

Employment & Labour - South Africa

Do Tax Changes Mean End of Travel Allowances and Medical Benefits?

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Changes to Taxation of Travel Allowances Proposed Simplification of Tax Deductions for Medical Aid Contributions Implications for Employers

The Taxation Laws Amendment Bill 2009 contains a number of proposals affecting employees. The two most significant proposals affect employees with a travel allowance, and employer contributions to medical aid.

Changes to Taxation of Travel Allowances

The amendments to the tax provisions affecting travel allowances were to some extent previewed in the 2009 Budget, in which it was announced that the deemed business kilometres provisions would be scrapped with effect from the 2010/2011 tax year.

However, the bill contains a proposal, not announced in the 2009 Budget, to increase the portion of a monthly travel allowance which is currently subject to employees' pay as you earn tax (PAYE) from 60% to 80% with effect from March 1 2010. No changes to the table of deemed costs have been proposed at this stage.

Current rules

In terms of tax legislation, any amount paid to an employee as a travel allowance that is not actually spent on travelling for business purposes must be included in the employee's taxable income. The employee then claims a deduction in his or her tax return against the travel allowance based on the deemed or actual kilometres travelled for business purposes and the costs incurred. For this purpose, private travel includes travelling between an employee's place of residence and place of employment.

In terms of the deemed business kilometre provisions, the first 18,000 kilometres a year travelled in the vehicle will be deemed to be private travel and the balance of the total kilometres travelled (up to a maximum total of 32,000 kilometres a year) will be deemed to be business travel. There is no need to maintain a logbook in order to claim a tax deduction based on deemed kilometres.

Reasons for changes

The rationale behind the latest changes appears to be a perceived distortion of vehicle purchasing decisions as a result of the significant tax benefits which could be claimed in respect of vehicles used for business travel purposes. The 2009 Budget Review stated as follows regarding travel allowances:

"Claiming 'deemed business kilometers' as a traveling expense is one of the few remaining salary structuring methods used to reduce tax liability. More than 500 000 taxpayers annually claim this deduction. Excessive deductions that do not match actual business expenses distort household purchasing decisions and traveling choices.

It is proposed that the deemed business kilometer procedure be scrapped from 2010/11. Taxpayers who are required to use their personal vehicles for business purposes will still be able to keep a logbook to claim business traveling expenses. This reform will improve the overall equity and efficiency of the income tax system. The default practice of claiming private kilometers traveled as business travel cannot be justified from an equity perspective."

The Explanatory Memorandum analyzes certain statistics in respect of tax claims by individuals with travel allowances. Not surprisingly, the majority of taxpayers (97% in the 2004/2005 tax year) claimed a tax deduction based on the deemed business kilometre method rather than the logbook method. In addition, individual taxpayers' travel expense claims greatly exceed the amounts contributed towards retirement funds and medical expenses. Other tables illustrated the regressive element of the deemed kilometre provisions which provide higher benefits to wealthier taxpayers.

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The Explanatory Memorandum states that the deemed kilometre method, while created to simplify compliance and enforcement, has become a method for claiming commuting expenses (as a salary sacrifice) by anyone who drives more than a certain number of kilometres each year. The net effect is an incentive for longer driving, which acts against environmental objectives. It is also questionable whether many of the kilometres claimed were actually driven for business purposes.

While it would be easy to take issue with some of these reasons (eg, the deemed kilometre provisions specifically do not require proof that the kilometres were driven for business purposes), it is clear that policy has shifted away from granting any tax benefit in these circumstances. The Explanatory Memorandum makes a number of other comments, such as that the rules for the company car fringe benefit may have to be revisited.

Impact on employees

The effect of this proposed amendment on employees in receipt of a travel allowance will be that in the 2010/2011 tax year, they will be obliged to base their claims for a business travel deduction against a travel allowance on the actual business kilometres travelled in the vehicle during the tax year. Accordingly, employees will have to maintain a logbook of all business and private travel in order to substantiate their tax deduction.

Individuals who claim substantial tax deductions based on the deemed kilometre provisions should be aware that this option will no longer apply next year and that 80% of their travel allowance will be subject to monthly PAYE. Accordingly, taxpayers should review the amount of their travel allowance for the 2011 tax year.

Proposed Simplification of Tax Deductions for Medical Aid Contributions

The second proposed change affects employer contributions to a registered medical scheme. At present, separate provisions allow for an effective tax deduction up to the capped amounts for contributions by an individual taxpayer and by an employer to medical aid. The total deduction may not exceed the capped amount, irrespective of whether the contributions are paid by the employer, the employee or both parties.

According to the Explanatory Memorandum, the dual medical scheme deduction has given rise to "undue complexities and evasion". Therefore, it is proposed that any employer contribution to medical aid will be a taxable fringe benefit in full with effect from March 1 2010. The employee can then claim a tax deduction up to the capped amounts, whether such contributions were made by the employee or by the employer on his or her behalf.

Although the Explanatory Memorandum states that the net tax effect of this change will be neutral for both employers and employees, it is not clear that employers can take the capped amounts into account when calculating monthly PAYE. Presumably this is the intention, otherwise the employee will benefit from the tax deduction only on assessment.

Implications for Employers

Employers should be aware of a number of issues which may arise from the proposed legislative changes. In particular, the increased PAYE deduction from travel allowances to 80% will impact on many employees' cashflow. This should be considered when awarding, for example, increases and bonuses to employees, as the increased PAYE liability may negate the impact of the salary increase. This process may have to be carefully managed with employees.

In addition, employers should revise the quantum of travel allowances granted to employees in light of the removal of the deemed kilometre provisions, since the amount of a travel allowance should be calculated with reference to the tax deduction which may be claimed by the employee concerned.

If the employee's actual business kilometres for the 2011 tax year are substantially lower than the deemed kilometres would have been, there may be a significant shortfall in tax which the employee will have to pay to the South African Revenue Service on assessment, although the increased PAYE deduction will alleviate this to some extent.

Clearly, all employees in receipt of a travel allowance should be advised to keep a logbook of their business and private travel from March 1 2010 in order to claim any tax deduction against their allowance.

Another issue which may be relevant is the potential impact on employees' pensionable earnings if a travel allowance is adjusted or falls away. Careful thought should be given to ensure that pension fund contributions are not affected by the adjustment in the travel allowances.

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