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TAXATION | BASIC

Video Transcription: Introduction to Employees' Tax

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Hi, I'm Shaun Parsons and in this video we are going to review the basics of employees' tax.

A taxpayer's taxable income, and therefore their income tax for the year, is only determined at the end of the year of assessment. This process requires the taxpayer to gather all of their tax information, to submit an annual tax return, and for the tax return to be assessed by SARS. This process may take a long time to complete, and it may be many months after the end of the year of assessment before the taxpayer's income tax for the year is finalised. The success of this process also depends on the taxpayer having the necessary knowledge and resources to submit the tax return, and there is the risk that this may not happen. Finally, the taxpayer has to take responsibility for settling the amount of tax owed.

For these reasons it makes sense to collect income tax in advance, and at the source of the income, i.e where it is earned. It also makes sense to place the responsibility for collection on the employer as it is generally easier for SARS to ensure that employers comply with this responsibility.

Employers are therefore required to withhold employees' tax from the salary or wages of employees each time they pay them, and to pay this over to SARS. This payment of employees' tax reduces and may even eliminate the final amount of income tax that the employee must pay when the annual tax return is assessed.

Employees' tax arises when three elements are present: An employer, an employee and remuneration. So what is remuneration? Remuneration as defined includes salaries and wages, bonuses, leave pay and commission. It also includes allowances, such as a travel allowance, and fringe benefits, such as employer-provided accommodation, as well as pensions.

An employee is someone who receives remuneration, and an employer is someone who pays remuneration. It is important to note that these definitions depend on the presence of remuneration, rather than a legal or contractual employment relationship. So, for example, a pension fund is an employer because it pays pensions, which are included in the definition of remuneration and a person who receives a pension is considered an employee for the purposes of that pension.

While income tax for the year is calculated on a person's taxable income, which includes items like interest or rent income, employees' tax is calculated only on the employee's balance of remuneration. So what is this balance of remuneration? The balance of remuneration is the employee's remuneration reduced by a limited number of deductions. These deductions typically relate to payments that are administered through the employer's payroll function, such as contributions to retirement funds.

Employees' tax is withheld every time remuneration is paid to an employee, and is calculated using the progressive tax table for individuals. This table is revised every year during the budget speech. The tax table for individuals is based on an individual's taxable income for the full year. For this reason, the employee's balance of remuneration for the payment period is multiplied by the number of periods in the year to determine what is referred to as the employee's annual equivalent.

In our example, we will assume that our employee is paid monthly, so he will have 12 payment periods in the year. So, if our employee is paid R10 000 a month and makes a contribution of R500 a month to his pension fund, his balance of remuneration of R9 500 will be multiplied by 12 to arrive at his annual equivalent of R114 000. Remember, it is possible that payments could be made at other intervals, such as on a weekly basis.

The income tax on the annual equivalent can then be determined using the tax table. This amount is reduced by the rebates that our employee qualifies for, according to his age. It is also reduced by the credit for medical aid contributions if the employee belongs to a medical aid. If the employee is 65 years or older, the annual tax figure will also be reduced by a credit for medical expenses.

This calculation gives an annual tax figure based on the employee's balance of remuneration. The annual tax figure is then divided by the number of periods in the year to calculate the employees' tax that must be withheld for that one period. Since our employee is paid monthly, the annual tax figure will be divided by 12. This simple calculation works when we can reasonably expect that what the employee is paid this month will be repeated every other month. However, this will clearly not always be the case.

For example, if our employee with a salary of R10 000 and pension contributions of R500 is paid a bonus of R50 000 in March, it is hardly reasonable to assume that his annual equivalent should be R714 000. Clearly, multiplying this month's balance of remuneration by 12 will give a significantly exaggerated total for the year, and would result in far too much tax being withheld.

To get the calculation right, we have to separate recurring from once-off amounts. Only the recurring amounts are multiplied by 12 and the once-off amounts paid in the month are then added to the annual equivalent. This gives a much more accurate approximation of what the employee is likely to earn for the year. In our example, we should multiply R9 500 by 12, and then add the R50 000 bonus to arrive at an annual equivalent of R164 000.

To find out how much employees' tax must be withheld in a month in which a once-off amount is paid, we don't divide the annual tax amount by 12. This would assume that the employee would pay a portion of the tax on the bonus each month. But the employee needs to pay all of the tax on the bonus in the month in which the bonus is received.

So, we calculate the tax on the annual equivalent including the bonus amount, and subtract from this the tax calculated on the annual equivalent, excluding the bonus. The difference is the tax on the bonus, which is the "extra" employees' tax that is paid in the month, in which the bonus is received. The total employees' tax withheld is therefore the tax on the annual equivalent excluding the once-off amount divided by the number of periods in the year, plus the tax on the bonus.

So, for our employee we will calculate the tax on R164 000, and subtract from that the tax calculated on R114 000. The difference is the tax on the R50,000 bonus. 1/12 of the tax on R114 000 is added to this amount. In other words, the sum of the two amounts is the employees' tax that the employer must withhold for March.

Let's assume that our employee is not paid a bonus for the rest of the year of assessment and continues to earn his regular salary and to contribute to the pension fund. For each of the remaining 11 months, 1/12 of the employees' tax on R114 000 will be withheld as employees' tax each month. At the end of February, the employee will have paid employees' tax on his regular salary 11 times, and the tax on his regular salary plus his R50 000 bonus in one month, i.e March. So he will have paid exactly the right amount of employees' tax to cover the tax on his total balance of remuneration.

At the end of the year of assessment, the taxpayer will submit an annual tax return for individuals. In this return he will include all his income, deductions and capital gains, not only the balance remuneration from his job. SARS will calculate the total income tax owing on his taxable income, and will subtract from this the amount of employees' tax that he has already paid. The difference is the amount that the taxpayer will either pay to or be refunded by SARS.

Where an individual's only source of income is his or her salary, and all of the deductions and rebates they are entitled to are accounted for in the employee's tax calculation, the employee's tax withheld during the year will equal the total tax on that individual's taxable income, so no additional tax payment or refund will be necessary. To simplify things, employees who earn less than R350 000, have had only one employer during the year, and have no other sources of income or deductions and rebates that they wish to claim, are not required to submit an annual tax return.

Employees' tax is an efficient way to ensure that income tax is collected from employees. It is an advance payment of tax that is calculated each time an employee is paid. When income tax is calculated on a taxpayer's total taxable income at the end-of-year of assessment, the tax already collected in the form of employees' tax reduces the amount still owing by the taxpayer.

Thanks for watching.