16

Gerald Seegers	Director	(011) 797-4560	<a href="mailto:gerald.seegers@za.pwc.com">gerald.seegers@za.pwc.com</a>
Alan Seccombe	Director	(011) 797-4110	<a href="mailto:alan.seccombe@za.pwc.com">alan.seccombe@za.pwc.com</a>
Sonja Nel	National Marketing	(011) 797-4207	<a href="mailto:sonja.nel@za.pwc.com">sonja.nel@za.pwc.com</a>

*The HR Quarterly is designed to keep you abreast of developments and is not intended to be a comprehensive statement of the law. It should not be relied upon as a substitute for specific advice in considering the tax effects of particular transactions. No liability is accepted for errors or opinions contained herein.*

## From the editor

As the global recession continues, many companies continue to operate in survival mode, with their leaders focussing on the short to medium term. This issue of HR Quarterly highlights some of the changes with HR and Tax environment that will have to be addressed in the short-term to ensure its survival.

We are now well aware that the global landscape for executive compensation is transforming and is in many cases driven by the respective regulators meaning that South African companies is heading the same way and will also have to embrace these changes. The impact of this will not stop at the executive level and will no doubt drive change deeper in the organisation bringing about changes in the levels of compensation and the way they previously looked at setting compensation.

The South African Revenue Service also wants its slice and with current collections behind target, greater focus will be on employers as is evident in the proposed

amendments. Habitual non-compliance is seen to hinder tax processing with the result that SARS intends enforcing audits and imposing significantly higher administrative penalties for non-compliance.



Gerald Seegers  
Director  
Human Resource Services  
(A specialist division within Tax)

# Executive Reward – a look into the future

*Over the last 18 months, we have seen a widespread reversal in the global economy. A number of major financial institutions throughout the world have collapsed and others would have but for substantial government intervention.*

*Economic conditions in South Africa are currently challenging and many companies are having to deal with falling share prices and retrenchments as the downturn and recession spread.*

The current downturn, together with the turmoil we have seen in the financial services sector, has brought executive pay firmly into the spotlight. Questions have arisen about the incentives paid to executives under variable pay schemes and the role such schemes have played in encouraging executives to take excessive risks without adequate regard to the long-term performance of the company or financial institution. Now, more than ever, we are seeing shareholders demand a clear link between pay and performance and that executives should not be rewarded for failure.

As a consequence, steps have been taken on a number of levels to set out principles that should govern executive remuneration. This article sets out those principles and considers how they will affect the future of executive reward in South Africa.

## The Emerging Principles

In general, regulators and governments globally agree on the basic principles required for sound compensation practices and to address the perceived flaws identified as a result of the financial crisis. There is consensus that



change is necessary and that intervention is required to mend the cracks and build a solid base for sound executive compensation practices in the future.

### United Kingdom

One of the first movers in this regard was the Financial Services Authority (FSA) in the UK. The FSA is an independent nongovernmental body that regulates the financial services industry in the UK.

The FSA published a set of *Good Practice Principles* in October 2008 and became the first regulator to

publish an industry-wide comprehensive code of practice on remuneration. It is expected that the code will be brought into effect in early November 2009 and until that time it is being regarded as a benchmark for good practice. It will apply to all financial institutions incorporated in the UK and will have implications beyond the financial sector.

The draft Code of Practice sets out the following general principle:

*“A firm must establish, implement and maintain remuneration policies, procedures and practices that are*

*consistent with and promote effective risk management.”*

This general principle is then supported by 10 specific principles under four main headings:

Governance;

Measurement of performance for the calculation of bonuses;

Measurement of performance for long-term incentive plans; and

Composition of remuneration.

### **Governance**

Role of bodies responsible for remuneration policies and their members.

A remuneration committee should:

exercise, and be constituted in a way that enables it to exercise, independent judgement;

be able to demonstrate that its decisions are consistent with a reasonable assessment of the firm’s financial situation and future prospects;

have the skills and experience to reach an independent judgement on the suitability of the policy, including its implications for risk and risk management; and

be responsible for approving and periodically reviewing the remuneration policy and its adequacy and effectiveness.

Procedures and input of the risk and compliance functions

Procedures for setting remuneration within a firm should be clear and documented and should include measures to manage conflicts of interest;

A firm’s risk management and compliance functions should have significant input into setting remuneration for other business areas.

Risk and compliance function remuneration

Remuneration for employees in risk management and compliance functions should be determined independently of other business areas;

Risk and compliance functions should have performance metrics based on the achievement of the objectives of those functions.

**Measurement of performance for the calculation of bonuses**

Profit-based measurement and risk-adjustment

Assessments of financial performance used to calculate bonus pools should be based principally on profits;

A bonus pool calculation should include an adjustment for current and future risk, and take into account the cost of capital employed and liquidity required.

Long-term performance measurement

The assessment process for the performance-related component of an employee’s remuneration should be designed to ensure assessment is based on longer-term performance.

Non-financial performance metrics

Non-financial performance metrics should form a significant part of the performance assessment process;

Non-financial performance metrics should include adherence to effective risk management and compliance with the regulatory system and with relevant overseas regulatory requirements.

**Measurement of performance for long-term incentive plans**

The measurement of performance for long-term incentive plans, including those based on the performance of shares, should be risk adjusted.

**Composition of remuneration**

Fully flexible bonus policies

The fixed component of remuneration should be a sufficient proportion of total remuneration to allow a firm to operate a fully flexible bonus policy.

Deferral of the majority of any significant bonus

The majority of any bonus should be deferred with a minimum vesting period if, when compared with the fixed component of an employee’s remuneration, the bonus is a significant proportion of that fixed component.

Linking deferred element to the firm’s future performance

Any deferred element of the variable component of remuneration should be linked to the future performance of an employee’s division or business unit.

The final version of the *Code of Practice* is due to be published later this month.

## Financial Stability Forum

The Financial Stability Forum (FSF) brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors and committees of central bank experts.

In March 2009, membership of the FSF was expanded to all G20 countries, as well as to Spain and the European Commission, and the Financial Stability Board (FSB) was created. As a member of the G20, South Africa is a member of the FSB.

On 2 April 2009, the FSB published its principles for sound compensation practices, which were endorsed by the G20 leaders. They are entirely consistent with the FSA's draft *Code of Practice* and have as their general aim to ensure the effective governance of compensation, alignment of compensation with prudent risk taking and effective supervisory oversight and stakeholder engagement in compensation.

The three overarching principles adopted by the FSF are:

### Effective governance of compensation

The board of directors of major financial firms should exercise good stewardship of their firms' compensation practices and ensure that compensation works in harmony with other practices to implement balanced risk postures. The principles need to become

ingrained over time into the culture of the entire organisation.

### Effective alignment of compensation with prudent risk taking

An employee's compensation should take account of the risks that the employee takes on behalf of the firm. Compensation should take into consideration prospective risks and risk outcomes that are already realised.

*Firms should demonstrate to the satisfaction of stakeholders that their compensation policies are sound.*

### Effective supervisory oversight and engagement by stakeholders

Firms should demonstrate to the satisfaction of their regulators and other stakeholders that their compensation policies are sound. As with other aspects of risk management and governance, supervisors should take rigorous action when deficiencies are discovered.

The FSF principles will be reinforced through supervisory examination and intervention at a national level. Authorities, working through the FSF, will ensure the coordination and consistency of approaches across jurisdictions. This places all national authorities – including South

Africa – under an obligation to give effect to the FSF principles.

## European Commission

To address public outrage at bonuses executives receive despite their companies failing and their share price crashing, the Commission of European Communities (EEC) has also issued recommendations on remuneration. It has been working with various global institutions to ensure consistency with other initiatives.

On 30 April 2009, the EEC published its recommendations on the structure of remuneration for directors of listed companies and remuneration in the financial services industry. The recommendations cover the structure of remuneration and governance and they accord with the *Code of Practice* published by the FSA and the FSF principles. For example, the recommendations require a balance between fixed and variable pay with the variable pay element being subject to limits. Emphasis is also placed on transparency so that remuneration policies are clear, properly documented and disclosed to external shareholders in a way which means that they are clearly understandable.

Member states are required to take all appropriate measures to ensure that listed companies to which the recommendations apply have regard to them. Such action must be taken before 31 December 2009. In respect of the recommendation on remuneration in the financial

services industry, this will be followed up with legislation.

### Country specific

A number of countries have responded to the demands of the FSF, G20, EEC and the general public by publishing their own standards and principles for executive remuneration. These include Australia, Switzerland and the United States.

There is a common emphasis on the need to ensure that remuneration practices are sound and do not encourage excessive risk taking. Further, the requirement for transparency and accountability in the process of setting remuneration, together with the independence of the remuneration committee or compensation committee, is stressed.

Providing shareholders with a 'say on pay' is also being considered by some countries. For example, in the statement published by the US Treasury at the beginning of June 2009, one of two key areas where legislation is being proposed is to:

- provide shareholders in public companies with the right to cast a non-binding vote each year to approve or disapprove of executive pay packages;
- give shareholders a vote on annual compensation, including salary, bonus and other forms of compensation, for the top five executives;
- allow companies the opportunity to include additional resolutions on

specific compensation decisions; and

provide shareholders with the right to cast a non-binding vote on golden parachutes (payments normally made to executives in connection with the change of control of the company).

A similar regime already operates in a number of countries, including the UK.

### South Africa

To date, the South African Reserve Bank (SARB) has not followed its G20 compatriots in setting out how the remuneration policies of South African financial institutions should be devised.



Given the momentum which has developed globally on reforming executive remuneration, it must only be a matter of time before a statement is made by SARB. Indeed, as a member of the G20 and FSF, SARB has an obligation to ensure that the financial system in South Africa is stable and that the remuneration systems of those institutions are consistent with the FSF principles.

Although the focus over recent months has been on the flawed remuneration policies in the financial services sector, this is not only a financial services issue and the principles summarised in this paper will impact on all companies. The structure of executive remuneration is changing and the direction in which it is travelling now seems to be clear.

Undoubtedly, remuneration committees and executives of South African companies will have to face the issues of governance, transparency and alignment of remuneration with risk taking, which have been highlighted in this paper. With the publication of the draft King III report on corporate governance and the recent announcement by the Institute of Directors that an institutional shareholder code will be launched in September 2009, there are already signs in the South African market that governance is becoming more prominent.

Shareholders, feeling the pain of falling share prices and with an eye to the institutional shareholder code, will demand that changes be made.



South African companies would be well advised to turn their minds to these issues sooner rather than later and before the requirements are imposed on them.

### **What should companies be doing?**

Given recent events, it seems that unprecedented changes to the structure of executive compensation are inevitable and need to be embraced.

The exact changes will, of course, depend upon the particular company. However, we believe that the steps which will need to be taken by South African companies fall into three categories:

Governance – changes need to be made to ensure that robust governance processes are in place and to rebuild trust between executives, remuneration committees and shareholders.

Incorporating risk into financial measures – companies must ensure that bonus and long-term incentive outcomes adequately capture the risk assumed in generating profits in a particular year.

Composition of remuneration – the totality of the reward package and the function of constituent elements must be considered when making decisions on executive compensation. In particular, companies must address when and how deferred compensation should be used in order to align executives with appropriate risk taking.

### **Governance**

Perhaps one of the most striking changes likely to come out from the current crisis is around governance. As a consequence, the role of the remuneration committee will be extended and will also need to strengthen.

The remuneration committee will need to take responsibility for compensation throughout the company – not just for executives – and the approach taken in this regard must be consistent across all grades and employee levels. Thought will need to be given to the composition of the remuneration committee to ensure that it has the necessary expertise to perform this broader role effectively.

Remuneration committee members will have to be independent overseers of the compensation structures and will have to ensure that they have the appropriate skills and knowledge to do this. A process should be put in place to identify any gaps in capability and effectiveness and remedial steps taken where necessary. This may mean that members will need to participate in education programmes to increase their knowledge.

The remuneration committee will not be able to operate independently of the business. Regard will need to be given to the company's financial situation and how policies adopted and followed will impact on risk. This means that it may be necessary to call upon business experts when complex compensation decisions need to be made.

In addition, the remuneration committee will have to demonstrate to the outside world of regulators and shareholders that its processes are robust and its decisions, particularly where discretion has been exercised, based on sound principles. Transparency of decisions will be paramount and we are likely to see increased emphasis on disclosure of remuneration. This is a trend that is already being seen in the South African market with King III, the amendments to the JSE Listing Requirements and the forthcoming institutional shareholder code.

Increasingly, we will see shareholders challenge the remuneration committee to explain and justify the policies adopted. In the recent round of annual general meetings in the UK, shareholders in a number of large FTSE listed companies have vented their anger at remuneration decisions taken by voting against the company's remuneration report. There have also been calls for remuneration committee chairmen to stand down, demonstrating a general dissatisfaction with the state of executive compensation in some areas.

The public scrutiny of decisions taken by remuneration committees will increase rather than decrease and they need to be prepared. We understand that through the institutional shareholder code, institutional shareholders in South Africa will be encouraged to engage actively with companies and that they will have a crucial role to play in the new world of King III.

## Incorporating risk into financial measures

In order for the changes made to the compensation model to be successful, regard must be had to a company's wider enterprise risk management approach. Compensation must be aligned with how the company is run and performance measured – a 'one size

*Increasingly, we will see shareholders challenge the remuneration committee to explain and justify the policies adopted*

fits all' approach will need to be abandoned in favour of tailored models that reflect the particular business strategy in the current climate.

It is clear from the principles that have been published that a clear link between performance and risk adjustment will be expected. Perhaps the easiest way to bring risk factors into remuneration decisions is to introduce an explicit consideration of risk into bonus pool determinations. The bonus pool must be justified in the context of risks taken to achieve that pool and as against the company's risk policies. Input from the risk function of a company and a coordinated approach that includes the HR and finance teams will be vital in this regard.

Alternatively, non-financial measures could be used to determine bonus allocations. Sufficient weight will need to be given to non-financial measures, such as customer satisfaction, people development and key operational metrics, to ensure that a sufficient portion of the bonus is determined by reference to them.

Finally, consideration should also be given to the performance measures used in long-term incentive plans. In the South African market, we have traditionally seen a tendency for companies to use earnings per share (EPS) and total shareholder return (TSR) measures. However, with a focus on risk adjustment, we are likely to see more companies adopting measures such as return on capital and economic profit. A criticism of relative TSR as a performance measure over recent years has been that it is an abstract external measure over which executives have little control. Introducing a measure such as economic profit may provide a clearer line of sight and prove to motivate executives more effectively.

## Composition of remuneration

One of the key criticisms of the part played by executive compensation in the financial crisis is that executives have been encouraged to take risks without adequate reference to the long-term prospects of the company. This has resulted in an over emphasis on short-termism and there have been calls for the focus to shift to sustainable earnings growth and real, rather than illusory, profits.



A deferral mechanism for variable pay should align reward with sustainable performance and ensure that only achievement of long-term strategic targets is rewarded. As a consequence, the role of deferred compensation as an element of a remuneration package, and its design, must be considered by companies.

Companies should be questioning how much compensation should be deferred, over what period of time and under what circumstances the deferral should be forfeited or clawed-back. Where no deferral mechanism is currently operated, a policy will need to be developed. It is important to note, however, that this cannot be done in isolation and the part played by variable pay in an executive's reward package must be considered. A clear principle that has emerged over recent months is that executives should be paid sufficient base pay so that there is no requirement to pay variable pay when targets are not met.

In order for the deferral to be meaningful, it must relate to a significant proportion of variable pay. The emerging market view on deferral is that for senior management, over half of incentive compensation should be paid in deferred form and that deferral should be for a three to five year period. There are a number of ways to achieve this, ranging from deferral into cash, shares or divisional equity. The most appropriate mechanism will depend upon the circumstances of the company and the desirable behavioural impact.

The circumstances in which deferral should be forfeited will also depend upon the company in question. For example, should it be forfeited for poor corporate or divisional performance or misconduct and for how long? Much has been made of the ability to claw-back bonuses as opposed to them being deferred. This would mean that the bonus is paid but subject to certain conditions that allow it to be

reclaimed within a specified period, for example, where it transpires that a restatement of earnings is required. The difficulty with implementing a claw-back arrangement is that it is harder to reclaim something which has already been paid and it may involve protracted court proceedings. However, in extreme circumstances, such as incorrect financial data, a claw-back mechanism for cash bonuses should be introduced.

### In conclusion

Executive reward systems globally must change in order to become more transparent, responsive, adaptable and accountable. Although the focus has to date been on the financial sector and the role of executive compensation in the credit crisis, the codes of best practice which continue to be laid down by regulators across the world will permeate all industries.

Although SARB has not yet published principles that it expects South African financial institutions and companies to adhere to, we believe that this is only a matter of time. There is already an increased focus on governance and institutional shareholders.

The global structure of executive reward is transforming and South African companies need to be prepared for the changes heading their way.

**Nia Davies**  
[nia-davies@za.pwc.com](mailto:nia-davies@za.pwc.com)

# UIF and foreign employees

*In terms of section 4(1)(d) of the Unemployment Insurance Contribution Act of 2002, employers are not required to withhold and pay Unemployment Insurance Fund (UIF) contributions in respect of employees who have "... entered the Republic for the purpose of carrying out a contract of service, apprenticeship or learnership within the Republic if upon the termination thereof the employer is required by law or by the contract of service, apprenticeship or learnership, as the case may be, or by any other agreement or undertaking, to repatriate that person, or if that person is so required to leave the Republic."*

In view of this, it is clear that where a foreign employee is rendering services in South Africa in terms of a contract stipulating that they will be in South Africa for a limited period before being required to be repatriated to their home country or rotated (seconded) to another country, they would fall outside the UIF net and no UIF contributions would need to be made by them or on their behalf by their employer.

Typically with these types of employees, their work permit will be employer specific (i.e. based on their employment with that particular employer) and a condition of their work permit will be that, if they were to become unemployed, their work permit would automatically become null and void and they would be required to leave South Africa. This is unless an application for a new work permit or an appropriate temporary residence permit is made to the Department of Home Affairs for the conditions of the existing permit to be amended. As a result, the prospect of claiming UIF benefits would remain irrelevant to them. They would not have contributed to the UIF and they would not be entitled to claim UIF benefits, hence there should be no UIF issue with this class of employees.



## Foreign spouse of SA citizen

There is, however, at least one specific category of foreign employee (and possibly more) that would not fall within the above exemption and this is the foreign spouse of a South African citizen or permanent resident. Such an employee would typically not have "entered the Republic for the purpose of carrying out a contract of service ... within the Republic" and upon the termination of such an employee's services, the employer is not "required by law or by the contract of service ... to repatriate that person". As a result, employers of such employees will in fact be required to withhold UIF from and on behalf of these employees.

Where the problem arises, however, is if members of the public who fall within this category (i.e. foreigners in respect of whom UIF is required to be withheld) attempt to claim UIF benefits. As we understand it, these people are normally advised by Department of Labour officials that, unless they can produce a South African bar-coded identity document, they will not be able to claim any benefits. Foreigners who do not have permanent residence status or have not become South African citizens, would not qualify for a South African identity document and, therefore, would not be able to claim UIF benefits. As a result, while the UIF legislation requires them and their employers to make UIF contributions,

they do not practically have access to UIF benefits.

As we understand it, the Department of Labour has been approached about this and, to date, they have been reluctant to amend this practice, presumably since it is necessary to limit fraudulent claims. Comments have been made by other commentators that the Department of Labour should be challenged on constitutional grounds and, while such a challenge may have merit, it would be a costly and time-consuming exercise and there would be no guarantee of success with such a challenge. As a result, many potential UIF claimants have reluctantly accepted their fate.

### Door open

The good news in this regard is, however, twofold. Firstly, we have been advised by a senior official from the Department of Labour that, if officials have been turning potential claimants away on this basis, this is incorrect and claimants should not simply accept this. He advised that there is a process in place in terms of which such claims must be properly evaluated. This would entail the claim being submitted by the regional office of the Department of Labour where the claim has been lodged, to its Head Office in Pretoria as the regional office does not have the

authority to authorise or approve such a claim. This is likely to be a time-consuming exercise and is unlikely to result in the timeous payment of UIF benefits. It does, however, at least leave the door open to such employees, with an entitlement, to at some stage receive UIF benefits.

*The 2009 reconciliation process and the new penalty regime was the first step in SARS's attempt to modernise and streamline the employer reconciliation process.*

A second and perhaps more significant development is the recent draft regulations released by the Minister of Labour for comment. In terms of these draft regulations, it is proposed that the definition of "identity document" in the current regulations be amended to include "valid foreign identity documents of spouses, life partners ...". What this should mean, if the draft amendment is promulgated in its current form, is that foreign spouses of South African permanent residents or citizens should be able to claim UIF benefits on the strength of their foreign passports. They will therefore not have to accept being turned away or

have to follow a lengthy and bureaucratic process in order to get their claim approved.

While the proposed remedies should in theory go some way to alleviating the plight of these claimants, the test will be how such claims are administered by Department of Labour officials and how willing claimants will be to insist on their claim being considered and submitting themselves to the bureaucratic processes. If there is an urgent need for financial relief by way of UIF benefits, however, claimants would be wise to seek alternative resources as the waiting period for benefits may well exceed their period of unemployment.

Barry Knoetze  
[barry.knoetze@za.pwc.com](mailto:barry.knoetze@za.pwc.com)



# PAYE non-compliance - avoiding unpleasant surprises!

*Employers often receive a nasty surprise as to the status of their employees' tax (PAYE) account at SARS when making enquiries in this regard. Such enquiries typically occur when employers apply for tax clearance or tax exemption certificates or as part of due diligence procedures when businesses are sold.*

The reasons for these surprises can be varied, but typically occur for one or more of the following:

- errors by SARS when capturing monthly PAYE returns or payments which result in the allocation of PAYE payments to incorrect periods or to another employer;
- errors by the employer in reflecting the period or reference number when making payments which result in payments or returns being incorrectly captured by SARS;
- payments having been made by employers following a SARS audit or a reconciliation assessment not being properly allocated by SARS.

## No regular updates

As SARS does not as a matter of course provide employers with a regular update as to their PAYE account status, it is very difficult for employers to be aware of outstanding

returns, payments or of any other form of non-compliance, unless the employer proactively requests account statements from SARS at regular intervals and reconciles these accounts.

The danger of employers not being aware of the status of their PAYE accounts is that, from 1 January 2009, SARS has the authority in terms of section 75B of the Income Tax 58 of 1962 (the Act), read together with the regulations to this section published by SARS, to impose penalties on taxpayers for non-compliance.

Non-compliance in terms of this legislation includes, amongst other things, the failure to furnish, file or submit any return or document as and when required in terms of the Act. Penalties for non-compliance are based on a fixed amount depending on the taxable income of the taxpayer

for the preceding year. Also, in terms of the regulations, SARS may impose (in addition to any other penalties) a percentage based penalty, equal to 10 percent of the total amount of PAYE deducted or withheld, or that should have been deducted or withheld, by an employer from the remuneration paid to its employees, where the employer fails to submit a PAYE return as and when required under the Act.

Although the provisions that govern the percentage based penalties in terms of the new regulations have not come into operation yet, the Act (in the Fourth Schedule) provides for the imposition of a similar percentage based penalty of 10 percent. (The new regulations will become effective at a date to be determined by the Minister of Finance and, simultaneously the current penalty provisions contained in the Fourth Schedule to the Act will be deleted).

*Employers should follow a proactive approach and regularly obtain status reports from SARS with regard to their PAYE accounts at SARS.*

Employers may therefore face penalties of up to 10 percent of their total annual employees' tax withheld should they not submit their PAYE reconciliations on time. For employers with very high annual payrolls and, consequently, high PAYE deductions, this penalty will be significant. On 25 June 2009, SARS issued penalty letters in terms of the current percentage based penalty legislation to 7 000 employers who had not submitted their 2009 reconciliations before the filing deadline of 31 May 2009.

What is most interesting is that some employers who submitted their annual reconciliations on time were also issued with the penalty letters due to their submission failing the SARS validation process.

It should be kept in mind that with regard pre-existing non-compliance, in other words non-compliance prior to 1 January 2009, the new penalty provisions and rates as set out above will apply from 1 April 2009.

#### Biannual reconciliations

Further, it was proposed in the 2009 Budget that employers should in future submit biannual PAYE reconciliations as opposed to annual PAYE reconciliations. This proposal was confirmed in SARS'S Policy Document on PAYE, SDL and UIF Reconciliations for the 2009 and 2010 tax years (released at the end of 2008 for comment) where SARS proposes that, for the 2010 tax year, PAYE reconciliations must be submitted to SARS at two distinct points of the

year. According to this proposal, there will be two periods of the tax year for which PAYE reconciliations must be submitted. The first period, from 1 March 2009 to August 2009, will form the basis for a 6-month reconciliation. The second period, from 1 March 2009 to February 2010, will form the basis for a full 12-month reconciliation. In the 12-month reconciliation, the first 6 months will be a summary field and the last 6 months' data will be shown separately per month.

The proposed biannual PAYE reconciliation process has not been promulgated at this stage and therefore remains a proposal. However, should this proposal be enacted, it will increase employers' administrative burden and, should employers not submit their PAYE reconciliations according to deadlines set by SARS, a possibility exists for SARS to impose penalties of up to 10 percent of the PAYE withheld biannually due to non-compliance by employers.

As non-compliance is defined very broadly in terms of the penalty legislation and it is proposed that employers' filing obligations increase in future, a greater opportunity exists for SARS to levy penalties due to non-compliance. In certain instances it may be possible for SARS to issue penalty letters to employers even when such employers are not aware of the non-compliance (since SARS does not provide employers with regular updates as to their PAYE account status). While there is a

process to request SARS to review the penalties imposed, these procedures can be time-consuming and onerous.

A further change relates to the additional mandatory information to be disclosed on IRP5 certificates. SARS has indicated that this is driven by the reporting requirements of the proposed social security system, which will entail monthly reconciliation.

Data such as income tax reference numbers of employees and country of citizenship will become mandatory fields. Employers will need to implement steps to collate this data timeously.

#### Proactive approach

In light of this, it is recommended that employers follow a proactive approach and regularly obtain status reports from SARS with regard to their PAYE accounts at SARS (both with regard to the period from 1 January 2009 and prior to this date). In this manner, non-compliance according to SARS'S records, for whatever reason, can be resolved timeously and, hopefully, prior to the levying of any penalties by SARS.

Julia van den Heever  
julia.van-den-heever@za.pwc.com

Vusi Mashiane  
vusi.mashiane@za.pwc.com

# Pension and provident fund membership

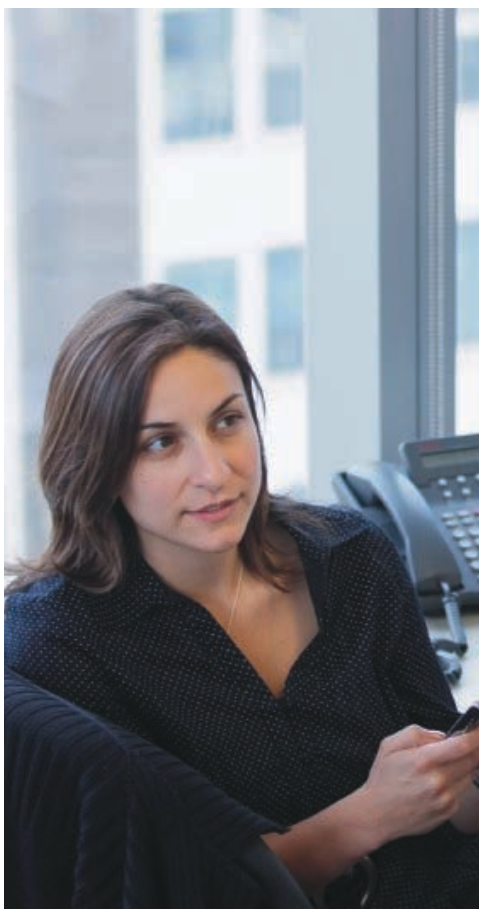
*It is often a subject of debate whether employees are required to become members of the employer retirement fund, or whether they can elect to join the fund or not.*

Central to this question is the definition of a 'Pension and Provident Fund' in Section one of the Income Tax Act. In terms of the Act, the fund rules must provide that membership of the fund throughout the period of employment shall be a condition of employment by the employer of all persons of the class or classes specified therein who enter his employment on or after the date upon which the fund comes into operation.

The effect of this provision is that it cannot be left to either the employer or an employee, who falls within a specified class of membership, whether that employee should be a member of the fund. This does not mean that every employee must be a member, but only those who fall within specified classes. In other words, once a class is specified, all falling into a class ought to become members of the fund.

Non-membership, on an interpretation of the provisions above, should depend on whether it can be said that a specified employee does not belong to a specified class. In this way, the fund may specify as a participating class, only employees whose salaries exceed a specified figure, or who have been employed for a specified period. All employees who fall within such class or classes must become members.

Where employees fall within a specified class, any option given to join the fund could have the effect that the Commissioner may not approve the fund, or if it transpires so



subsequently, he may withdraw the approved status of the fund.

In particular, trustees, as custodians of the fund rules, should take cognisance of the above provisions, as their application in practise are often overlooked with detrimental tax and legal consequences for the fund, employer and even the trustees.

## Constitutionality

It would be interesting to see if the provisions contained in the Income Tax Act would withstand constitutional scrutiny, particularly where an employee who does not want to participate in the fund (but

belongs to a participating class), can argue that one or more of his/her constitutional rights have been infringed.

To this end, Section 36 of the Constitution provides that a right in the Bill of Rights (such as freedom of association or the right to fair labour practice) may be limited having regard to, inter alia, the purpose and importance of the limitation. If the purpose of the legislation would be to encourage and further a savings culture, which according to the popular view is lacking in South Africa, then it may very well be said that the limitation of the rights mentioned above achieves an important objective. However, if the question does arise, it should be left to the court to decide.

What is important though is that the law as it reads at present, should be applied and, trustees being the custodians of the fund rules, should take cognisance of the interaction between the Pension Funds Act, Income Tax Act, labour laws and the Constitution. Perhaps a good place to start would be to look at the fund rules and see which employees belong to the fund, or rather, which employees do not belong to the fund, and then ask why?

Anton Lockem  
[anton.lockem@za.pwc.com](mailto:anton.lockem@za.pwc.com)

## About PricewaterhouseCoopers

PricewaterhouseCoopers provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 146,000 people in 150 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

## PricewaterhouseCoopers Human Resource Services

PricewaterhouseCoopers' Human Resource Services practice works with clients who strive to make their people a sustainable source of competitive advantage. Our strategy is built on our own belief in developing our people to be creative and effective team players committed to outstanding client service.

We bring the ability to take fresh perspectives, to think differently, and to develop and implement new and value-adding solutions. We work in close relationships with clients to offer practical, multi-disciplined approaches to the increasingly complex challenges facing businesses. One of the main challenges is to create environments in which their people can work most effectively. Our Human Resource Services practice brings together all of the professionals working in the human resource service arena – tax, benefits, retirement, communications, financial planning, international assignment, equity, culture and change, compensation, strategy, regulatory, legal, and process management – affording our clients an unmatched breadth and depth of expertise, both locally and globally.