University of the Witwatersrand

A RESEARCH REPORT SUBMITTED TO THE FACULTY OF COMMERCE, LAW AND MANAGEMENT, UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG, IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF COMMERCE (SPECIALISING IN TAXATION)

An examination of the treatment of fees received by directors for South African tax purposes

Abstract

The study is about the way non-executive directors are treated for tax purpose by SARS and its reasoning regarding the VAT and PAYE liability of resident and non-resident non-executive directors. This research then evaluates both statutory and common law to determine whether non-executive directors can be treated as independent contractors. The report further evaluates whether the SARS reasoning is consistent with international conventions and treaties. The research suggests that it was never the legislature's intention to treat services rendered by office holders as 'enterprise' liable for VAT.

Key words: non-executive director; non-resident non-executive director; independent non-executive director; statutory law; common law; Independent contractor; employee; remuneration; enterprise; locatio operarum; conductio operis; supervision and control test; organisation test; multiple or dominant impression test; flexible test; statutory test; PAYE; VAT; OECD MTC; Constitution; International law; treaties.

Declaration

I declare that this research report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Commerce (specialising in Taxation) at the University of Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other university.

Obed Letlape

23 April 2023

Dedication

All this work is dedicated to:

To my beloved Mannyadi

To my children, Karabo, Lesego and Gontse

To the memory of my courageous Toko, Sefora, Mmamakidiane and Tshediso

For their love, patience, support and understanding

Thank you!

Table of contents

Chapter 1: Introduction

The question of whether non-executive directors are 'employees' in terms of the Fourth Schedule of the Income Tax Act 1962 remained unresolved for some time, until the Minister of Finance in the 2016 Budget made an announcement and SARS published BGR 40. The publication has led to confirmation that a non-executive director is a holder of office not a common law employee. In addition, SARS characterized a non-executive director as an independent contractor and treated the services rendered by a non-executive director as a vatable supply by vendor in terms of the VAT Act 1991.

The disquiet has continued, and others have argued that SARS' assertion of treating a non-executive director as independent contractor is incorrect. In addition, the provisions SARS relies on to define a non-executive director as an independent contractor only refers to a person carrying on an enterprise "by him independently of the employer and receiving remuneration". The exclusionary provisions relied upon refer only to services provided independently from the company, not by a contractor but by a person to whom remuneration is paid - in fact, there is no reference to an independent contract at all. Therefore, SARS argument of treating a non-executive director as an independent contractor is not supported by the exclusionary provisions of the definition of 'enterprise' in the VAT Act 1991. The ruling could possibly be supported by common law but, if that be the case, then each case will have to be determined on its own merit, and any general application will be inconsistent with the legislation.

The directors of the company are appointed in terms of s 66 of the Companies Act 2008, and there is no distinction between an executive and non-executive director. The Act goes further to confirm that the directors of a company are gainfully employed, and they are all remunerated for the services rendered to the company. Therefore, directors are holders of office, and they all receive remuneration as defined in terms of the Income Tax Act 1962. The exclusionary provisions of the definition of 'remuneration' in the Fourth Schedule includes any amounts received from a trade carried on independently. SARS characterizes all non-executive directors as independent, therefore, free from bias and conflicts of interest. However, not all non-executive directors are independent, some own shares, some provide professional services to the same companies and some are economically dependent on the enterprises they serve. King IV Report splits non-executive directors between non-executive directors and independent non-executive directors, which muddies the waters even further.

SARS in BGR 40 regards non-resident non-executive directors as employees and treats their fees earned for service rendered as remuneration and therefore, liable for PAYE. In contrast, resident non-executive directors are treated as independent contractors only liable for VAT. SARS treatment of non-resident non-executive directors could be seen as discriminatory and inconsistent with the provisions contemplated in the OECD MTC (2017) and bilateral Treaties. In terms of the South African Constitution (1996) bilateral Treaties are treated as International Law and codified into our laws. It is highly possible that this treatment of non-resident is inconsistent with the South African Constitution (1996).

Research methodology

The methodology of the study presents an innovative, thorough, and systematic attempt to address the research question, which is based on the treatment of non-executive directors for tax purposes.

The research method adopted is of a qualitative, interpretive nature, based on an extensive literature review, detailed interpretation and analysis of the following sources –

- Books
  Cases
- Electronic databases
- Electronic resources - internet
- Journals
- Magazine articles
- Publications
- Statutes

Research question

Is SARS treatment of non-executive directors as independent contractors not as employees and therefore subject to VAT on the directors fees received, correct?

Research sub-question

SARS treatment of non-executive directors with regards to VAT.

- The difference between an executive, non-executive and independent non-executive directors.

- The difference between an independent contractor and employee.
- The impact of SARS interpretation of non-executive director liability on the provisions of the OECD MTC and/or Treaties
- The UK's VAT Act and case law pertaining to the treatment of Directors with regards to VAT

Chapter overview

The primary purpose of chapter 2 is not to provide an overview of SARS contention and treatment of non-executive directors - but, it is to explore SARS rationale in treating non-executive directors as independent contractors, whose fiscal liability includes VAT payments in accordance with the VAT Act 1991. The enquiry extends further into the fiscal and common law tools SARS employed in its justification.

Chapter 3 represents a vigorous analysis of the complexities, differences and nuances accompanying the many different definitions of directors. It further explores and identifies the confusion caused by their fiscal properties and the general inconsistencies that is evident in their interpretation and application.

A non-executive director is treated as an independent contractor for VAT purposes and an executive director is treated as an employee for PAYE purposes. Chapter 4 examines the rationale and thought process that led to this distinction and its impact in practice.

In chapter 5, the enquiry explores more expansively the common law conception and principles of what in practice can be construed as an employee or independent contractor. The enquiry descends into the difficulties that are strewn in the definition of the conception and the many court cases that were involved in unpacking the impasse.

Chapter 6 further examines statutory provisions in our body of law to find a more befitting statutory definition that avoids ambiguities or leads to a generally acceptable position.

The enquiry in chapter 7 seeks to reconcile the fiscal liability or treatment of the NED with the OECD MTC and examine whether our preferred treatment is consistent with our Treaties. It further examines whether our treatment of NED's is consistent with the provisions of our founding Constitution and

International law. More importantly, the inquiry, seeks to explore and gather information regarding the discriminatory nature or tone of this treatment.

Chapter 8 represents a more aggressive comparison of our treatment of non-executive directors for VAT purposes with the UK VAT Act and its attended treatment of directors. It further highlights the impact of these differences in our bilateral relationship and Treaties.

Chapter 9 is a synopsis of all the inconsistencies and absurdities found in SARS interpretation of the law with regards the tax liabilities of non-executive directors. Highlights the difficulties found in the definitions of directors and the confusion this interpretation lends itself to, in practice. The enquiry further points to inconsistencies with our Constitutions, International Law and Treaties.

Chapter 2: SARS treatment of non-executive directors with regards to VAT

It has been a long-standing practice of corporate South Africa that the remuneration paid to executive directors is included in their income and subjected to PAYE taxation. The dilemma has always been the characterization of fees paid to non-executive directors for taxation purposes. The tax treatment has been primarily unclear because it has been difficult to determine whether a non-executive director is an employee or office holder or both. Frankly, SARS hasn't been able to provide any leadership from both a statutory or common law perspective and to that end corporate was left to its own devices.

This situation has been exacerbated by the fact that there is no definition of "executive or non-executive director" in the Income Tax Act 58 of 1962. In addition, the Companies Act 71 of 2008, makes no attempt to distinguish executive from non-executive directors, either. The Income Tax Act 1962, in para I of the Fourth Schedule in the definition of 'employee' and 'remuneration' includes executive directors. Consequently, the treatment of executive director as recipients of remuneration and subjected to employees' tax as common law employees, is trite in terms of our fiscal legislation and general corporate practice.

The impasse, regarding the tax implications of non-executive directors extended to whether they should be treated as "independent contractors" whose tax liability should include VAT payments in accordance with the VAT Act 1991 as opposed to payment of 'employees' tax in terms of the Income Tax Act 1962. In Eversheds Sutherland International, (2017), '*VAT and employees' tax in regards non-executive directors*, the authors opined that, "The question in regards the requirement to deduct employees' tax from the remuneration paid to non-executive directors (NED), or whether the NED would be required to be registered for VAT, has been longstanding debate. Often companies applied the more cautious approach and deducted employees' tax." Notably, this led to confusion and resulted in a cacophony of different treatments and the absence of a uniform touchstone.

A look at the Income Tax Act 1962 to resolve the question of whether non-executive directors are employees is not helpful either and the impasse remain unresolved. Until the Minister of Finance in the 2016 Budget, announced far-reaching solutions to this perennial problem, in terms of the National Treasury, 2016, *Annexure C: Additional tax policy and administrative adjustments to the Budget Review, Taxation of non-executive director fees*, p. 164, Govt. Printer, Pretoria, which subsequently resulted in the issuing of SARS Executive: Legal Advisory, (2017), *Binding General Ruling ('Income tax') 40: Remuneration paid to Non-Executive Directors ('*BGR 40'), Govt. Printer, Pretoria – which provided some convention on the fiscal treatment of non-executive directors.

In terms of BGR 40, SARS contends that a non-executive director is distinct from an executive director and the former is not responsible for the day-to-day management of the company and it is trite that the latter is characterized as an employee in terms of the Income Tax Act 1962. This assertion is further confirmed by the Institute of Directors of Southern Africa, (2009), *The King Report on Governance for South Africa, and the King Code of Governance Principles ('*King III'), p. 53, LexisNexis Publishers, South Africa, which defines a non-executive director in this manner: "The non-executive director plays an important role in providing objective judgement independent of management on issues facing the company; Not being involved in the management of the company defines the director as non-executive; and non-executive directors are independent of management…,"

Joubert, E.P. & Loubser, A., 2016. Executive directors in business rescue: Employees or something else?, *De Jure Law Journal*, 49(1), 95-104, went further to articulate the character of executive as opposed to non-executive directors: "Executive directors are normally in the full-time employment of the company and are thus employees, albeit a special type of employee. Because they have not been specifically excluded from the definition of 'affected persons', or from enjoying any of the special rights and powers given to employees by Chapter 6 of the Companies Act…"

SARS further contends that a non-executive director, by its non-involvement in the day-to-day management of the company, fails to meet the definition of an employee in terms of common law and hence, it doesn't qualify to receive remuneration as contemplated in para 1 of the Fourth Schedule of the Income Tax Act 1962.

SARS pursues this enquiry further by employing both the 'premise' and 'control or supervision' statutory tests, to determine whether directors fees received by non-executive directors can be categorized as 'remuneration' as defined in para 1 of the Fourth Schedule of the Income Tax Act 1962. The exclusionary subpara (ii) of the definition of 'remuneration' in s 1 of the Fourth Schedule of the Income Tax Act 1962 covers both tests as follows:

[Premises test]:

> "… a person shall not be deemed to carry on a trade independently as aforesaid if the services are required to be performed mainly at the premises of the person by whom such amount is paid or payable or of the person to whom such services were or are to be rendered…"

[Control or Supervision test]:

> "… the person who rendered or will render the services is subject to the control or supervision of any other person as to the manner in which his or her duties are performed or to be performed or as to his hours of work…"

SARS contends that normally non-executive directors don't use company premises to do their work, in fact, they only attend Board meetings whether held at the company's premises or elsewhere. Consequently, the amount of time spent at the company will not qualify as 'mainly' or a quantitative measure of more than 50% as affirmed by Botha JA in the Sekretaris *van Binnelandse Inkomste v Lourens Erasmus (Eiendoms) Bpk* 1966 (4) SA 434 (A) case. In addition, non-executive directors are independent of the company's management and invariably they aren't controlled or supervised by the same management, with regards the performance of their duties. Invariably, the conclusion is that non-executive directors meet the requirement of the exclusionary 'premises' and 'control or supervision' provisions and their fees cannot be categorized as remuneration as defined, nor can they be subjected to PAYE.

SARS in BGR 40 asserted the following: "It is concluded in paragraph 3.2 of BGR 40 that an NED is not considered to be a common law employee. This is based on the view that the services must be supplied independently and personally by the NED. Any director's fees paid or payable to an NED for services rendered in that capacity is therefore not regarded as 'remuneration".

SARS further affirms that directors fees aren't 'remuneration' as defined and therefore non-executive directors should be treated as independent contractors and their fees be subjected to VAT. In SARS Executive: Legal Advisory, (2017), *Binding General Ruling ('VAT') 41 (ISSUE 2): 'VAT treatment of Non-Executive Directors* ('BGR 41'),SARS concludes that, "… an NED performs services personally and independently, and any directors fees paid or payable for services rendered are therefore not regarded as 'remuneration'. It then follows that for VAT purposes an NED is treated as an independent contractor as contemplated in proviso (iii)(bb) to the definition of "enterprise" in s 1(1) of the Value-Added Tax Act 89 of 1991."

The SARS position was confirmed by de Koker, A. P. & Williams, R. C., 2021, *Silke on South African Income Tax,* 70th edn, LexisNexis, Durban as follows: "Directors fees payable to resident non-executive directors are not regarded as remuneration and are not subject to employees' tax. Non-executive directors are not common law employees, and they are not subject to the control or supervision of any other person as to the manner in which their duties are performed or are to be performed or as to their hours of work. Directors fees payable to non-resident non-executive directors are regarded as remuneration and are subject to employees' tax. This is because Binding General Ruling 40 does not apply to them as it specifically excludes non-resident non-executive directors. The rule excluding amounts paid to independent contractors from remuneration (exclusion (ii) to the definition of 'remuneration') further does not apply to any amounts paid to non-residents for services rendered."

Nair F, in *'Taxation of Non-Executive Directors*, summarized the outcomes reflected in BGR 40 and 41 and concurred that they essentially culminate in the following:

"Non-executive directors are not common law employees nor are they deemed employees under the Income Tax Act.

- Consequently, non-executive director fees earned by South African tax-resident non-executive directors do not constitute remuneration subject to PAYE, and the limitation of income tax deductions under section 23(m) of the Income Tax Act does not apply. Non-executive director fees are, however, still subject to normal tax.
- Non-resident non-executive directors who serve on boards of tax-resident companies are not affected by the rulings and their non-executive director fees will remain subject to PAYE.
- Non-resident non-executive directors are also subject to the income tax deduction limitations under section 23(m) of the Income Tax Act.
- Both resident and non-resident non-executive directors are independent contractors under the Value-Added Tax Act.
- Consequently, if any non-executive director physically performs non-executive director services in South Africa or through a fixed or permanent place in South Africa on a continuous or regular basis, that non-executive director is regarded as carrying on an "enterprise" for VAT purposes.

- As a result, a non-executive director who was entitled to receive non-executive director fees in excess of R1 million after 1 June 2017 became liable to register as a VAT vendor from the date of appointment or re-appointment, levy VAT on those non-executive director fees and comply with other administrative requirements under the VAT Act 1991."

It can, however, be argued that the Income Tax Act 1962, Labour Relations Act 66 of 1995 and the Companies Act 2008 fail to distinguish between an executive and non-executive director and statutorily these two functionaries should be treated the same. Paragraph 1 of the Fourth Schedule of the Income Tax Act 1962 defines 'employee' as follows:

> "(a) any person (other than a company) who receives any remuneration or to whom any remuneration accrues."

It is clear that any director who receives remuneration as defined, irrespective of their designation, is covered in para 1(a) of the Income Tax Act 1962. In terms of para 1 of the Fourth Schedule of the Income Tax Act 1962 'remuneration' is defined as follows:

> "Means 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 …, whether in cash or otherwise or not in respect of services rendered … "

In addition, it is general corporate practice that executive directors will receive remuneration as defined and non-executive directors will receive fees. There is no distinction of the fees or any other further qualification of the nature of these fees. It is plausible that these fees could invariably include fees received by non-executive directors for services rendered. Notably, the definition of 'remuneration' in para 1 of the Fourth Schedule of the Income Tax Act 1962, doesn't explicitly exclude fees paid to non-executive director. A simple reading of the Income Tax Act 1962, therefore, treats both executive and non-executive directors as employees of the company and recipients of remuneration as defined.

Revelas J, concluded in *PG Group (Pty) Ltd v Mbambo NO & others* (2005) with regards the definition of 'employee' in the Income Tax Act 1962 that, "this definition will apply to most, if not all the directors." It is inconceivable that the learned Judge was only referring to executive directors, therefore, the assertion included non-executive directors as well. All directors both executive and non-executive are employees of the company in terms of the Income Tax Act 1962 and are invariably thrown into the ambit of the Labour Relations Act 1995 and s 220 of the Companies Act 2008.

de Koker & Williams (2021) argues emphatically that a director will always be an employee for the purposes of the Seventh Schedule, irrespective of whether he is regarded as an employee with regards the Fourth Schedule. In his argument, a director's position as an employee in the Fourth Schedule only applies to the taxation of fringe benefits and doesn't extent to the general provisions of the Act. This conception seems to suggest that a director is an employee, but only included as an employee within the general provisions of the Act to the extent that he receives fringe benefits. It is highly probable that some directors receive fringe benefits and some don't, and the implications are that some directors are employee and some aren't in terms of the Fourth Schedule. The dilemma is that BFR 40 & 41 paints all non-executive with broad brushstrokes without considering the possibility that some non-executive directors are employees in terms of the Seventh and Fourth Schedules.

Eversheds (2017) avowed that, "Neither the Income Tax Act nor Value-Added Tax Act specifically define or recognise the NED. This is part of the issue, as fees paid to a NED should be no different than fees paid to an executive director, as both are fees paid for the holding of an office."

Chapter 3: The difference between an executive, non-executive and independent non-executive directors

As alluded to above that there is no distinction between an executive and non-executive director in terms of the Income Tax Act 1962. This truth has been confirmed in the case of *Howard v Herrigel* 1991 (2) SA 660 (A) where the Court held that "it is unhelpful and even misleading to classify company directors as 'executive' or 'non-executive' for purposes of ascertaining their duties to the company or when any specific or affirmative action is required of them." The Companies Act 2008 defines a director as:

> "… a member of the board of a company, as contemplated in s 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated."

In terms of s 66 of the Companies Act 2008, the directors of a company are appointed in terms of its Memorandum of Incorporation or its shareholders and there is no distinction between an executive and non-executive director. In fact, the Companies Act 2008 in its definition only distinguishes between a director or alternate director as the only names that can possibly be attributed to a director.

Joubert & Loubser (2016) stated that, "In contrast to the King Reports… the Companies Act 2008, does not use the words 'executive' or 'non-executive' either in its definition of a director in section 1 or in sections 75 to 78 dealing with the duties and liabilities of directors. However, the Companies Act 2008, describes some directors in such a way that a distinct description of a particular director similar to that found in the King Reports can be implied."

It is a matter of fact that there are certain directors that aren't involved in the day-to-day operations of the company. Section 94(4) of the Companies Act 2008 and reg 43(4) of the Companies Regulations of 2011, confirms as a matter of law that there are directors involved in the day-to-day operations of the company. A clear reading of the provision imports the existence of directors that aren't involved in the day-to-day management of the company without according a name to such a director involved in such a function. The definition of a director in the Companies Act 2008, confirms that any person occupying the position of a director can be allotted any name, which the company/industry can deem fit.

Section 94 (4) of the Companies Act 2008, regulating the composition of audit committees, explicitly states that a director who is elected to serve on the audit committee must not be involved in the day-to-day-management of the company or be in the full-time employment of the company. Clearly, this section requires that only members of the board not involved in executive management may be members of the audit committee – this member of the board is referred to as a non-executive director. Another example is found in regulation 43(4) of the regulations framed in terms of Companies Regulations of 2011, of the Companies Act 2008, where the composition of the Social and Ethics Committee is prescribed. This Regulation requires that at least one of the directors serving on this committee must be a director "who is not involved in the day-to-day management of the company's business. Again, the reference is to a non-executive director. It is clear, despite the fact that there is no express distinction between the various types of directors in the Companies Act 2008, that the Act acknowledges that there is a difference." (Joubert & Loubser 2016).

That difference largely resides with the different functions that members of the board of the company are responsible for. However, this allotment cannot deviate from director's obligations required by "director's standards of conduct" in terms of s 76 of the Companies Act 2008 - these should be complied with by all directors irrespective of designation. Notably, practice has resolved to separate members of the board into executive and non-executive.

Gaibie AJ averred in *Protect A Partner (Pty) Ltd v Machaba-Abiodun & others* (2013) 34 ILJ 392 (LC) that, "In general, there are essentially two types of directors, more commonly known as non-executive and executive directors. The directors of an organisation are the persons who are the members of its board. An executive director, sometimes also referred to as an "inside director" is a director who is often an employee, officer, significant shareholder, or someone similarly connected to the organisation. Inside directors or executive directors represent the interest of the entity's stakeholders, and often have special knowledge of its inner workings, its financial or market position, its vision and its mission. Typical executive directors would include: a chief executive officer who may also be the chairman or chairperson of the board, other executives of the organisation, such as its chief financial officer or any other director tasked with the management of the entity's operations. A non-executive director is usually referred to as a member of the Board who is not otherwise employed by or engaged with the entity or the organisation, and does not generally represent any of its stakeholders…"

The author of the document by Deloitte Touche Tohmatsu Limited, (2013), '*Duties of directors*, distinctly characterised a non- executive from an executive director in this manner, "Non-executive directors are independent of management on all issues including strategy, performance, sustainability, resources, transformation, diversity, employment equity, standards of conduct and evaluation of performance." Eversheds (2017), asserted as follows: "In fact, a NED has the same duties, requirements, and liabilities as that of any other director. In some instances, such as the audit committee members, it is required that the director not be party to the day-to-day management activities. The independence required is to avoid biases and conflicts of interests…"

SARS in BGR 40 and BGR 41 categorises directors as executive and non-executive and goes as far as defining non-executive director as an independent contractor for the purposes of treating director's fees as a vatable supply. King III has expanded these designations to include an executive, non-executive and independent non-executive director. In fact, it further proffers a distinction between dependent and independent non-executive directors.

It is trite in the South African context, that for companies to demonstrate their commitment to effective governance their boards should constitute a mix of executive, non-executive and independent non-executive directors. The distinction is further required by the JSE (2007) in terms of its listing requirements in order to strengthen governance and oversight. In para 3.84(e) of the JSE Limited, 2007, *JSE Listing Requirements*, LexisNexis, obliges listed companies to categorise each director's capacity as executive, non-executive or independent. The JSE (2007) further affirms in para 3.84(e)(iii) that, "Independent directors should be determined holistically, on a substance-over-form basis, in accordance with the indicators set out in the King IV Report and section 94(4)(a) of Companies Act 2008."

It is a global phenomenon that to maintain good governance and oversight the board should include a balance of power that requires the inclusion of independent directors. The Organisation for Economic Co-operation and Development ('OECD'), 2015, *G20/OECD Principles of Corporate Governance,* pp. 50-52, OECD Publishing, Paris, affirms that these principles, "are intended to operate as an international reference point for implementing good corporate governance globally. It is noteworthy that these principles emphasise the board's ability to exercise an objective, independent judgment on corporate affairs." Cassim R, 2021, 'A Comparative Analysis of Director Tenure in South Africa and Selected International Jurisdictions', *Comparative and International Law Journal of Southern Africa*, 54(1), 6-10, emphatically supports the OECD (2015) assertion by stating that, "independent directors may play a key role in instances where the interests of management, the company, and its shareholders may deviate, such as executive remuneration, take-over defenses, large acquisitions, audit functions and changes of corporate control."

King III states that in contrast to SARS, that there are two types of Non-Executive Directors, those that are independent and those that aren't. It is therefore a misnomer, according to King III, to suggest that all non-executive directors are independent. It can be safely assumed that all non-executive directors that aren't independent in terms of King III cannot be independent contractors even though they do not meet the requirements of a common law employee and the deeming statutory provisions.

The Institute of Directors in Southern Africa, 2016, *The King IV Report on Corporate Governance for South Africa ('*King IV'), pp. 13-51, LexisNexis Publishers, South Africa, opines that, "Principle 7(27) of the King IV Report on Corporate Governance (2016:51) distinguishes between a non-executive and independent non-executive director by defining and categorising an independent non-executive director as follows: 'Non-executive members of the governing body may be categorized by the governing body as independent if it concludes that there is no interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making in the best interest of the organization."

The report further emphatically defines independence as follows: "… means the exercise of objective, unfettered judgement. When used as the measure by which to judge the appearance of independence, or to categorise a non-executive member of the governing [director] or its committee as independent, it means the absence of an interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making." It emphasizes that 'Having members of the governing body who are independent in appearance is an essential element in most governance codes." It further contextualized the relevance of independence, namely that, "All members of the governing body, whether they categorized as executive, non-executive or independent non-executive have, as a matter of law, a duty to act with independence of mind in the best interest of the organisation. Although important, independence in appearance is but one consideration in achieving balance in the composition of the governing body."

King IV contended that a director is independent when a conflict of interest is absent and went further to define a 'conflict of interest' in this manner: "A conflict of interest, used in relation to members of the governing body and its committees, occurs when there is a direct or indirect conflict, in fact or in appearance, between the interest of such member and that of the organization. It applies to financial, economic and other interests in any opportunity from which the organization may benefit, as well as use of the property of the organization, including formation. It also applies to the members related parties holding such interest."

Deloitte (2013), confirms that King III defines an independent director as follows: "In essence, an independent director is a non-executive director who:

> • is not a representative of a shareholder who has the ability to control or significantly influence management or the board;
> • does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group's total number of shares in issue;
> • does not have a direct or indirect interest in the company which is less than 5% of the group's total number of shares in issue, but is material to his or her personal wealth;
> • has not been employed by the company or the group of which it currently forms part in any executive capacity, or appointed as the designated auditor or partner in the group's external audit firm, or senior legal adviser for the preceding three financial years;
> • is not a member of the immediate family of an individual who is, or has during the preceding three financial years, been employed by the company or the group in an executive capacity;
> • is not a professional adviser to the company or the group, other than as a director;
> • is free from any business or other relationship (contractual or statutory) which could be seen by an objective outsider to interfere materially with the individual's capacity to act in an independent manner, such as being a director of a material customer of or supplier to the company; or
> • does not receive remuneration contingent upon the performance of the company."

The Companies Act 2008, Income Tax Act 1962 and the VAT Act 1991 don't define the term 'independence'. And the only reasonable conclusion that can be drawn from s 94 (4) of the Companies Act 2008 and regulation 43(4) of the regulations framed in terms of Companies Regulations of 2011, of the Companies Act 2008, through deductive reasoning, is that those directors who are not responsible for the day-to-day management of the company's operations are by default independent and characterized as non-executive directors. It is, therefore, reasonable to conclude that most requirements by King III for a non-executive director to be independent aren't shared with the Income Tax Act 1962, Companies Act 2008 nor the VAT Act 1991.

It is highly probable that non-executive directors could for an example hold a direct equity interest, represent a shareholder, or hold significant sway or influence in the day-to-day management of the company. These same directors will not fit the independence criteria required by King III, but by merely not being involved in the day-to-day management of the company, will be characterized as non-executive and independent in terms of the Income Tax Act 1962 and Companies Act 2008. Accordingly, what is independence in terms of King III is totally contradictory in terms of the Income Tax Act 1962 and Companies Act 2008.

The term 'independence' is defined in The Collins English Dictionary, 2000, 5 ed, p. 510, Harper Collins Publishers Limited, London. as "someone's independence is the fact that they don't rely on other people." Is the director independent from the company or from the management of the company? Notable a director will always rely on the company for settlement of payments due for the services rendered. It is questionable that he is wholly dependent on the company's management to perform his duties. The authors of Deloitte (2013), affirmed that, "… executive directors carry an added responsibility. They are entrusted with ensuring that the information laid before the board by management is an accurate reflection of their understanding of the affairs of the company."

It is reasonable to assume that non-executive directors are dependent on the quality of information from executive directors to be able to perform their functions based on the assertion above. There is some level of reliance and whether this dependence is material, doesn't fall within the scope of this inquiry, but it is obvious it exists.

If the director is only independent from the company's management, then the opposite is true that he is not independent from the company itself because he relies on the company to settle his bills. If that be the case, then he is susceptible to undue influence and bias from the company as intimated by King III and therefore cannot be referred to as independent. Based on this assertion, it is then highly unlikely that executive and non-executive directors can be independent from the company including those referred to as independent non-executive directors by King III.

In terms of IN 17, "… (What about independence from the person 'by whom payment is made' and 'to whom the service has been rendered'. What about independence from operating mainly at the premises 'by whom payment is made' or 'to whom the service has been rendered'?)". The central feature is independence and what is perceived as 'independence' is sometimes different according to the law and other different institutions. The JSE (2007) agrees with King IV on what is required to be independent: "non-executive members of the governing body may be categorized by the governing body as independent if it concludes that there is no interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making."

Does the following negate independence: Non-executive directors holding shares in the equity of the company (bias and conflict); Non-executive directors dependent on the executive management of the company to provide them with accurate and valid information in order to proffer opinions and lent their expertise (control); And what if the non-executive directors are economically dependent on the board fees they receive because this is the only directorship which they participate in (personal interest). Would we still consider them as independent? In agreement with King III some of the non-executive directors are independent and some aren't and therefore the provision cannot be generally applied, each case should be treated differently.

Chapter 4: The difference between an independent contractor and employee

4.1 The complexities between employee and independent contractor

The advent of civilisation has brought with changes in the manner people and countries interacted with one another socially, economically and otherwise. Over time these changes have evolved and today we refer to globalization as a euphemism for civilization. Its effects are no different, and continue to have some profound effect on trade, structure of economic entities and the labour market. The environment is fluid and these changes have polarized current discussions and complexities regarding the difference between an employee and an independent contractor. de Koker & Williams (2021) confirms that, what, it may be asked, is the significance of distinguishing between an employee and an independent contractor for tax purposes? First, the employer who becomes liable to pay an amount of remuneration to an employee must, unless the Commissioner has granted authority to the contrary, deduct or withhold from that amount the appropriate amount of employees' tax and pay it over to the Commissioner.

The search for the elusive distinction between the two concepts is as old as time itself. Kasuso, T. G., in his thesis "the definition of an employee under labour legislation: an elusive concept" (unpublished LLM thesis University of South Africa 2015) stated that, "Early definitions of employee did not exclude independent contractors. An employee though not defined in terms of contract was being contrasted with an independent contractor. This development started in the early 1930's when courts relied on the control test in distinguishing an employee from an independent contractor. This resulted in the development of an incoherent jurisprudence on the interpretation of the statutory definition of employee."

The difference between an independent contractor and employee is one of the most complex areas to discern, whether in practice, commercially or in fiscal matters. Mills S.W., 2004, 'The Situation of the Elusive Independent Contractor and Other Forms of Atypical Employment in South Africa: Balancing Equity and Flexibility', *Industrial Law Journal,* 1203-1235, confirms this state of affairs and asserts that, "Academics and labour lawyers internationally recognised this trend towards an increase in the forms of employment which fall outside the traditional paradigm of full-time employment of indefinite duration premised on the contract of employment… This has resulted in the fragmentation of contemporary labour markets and a consequent proliferation of labour patterns."

The distinction and its complexities are much more pronounced in both statutory and common law where most practitioners, experts, commentators seek some form of relief. It is a known secret, that these contradictions are not only prevalent in the labour market but permeated both our statutory and common law. Benjamin P., 2004, 'An Accident of History: Who Is (and Who should be) an Employee under South African Labour Laws', *Industrial Law Journal,* 788-804, confirmed these observations and has argued that the jurisprudential basis for identifying reality of an employment relationship in our law remains unclear. Our courts have for a very long time grappled with this question and it can be argued today, that neither statutory nor common law has provided sufficient evidence to put this gnawing dichotomy to bed. Slater, H. J., in his thesis "The distinction between a contract of employment and a contract with an independent contractor" (unpublished LLM thesis University of Port Elizabeth 2001) concurred with this observation that this is one of the most problematic areas in our jurisprudence and stated that although seeming to be a relatively simple question, distinguishing between an employee and other persons performing work has resulted in a surprising amount of difficulty.

The courts have always been faced with the question of making a distinction between an 'employee' and an 'independent contractor.' The learned Nugent J in the *Niselow v Liberty Life Association of Africa Ltd* (1998) 19 ILJ 752 (SCA) case said: "An independent contractor undertakes the performance of certain specified work or in production of certain result. An employee at common law, on the other hand, undertakes to render personal services to an employer. In the former case it is the product of or the result of the labour which is the object of a contract and in the later the labour as such is the object."

Notably, there is a body of statutes that defines the concept of 'employee' and since time immemorial this concept has evolved but the central tenets defining the term have remained traditionally static with little changes to respond to the contradictions and nuances of our current times. There has been numerous attempts to define the term 'employee' which have been used throughout time - but the endeavour to specifically define independent contractor has been fraught with ambiguities and no general consensus has been attained. Swart N.P. & Ozoo E., 2016, 'The dichotomy between an Employee (Location Operarum) and Independent Contractor (Conductio Operis) for Purposes of Liability in Law of Delict: An Analysis', *Journal of Scientific Research & Reports* 9(5), 1-13, "maintains that in legal literature no specific definition for an independent contractor has been established."

Historically the 'Law of Master & Servant', defined an employee relationship as an implied contractual relation in which one party agreed to be under the control of the other in the same manner that the servant is bound to obey orders not only as to the work that he would execute but also as to the details of the work and the manner of its execution. In return, the master had to pay a wage and grant certain minimum conditions for the protection of the worker. In the case of *De Beer v Thompson and Son* 1918 TPD 70 it was confirmed that, it was for this reason that the relationship between employer and employee was always referred to as that of a master and servant. In the past the employer/employee relationships were traditionally governed by the law of property and this was the lodestar that defined the landlord/tenant relationship.

A simpler definition was expressed by Davis JA in *State Information Technology Agency (SITA) (Pty) Ltd v Commission for Conciliation, Mediation and Arbitration & others* (2008) 29 ILJ 2234 (LAC) in his reference to, "André van Niekerk, 2005 (26) ILJ 1094, "who in turn refers to a most comprehensive and thoughtful analysis by Paul Benjamin (2004:787). Benjamin's contention is that the *Denel* judgment is congruent with Section 213 of the Labour Relations Act 1995 which *inter alia* defines an employee as any other person who in any manner assists in carrying on or conducting the business of an employer"." This definition by the court in the *Denel* case is at best no more different to the ubiquitous definition of 'employee' accorded the concept by the law of Master and Servant.

The authors, de Koker & Williams (2021) notably asserted that, "the perceived wisdom is that an employee is a person in the service of another under a contract of hire, express or implied, oral or written, where the employer has the power to control and direct the employee in the material details of how the work is to be performed, and a duty rests on the employee to carry out that work in accordance with the instructions of the employee. The corollary is true that, in the absence of control of the day-to-day responsibilities by the employer – it is inalienable that the purveyor of labour skills is an independent contractor not an employee as defined." This contention doesn't in any manner, shape or form make the distinction clearer and still leaves us farther from solving this perennial problem. In practice, it is often difficult to decide whether the person remunerated is being remunerated as an employee or in the course of an independent trade.

There is no attempt to appropriate a direct definition of the concept of 'independent contractor', other than some elimination of certain characteristics from the term 'employee'. de Koker & Williams (2001) go to substantive lengths to shed light on the term employee but invariably concedes that this definition substantively excludes that of an independent contractor. He goes further to shed light on some of the characteristics of an employee in the context of a board, and concludes that, “a director who receives a salary for the day-to-day running of a business, as distinct from fees received in his capacity as a director, is an ‘employee’. In contrast, the conclusion is that the one director who is not in receipt of a salary for the day-to-day operations of the company qualifies for an ‘independent contractor.”

Most literary authors, commentators and jurists try through inductive reasoning to extricate the definition of ‘independent contractor’ from that of an ‘employee’. This manner of attempting to solve this puzzle has been ubiquitously applied through both our statutory and common law. Zondo J in the *Medical Association of SA and Others v Minister of Health and Another* [1997] 18 *ILJ* 528 (LC) 533 case added his voice to this milieu, “To define the word ‘employee’ in such a way that it is easy to make the distinction between an employee and an independent contractor or to put it differently to make a distinction between a contract of service and a contract of work is one of the most difficult questions which the courts have grappled with in decades.”

In essence under common law the definition of employee excludes that of an independent contractor. The definition of employee in section 213 excludes independent contractors from its ambit. In agreement with the narrative above, that it is only by excluding the ‘employee’ from a set of defining factors that we find some definition of the elusive ‘independent contractor’, Kasuso (2015) asserts that the concept of an employee must be seen in contrast to that of an independent contractor. SARS in IN 17 further affirms that, “An independent contractor must be distinguished from its counterpart, the employee. Legally, the two terms (independent contractor and employee) are mutually exclusive and are direct opposites.”

Conradie et al (2006), distinguish between an employee and an independent contractor in the following way: An employee is someone who “works for a single employer in a permanent, full-time capacity, is subject to the supervision of the employer, receives regular monthly or weekly remuneration, and is obliged to place his/her full productive capacity at the disposal of the employer”. By contrast the independent contractor “usually performs a discrete service for a fee, does not work for a single ‘employer’, and is not expected to be at the employer’s beck and call”.

SARS in BGR 41 concluded that, directors fees aren’t ‘remuneration’ as defined and therefore non-executive directors should be treated as independent contractors and their fees be subjected to VAT.

SARS reasoning is that non-executive directors perform services personally and independently, and any director's fees paid or payable for services rendered are therefore not regarded as 'remuneration'. Notably, SARS argues further that, independent non-executive directors don't receive remuneration as defined and are therefore treated or are invariably defined as independent contractors. This conclusion is supported for fiscal purposes but hasn't been able to provide a defining or litmus test with regards the definition of the term 'independent contract'.

It is however critical for fiscal reasons that there is some agreement on the best manner that this distinction can be fairly articulated and applied in a manner that is fair, effective and reasonable - to ensure that any manner of liability arising from these conceptions achieves some level of equity for taxpayers and the SARS. The journey to understanding these terminologies, which lent a myriad of problems to our jurisprudence and day to day societal interactions has been arduous and hasn't been without contradictions.

4.2 Locatio conductio

The Latin words used in our jurisprudence to refer to these critical terms are as follows: an employee is called '*locatio conductio operarum*' and an independent contract is in turn referred to as '*locatio conductio operis*'. To get to some meaningful conclusion we look to both statutory and common law in the determination of the difference between an 'employee' and 'independent contract'. SARS: Legal Counsel, 2019, *Interpretation Note 17 (Issue 5), Employees Tax: Independent Contractors ('IN 17'),* Govt. Printer, Pretoria, states that, "South African law traditionally refers to the independent contractor contract as a contract of '*locatio conductio operis'* and Roman labour law used the term '*locatio conductio'* to include two types of transactions, namely:

> (ii) *locatio conductio operarum*, which is the letting and hiring of **services** (the master/servant or employer-employee contract); or
> (iii) *locatio conductio operis*, which is the letting and hiring of **work** (independent contractor contract)."

In the *Colonial Mutual Life Assurance Society v MacDonald* 1931 (1) A.D. 412 case the presence of the employer's right of supervision and control over the employee is an indispensable requirement for the existence of a contract of service (locatio operarum) as distinct from a contract of work (independent contractor) (conductio operis). The greater the degree of independence from such supervision and control the stronger the probability will be that it is a contract of work. The tests haven't been conclusive and have come under heavy criticism from the judiciary and industry commentators as well. The common denominator between the two conceptions is that a contract should be present, whether written or otherwise. It is essential that there should be an agreement between two or more parties making certain promises to each other, that are enforceable in law. A contract is a legally enforceable promise, or, as defined in Garner, A.B., 2016, *Black's Law Dictionary*, 5th edn, Thomson Reuters, London, as an "agreement between two or more persons which creates an obligation to do or not to do a particular thing." Others have argued that a contract should at least be characterized by the following elements: mutual assent, expressed by a valid offer and acceptance, adequate consideration, capacity and legality. The laws of contract are not within the scope of this thesis, but our concern is the impact of a contract on the terms '*locatio conductio operarum*' and '*locatio conductio operis*'.

4.3 Locatio conductio operarum

The '*location conductio operarum*', is a contract for the letting and hiring of services, in other words a contract of employment. Basson, A., Christianson, M., Garbers, C., Le Roux, P.A.K., Mischke, C. & Strydom, E.M.L., 1998, *Essential Labour Law Volume 1: Individual Labour Law*, vol. 1, p. 24, Labour Law Publications, Groenkloof, concurred that the definition of a contract of employment remains by and large just a rudimentary agreement between two parties in terms of which one party (the employee) places labour potential at the disposal and under the control of the other party (the employer) in exchange for some form of remuneration.

SARS in IN 17 substantively characterizes a contract **of** service as "a bilateral, consensual contract between two parties agreeing typically to at least two things, namely, the services to be rendered and the remuneration to be paid. The employer (in this case the *conductio,* that roughly means "the controller" or the one who brings together) could avail him or herself of the *actio conducti* to enforce due performance of the services promised, while the employee (in this case the *locator*, that roughly means "the person placing or locating his or her productive capacity in the market" or "for making his or her services available") can rely on the *actio locati* to enforce payment of the promised remuneration." Basson et al (1998:19) defines it as a consensual contract in terms of which a free men (*liberi*) agreed to let his personal services (*oparae suae*) to another person (*conductor operarum*) for a certain period, in exchange for remuneration. It is patently clear that the employer has a right to enforce performance and an obligation to remunerate the employee for the services rendered. The employee in turn has an obligation to provide services in accordance with the employer's terms and a right to claim payment for the performance. What is patently absent in this definition is the condition that such an agreement between these parties should be evidenced by a signed written contract. The court in the *Ingwane v Med-Afrique* [1997] 2 BLLR 210 (CCMA) determined that "no written contract was necessary. A contract was concluded as soon as both parties agreed to the essential requirements."

The character of an employment contract is not carved in stone, but the minimum requirements of a legal contract should at least form the basis of such a contract without any material deviations. A number of authors have over time looked at different factors which could be the convention of such a contract, in particular, Grogan, J., 2011, *Workplace Law*, 13th edn, p. 21, Juta Law Book, Johannesburg, who averred that the following should at least be considered:

> "1. Voluntarism. For the agreement to be valid there can be no compulsion to enter into (Basic Conditions of Employment Act, s 48) or be taken into employment… Jordaan cautions against a blind acceptance of voluntarism and freedom of contract "… particularly today when so much of the content of that relationship is governed by statute. Whatever voluntarism may formally exist at the inception of the relationship, the employee has little, if any, control over the substance of the relationship with the employer."
>
> 2. Legal *personae.* Two parties must enter into the agreement, one being the employee and the other the employer.
>
> 3. Time frame. The agreement can either be for an indefinite or fixed period.
>
> 4. Subjugation. ("To bring under the yoke; to force to submit" - Collins English Dictionary. Although this term appears to be harsh, it is used as a result of the so-called imbalance in bargaining power between the parties. The assumption is made that the employer enjoys a power advantage). The labour potential of the employee is placed at the disposal of and under the control of the employer. This implies that the employee must perform the services personally. The employer obtains the right to determine the manner in which the employee will do his/her work.
>
> 5. Remuneration. The employer pays a determinable amount in exchange for the labour potential. This amount can be in the form of cash or a combination of cash and kind."

In *Yewens v Noake 1881 (6) QBD 530,* Bramwell LJ stated: "A Servant is a person subject to the command of his master as to the manner in which he shall do his work." In the past, if an employer was able to tell an employee not only what to do, but stipulate how to do it and when, then this would indicate a contract of employment existed, whereas a smaller degree of control would point towards self-employment. This contention is congruent with the conditions of subjugation raised by Grogan (2011) as one of the conditions that should be considered in the definition of an employee.

The courts have considered some indicia which should be further considered, for an example in the United Kingdom case *J W Henderson Ltd v Short* 1946, the presiding judicial authority Lord Thankerton reduced the definition of 'employee' to what had been called the four indicia of a 'contract of service', namely (a) the master's power of selection of his servant, (b) the payment of wages or other remuneration, (c) the master's right to control the method of doing the work, and (d) the master's right of suspension or dismissal.

4.4 Locatio conductio operis

The '*locatio conductio operis'* contract differs fundamentally to the' *locatio conductio operarum*' in that the operative words are 'work' and 'service', respectively. The '*locatio conductio operis*' is a contract of work not service. The primary object of the contract is that the parties have agreed on the performance of certain work and the related remuneration is only honored when the said work is performed or completed to the satisfaction of the party paying. The characteristics of an employment contract as suggested by Grogan (2011) could still apply subject to certain deviations. The element of 'subjugation' could be minimized or removed all together depending on the type of work, which could sometimes be highly technical and only understood by the provider – this will make supervision and control difficult at least. In addition, the remuneration is directly linked to the work performed by the one party to the satisfaction of the paying party. The object of the relationship is the conclusion of certain work to the exclusion of any services that could or may have been performed.

The work not the services provided is of primary importance in the determination of an independent contractor. SARS in IN 17 concluded that, "The term '*locatio conductio operis'* (contract for work or service, that is, the independent contractor), on the other hand, under Roman law, constituted a contract in terms of which it was not the services as such that were the object of the contract, but the result as a whole… The decisive feature of contracts for work or services under Roman law was that the customer was not interested in the personal services or the labour (productive capacity) as such, but in the finished product or result of labour… In other words, the *conductor* is responsible for the success of the work. He or she has to face the problem of liability for defects under the contract of work. He or she, generally, would not be under the control and supervision of the *locator* (the customer or client)."

4.5 Conclusion

The elusive conception of the distinction between employee and independent contractor has lent perennial complications in endeavours to resolve labour and fiscal matters. This has led to a chorus of industry experts, writers and leaders embracing some view that "the problem is not in the definition of employee but the manner in which it has been interpreted by the courts." (Kasuso 2015). It could be added that the problems are not only in the interpretation of the statutes alone, but text and context of the definitions lead to ambiguities as well – in earnest the fault-lines lie squarely in both statutory and common law as well.

It is suggested that each case must be investigated separately to determine the status (employee or independent contractor), and a blanket principle cannot be embraced solely from the fact that an individual is referred to as an independent contractor. Swart and Ozoo (2016) concluded that the fact that an agreement is labelled "Independent Contractor: Memorandum of Agreement," does not necessarily mean that is the substance of the contract. It is the relationship between the parties as revealed by the contract which is decisive. In the case of Molahlehi AJ in *Linda Erasmus Property Enterprises (Pty) Ltd v Lucky Mhlongo & others* [2007] 6 BLLR 530 (LC) found that, "when a court or other dispute resolution bodies are called upon to decide whether a person is an employee or not, they are enjoined to determine the true and real position between the parties. In this regard, the issue is not exclusively decided on what the parties have decided to call their relationship. In other words, the designation of the position is not conclusive of the nature of the relationship. This on its own adds to the complexities and makes the work of the courts more difficult, in addition there are no discernable standards that are ubiquitous and applicable in all situations that requires an answer to the employee/independent contractor dilemma.

All in all, it is doubtful whether this Note (SARS: Legal Counsel, (2019), 'Interpretation Note 17 (Issue 5), Employee's tax: Independent Contractors') will be particularly helpful in distinguishing independent contractors from employees, especially when employers have to cope with formidable concepts such as labour brokers and personal service providers. The contention is made more difficult by the fact that interpretation notes by their nature do not have legal force and aren't binding on the taxpayer and the courts. The distinction between independent contractors and so-called employment companies, as a matter of practical reality, is murky, and service providers often fall within a grey area, being neither employees *strictu sensu* nor independent contractors, notwithstanding that for all other purposes they are not employees of the person paying them. The Note ends by reiterating that the responsibility rests on the person paying the remuneration to decide whether the recipient is an independent contractor or not. (de Koker & Williams 2021)

Chapter 5: Common law principles

5.1 Employment relationship

The Income Tax Act 1962 has given a substantive definition of the term ‘employee’ together with all the exclusionary provisions. However, we need to pursue the definition of ‘employee’ further from the statutory connotations that we derived from the Income Tax Act 1962 and the presumptions in the Labour Relations Act 1995. In terms of the Income Tax Act 1962, an employee is any person who receives remuneration or to whom remuneration accrues from an employer. It is critical that there is some form of relationship between the employer and employee, that requires the employee to perform some form of agreed service for a certain amount of remuneration, agreed to between the parties.

The Income Tax Act 1962 in para I of the Fourth Schedule defines an employer as, “any person (excluding any person not acting as a principal, but including any person acting in a fiduciary capacity…)… who pays or is liable to pay to any person any amount by way of remuneration, and person responsible for the payment of any amount by way of remuneration to any person under the provision of any law or out of public funds…” de Koker & Williams (2021) extends the enquiry further, through probing the question whether remuneration has been received ‘in respect of’ services rendered by the taxpayer, will depend on whether or not there is, as a matter of law, the necessary causal link with the services rendered or to be rendered and the receipt or accrual of the remuneration; and, crucially, whether or not there is the necessary relationship between an ‘employer’ and his ‘employee’.

It is however true that in contrast, the absence of a causal link that results in the payment of remuneration based on the fact that one party is employed for wages or a salary to perform continuous daily work for another party, subject to this party’s overall direction on the policy to be followed – fails to make this an employer/employee relationship. In fact, this situation suggests that where there is no degree of control or supervision present - the trade is possibly carried on independently by the service provider as an independent contractor.

In the *Van Zyl v WCPA Department of Transport* (2004) 25 *ILJ* 2060 the court concluded that, “in applying the presumption, the nature of the relationship must be considered in its entirety to assess whether parties in fact entered into an employment relationship.” This is a confirmation that in further determining the concept of employee, there is a need to not only consider the employment contract but expand the enquiry to analysing the existence of an employment relationship. The convention is confirmed by Le Roux R, 2007, 'The Worker: Towards Labour Laws New Vocabulary', 124 *SALJ* 469, 472-3 in it is stated that, "emphasis should be on the existence of an employment relationship as opposed to the existence of a valid contract of employment."

In *SA Broadcasting Corporation v Mckenzie* (1999) 20 ILJ 585 (LAC) the court concluded that, "The legal relationship between the parties must be gathered primarily from a construction of the contract which they concluded… although the parties' own perception of their relationship and the manner in which the contract is carried out in practice may, in areas not covered by the strict terms of the contract, assist in determining the relationship... In seeking to discover the true relationship between the parties, the court must have regard to the realities of the relationship and not regard itself as bound by what they have chosen to call it…"

The court in the *Denel* case concurred with the judgement in the *SA Broadcasting Corporation* case, the court should discover the true relationship between the parties and contended that, "In this regard it is important to bear in mind that a contract between any two persons may represent form and not substance or may not reflect the realities of a relationship…". Zondo JP went further and averred that, "When a court or other tribunal is called upon to decide whether a person is another's employee or not, it is enjoined to determine the true and real position. Accordingly, it ought not to decide such a matter exclusively on the basis of what the parties have chosen to say in their agreement for it might be convenient to both parties to leave out of the agreement some important and material matter or not to reflect the true position."

5.2 Control & supervision

The courts in their interpretation of the law have looked to a battery of tests to assist with finding the distinction or defining what an independent contractor is. In the initial rulings the control or supervision test has been the most favoured by our courts. These tests have been recognized by our legislation as conclusive as confirmed by IN 17, SARS states that, "the Legislator has, however, under its powers elevated two of these tests to form conclusive tests. These conclusive tests are referred to as statutory tests. Should any one of these conclusive tests apply, the exclusion from "remuneration" does not apply". The tests are referred to as the 'premises' and 'control or supervision' tests. The application of these tests by our courts was confirmed by Basson J in *Mandla v Lad Brokers (Pty) Ltd* (2000) 21 ILJ 1807 (LC) at para

8 that, “The greater the degree of supervision and control to be exercised by the employer over the employee the stronger the probability will be that it is a contract of service.” The court contended in Smit vs Workmen's Compensation Commissioner 1979 (1) SA 51(A) at 62DG that, “it had been held that the right to supervision and control was one of the most important indicia that a particular contract is in all probability a contract of service (employment contract)”.

The *Protect A Partner* case the learned judge concluded that, “… the element of control will be important. Traditionally, this element is determined by enquiring who makes the decision about what is to be done, the way in which it is to be done, the manner or the means by which it is to be done and/or the time when it is to be done? In addition, questions must be asked about who hires and fires the persons who must perform what is to be done, and who provides the material, the equipment or the tools to be used in performing what is to be done? These questions are, in the context of the control element, easy to answer in respect of employees who are either unskilled or semi-skilled precisely because such employees fit neatly into the typical master-servant relationship…”

In the Scottish case of *Short at* 233 Lord Thankerton recognizes the ‘control or supervision test’ and expands the test by what he refers to as the four *indicia* of a contract of service, namely (*a*) the master’s power of selection of his servant, (*b*) the payment of wages or other remuneration, (*c*) the master’s right to control the method of doing the work, and (*d*) the master’s right of suspension or dismissal. Joubert JA in the *Smit case further* rejected the crude “control” test, stating that the employer’s right of supervision and control is merely one out of several indicators (albeit an important one) in favour of a contract of service (an employee contract). In the main the absence of the element of control will characterize the party as an independent contractor.

The inquiry is made more difficult when looking at skilled workers and whether the employer exercises some form of control, and whether such control can be easily identifiable. At best the inquiry should be broadened and other factors should be considered. In the *Protect A Partner* case the difficulty of treating skilled workers with regards the ‘control or supervision test’ presented a number of difficulties and the court held that, “In the context of skilled or expert employees, the element of control may not be decisive precisely because the employer may be less skilled or less experienced than the skilled employee and may not have the appropriate skill or discretion to decide how the work should be done.” In *Lane v Shire Roofing company (Oxford) Limited* [1995] IR LR 493 (CA), the court held that, “… the element of control will be important: …it is recognized that the control test may not be decisive – for instance, in the case of skilled employee, with no discretion to decide how their work should be done. In such cases the question is broadened to ask whose business, was it? Was the workman carrying on his own business or was he carrying on that of his employers? It is another example of the test of “who had control over how the work was to be done?” being very important in assessing whether there was an employment relationship or whether the person doing the work was self-employed.”

This complexity importantly requires a different response, but it is an element that has been with our courts for some time. Consequently, it is congruent with the contention that the test itself is not the be-all and end-all. This assertion concurs with Joubert JA in the *Smit* case that this test is just but one of the tests and there are more indicators that courts should consider in their determination. This contention has been shared by Grogan (2011), who attacked the control test – and this led to the control element becoming just one of the factors to be considered in the dominant impression test not the extolled panacea.

5.3 Dominant Impression Test

It has been averred by Swart and Ozoo (2016), that the organisation test suggests that the control test is difficult to apply in all cases and is unrealistic. The multiple or dominant impression test criticised the supervisory and control test by stating that the latter test is merely one of the criteria to be considered, but it is not the dominant criterion. For an example in the *Motor Industry Bargaining Council v Mac- Rites Panel Beaters & Spray Painters (Pty) Ltd* 2001 (2) SA 1161 (N) case, the court indicated that the nature of the relationship between the parties must be determined by the terms of the contract between the parties and from the factual circumstances in which the work is performed. Therefore, the present contract and the evidence must be tested against the key elements of a contract of service and a contract of work. The tests are not always conclusive, and the court must look further into the contractual relationship of the parties involved.

In the *Stein v Rising Tide Productions CC* (2002) 23 ILJ 2017 (C) case at 2024 Van Heerden J averred that, “Problems experienced by the South African courts in the application of this control test for determining a master-servant relationship ultimately resulted in the courts acknowledging that, although the control test is an important factor in the enquiry, the crucial test, particularly in marginal cases, is whether or not the 'dominant impression' of the relationship is that of a contract of employment…” This contention has been independently supported by de Koker & Williams (2021) – and he concluded as follows: “the common law tests as they apply in South Africa do not permit a simple 'checklist' approach and there are no hard-and-fast rules in determining whether or not a person qualifies as an independent contractor. Thus an 'overall' or 'dominant impression' of the employment relationship must be formed. The common law position is that the so-called 'Dominant Impression Test' must be applied to determine whether a person qualifies as an independent contractor or an employee."

SARS in IN 17 asserts that, "In order to determine whether a person is carrying on a trade independent of the person to whom services are rendered and from whom payment is received, the common law tests, as further developed by the South African Courts, are used. Common law prescribes the use of certain tests to form a dominant impression of a relationship. There is no conclusive test under the common law." The 'Dominant Impression Test' according to Kasuso (2015) was developed by English courts in the case of *Ready Mixed Concrete v Minister of Pensions* (1968) 2 QB 497 in which it was held that no single factor was determinative of the employment relationship and all relevant circumstances had to be considered. South African courts follows the same legal dispensation suited to the English courts. The Dominant Impression Test was developed as a hybrid test in terms of which the approach was to look at the relationship as a whole and then draw a conclusion from the entire picture.

The Dominant Impression Test has been instrumental in assisting the courts finding some generally acceptable definition of 'employee' and that of 'independent contractor' in the main. The presumptions provisioned in s 200A (1) (a) – (g) of the Labour Relations Act 1995 served as a basis for the Dominant Impression Test which is currently extensively used by our courts. Notably, it is fair to reflect that the test hasn't been without criticism from many differed quarters. For an example in the *Board Executors Ltd v McCafferty* (1997) case the court found that dominant impression include among others: The right to supervise and control, extent to which employee depends on employer for the performance of his or her work, whether the employee is allowed to work for other persons, whether he has to perform his duties personally, whether the employee is allowed to delegate or perform tasks through others, whether he is paid by commission or a wage, whether he provides his own tools, right to disciplining the worker and termination of contract and whether the employee is integrated into the organisation. The list of relevant factors is non exhaustive. …. The theme underlying the test is that no single factor can conclusively indicate the existence of a contract of employment.

Although the test has been hailed as the most important instrument in defining an 'employee' from and 'independent contractor' it hasn't been the panacea – a number of courts have struggled with the conception. In the *Medical Association of South Africa* case, Zondo AJ had found the test unsatisfactory, and its results have lent uncertainty to the current environment. In addition, he averred that, "Some of the factors taken into account are of little value in distinguishing an employee from an independent contractor and do not offer any guidance." It should be noted that he was not alone in this thinking, and others have considered that the test should be broadened to include other elements or factors which could assist the situation. The court in the *SITA* case held that, "… when a court determines the question of an employment relationship, it must work with three primary criteria: 1) An employer's right to supervision and control; 2) Whether the employee forms an integral part of the organisation with the employer; and 3) The extent to which the employee was economically dependent upon the employer. These three tests are congruent with the principles in the *Denel* judgment." More importantly the court held that the 'reality test' in the *Denel* judgement was a carefully considered and analysed criteria by Zondo JP, and its jurisprudence has been embraced, in its essence by distinguished South African legal commentators.

Gaibie AJ contends in the *Protect A Partner* case that, "Benjamin clearly indicates that it is not necessary to establish the existence of all three criteria for the purposes of deciding whether an employment relationship exists. In this regard, he makes the following proposal: "It is suggested that the presence of any of these should, in normal circumstances, indicate that the person is an employee."

Other courts have expanded the factors to be included beyond the judgements of the *SITA* and *Protect A Partner* cases. This is more a reflection of the difficulties that courts are faced with and how narrow the current tools are. The response from our courts, practitioners including commentators is that the tests should be expanded and widened to find some acceptable solutions to this dilemma. In the *Market Investigations v Minister of Social Security* [1969] 2 QB 173 (HC) court case, Cooke J said: "The fundamental test to be applied is this: "Is the person who has engaged himself to perform these services performing them as a person in business on his own account?" If the answer to that question is 'yes', then, the contract is not a contract for service. If the answer is 'no', then, the contract is a contract of service… and that factors which may be of importance are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task."

The criticism levelled against the Dominant Impression Test doesn't in any manner shape or form suggests that 'control' is totally liquidated as one of its factors. In fact, the only issue is that as a determinant, the test will not achieve the expected outcomes. The court further asserted in the *Market Investigations* case that, "The most that can be said is that control will no doubt always have to be considered although it can no longer be regarded as the sole determining factor." The assertion mentioned is supported by a scholars and different judgements. In the *Protect A Partner* case the court concluded that, "…Whilst it is settled law that some form of control is necessary for an employment relationship to exist, the exact nature, form or extent of control required in any particular case is less clear." The court in the *Stein* case concurred with the assertion and Van Heerden J further held that, ".... notwithstanding its importance the fact remains that the presence of such a right of supervision and control is not the sole indicium but merely one of the indicia, albeit an important one, and that there may also be other important indicia".

5.4 Organisation test

Different courts have looked at different indicia to support their judgements and one indicium has been the parties proximity to the organization of the other party. In fact, in some court judgements or text from expert opinions, the words 'integration', 'contractually employed' have been used as synonyms, to define the parties relationship with the other parties organization. In the *Protect A Partner* case the learned Judge held that, "An employee does not form part of the organisation simply because he or she performs the same services or tasks as other employees in the organisation or because she does not do so on a fulltime basis…" According to Benjamin (2004), "...integration into the employer's organization is now a factor that may be taken into account in cases in which the conventional aspect of control and supervision are not present".

In the case of *Stevenson, Jordan and Harrison Ltd v McDonald and Evans* [1952] 1 TLR 101 at 11 Lord Denning alluded to the 'organisation' test in his endeavour to draw a distinction between an 'employee' and 'independent contractor' – he emphatically found as follows: "One feature which seems to run through the instances is that under a contract of service, a man is employed as part of the business, and his work is done as an integral part of the business, whereas under a contract for services, his work, although done for the business is not integrated into it but is only accessory to it."

Although helpful, the integration referred to is subject to some measure or degree of combining or incorporation, but the courts haven't been able to give some indication of what that measure is or should be. The test has come under criticism precisely because of the difficulty to determine the degree of integration of the one party to the other party's organization. In the *Smit* case Joubert JA reflected on the effectiveness and usefulness of the test and contended that in its current form the test was "juristically speaking of such a vague and nebulous nature that, more often than not, no useful assistance could be derived from it". He was not alone in this resolve, because some courts and commentators have found that it is therefore possible that the worker forms an integral part of the firm with little or no control over the performance of the work. Because of the difficulty in determining/measuring the degree of integration required to determine that the person is an employee or not, this test has been rejected. (Kasuso 2015).

5.5 Economic dependence

In the practical world both the private and public sector provide employment/work opportunities to people for the purposes of production and earning of economic benefits. The employers will in turn remunerate the employment/work with financial or economic benefits. It is therefore a fact of life that employees and independent contractors are to a large or some extent dependent on their employers for their economic well-being. However, the extent of the dependence is subject to some level of degree or measure – some could be partially dependent and some wholly dependent. It is a misnomer to contend that an independent contractor wouldn't necessarily be economically dependent on the party they are providing services to – They are, to the extent that they employ other resources to perform the work, and in turn these resources are acquired with financial resources, that the independent contractor should claim from the principal. In fact, both employee and independent contractor expect some form of economic return for their services – the only proviso is that one is wholly and the other is partially dependent on this economic resource. This indicium has been considered by our courts to explain or find the elusive distinction of employee/independent contractor.

In Conradie et al (2006) the authors asserted that, "The independent contractor differs from an employee on the basis that he/she contributes both personal labour and capital to the employment relationship. In contrast the employee only contributes a labour component." This contribution can be construed as economic in nature because in essence the labour is a cost that should be defrayed by whoever carries the contractual liability to honour it. Capital is by its nature a resource that could be in the form of money or some form of contribution in the form of assets – it is economic as well.

Benjamin (2004) takes a different view in that he argues that “A genuinely self-employed person is not economically dependent on their employer because he or she retains the capacity to contract with others. Economic dependence therefore relates to the entrepreneurial position of the person in the marketplace. An important indicator that a person is not dependent economically is that he or she is entitled to offer skills or services to persons other than his or her employer. The fact that a person is required by contract to only provide services for a single “client” is a very strong indication of economic dependence. Likewise, depending upon an employer or the supply of work is a significant indicator of economic dependence”. In fact, his argument is that if a worker has access to multiple employment that all offers to remunerate him for his services, then he is not dependent on any one of the employers, and therefore by this definition he is an independent contractor. The corollary is that he could be dependent to all of them for his economic well-being, does that make him an employee or independent contractor.

Benjamin (2004) further articulates that if you only provide services to only one client then you are economically dependent. In his view, you can’t have an independent contractor who only provides services to one client. He was supported in this contention by Conradie et al (2006:56) who argued that “should a worker be economically dependent on a single entity, they should generally be considered as employees.” There are a large number of people that are employed by more than one employer or they provide work for more than one entity. If we take Benjamin (2004) and Conradie et al (2006) assertions into consideration, do we consider or characterized this employee as an ‘independent contractor’?

5.6 Risk & loss test

The courts further looked at the economic investments made by the ‘employee’ or ‘independent contractors’ in the relationship and the susceptibility of the investment to risk and loss. It is argued by the courts that an independent contractor is most likely to invest resources into the arrangement - which could be at risk in terms of wear n tear or damage to the assets, in addition, the venture could make a loss - where costs incurred surpass revenue received. It is highly unlikely that an employee could be affected by such conditions. It could be argued that employees are exposed to some level of risk at their workplace, but they still are not susceptible to financial losses and in addition they are remunerated for services rendered not work done. This argument or inclusion of risk & loss as an indicum is more pronounced in the foreign case of *Zabu v Federal Commissioner of Taxation* (1996) 33 ATB 537, where the court confirmed that ‘risk & loss’ is considered as one of the indicia, and it therefore concluded as follows: “… where a person bears the risk of loss and is paid on the basis of the results of his labour and not for the actual work or services rendered, it most probably indicates that he is in fact an independent contractor." It should be added that the court's conclusion was supported by the fact that the party affected had supplied their own equipment and where at risk of loss in the event of failure of the venture.

The court in the *Protect A Partner* concurred with the judgement in the *Zabu* case and Gaibie AJ, concluded that in "the American Supreme Court, in *United States of America v Silk* (1946) 331 UA 704, the judge asks the question whether the men where employees "as a matter of economic reality". The answer to this question may cover much of the same ground as the control test (such as whether he provides his own equipment and hires his own helpers) but may involve looking to see where the financial risk lies, and whether and how far he has an opportunity of profiting from sound management in the performance of his task."

5.7 Productive capacity

The courts further looked at the person's ability to utilize their productive capacity in a manner they deem fit or any manner that can procure the best possible outcomes – some level of free will without control or supervision in applying one's productive capacity deems the person to be an independent contractor. In the *Niselow* case the court held that, "the relationship between the parties had to be gathered from the terms of the agreement between them and endorsed the finding of the Labour Court of Appeal that Niselow remained with the power to use his productive capacity in the manner in which he saw fit in order to achieve the results which he had contracted to produce. He was, therefore, said the court, not an employee for the purpose of the Act." Invariably the court concluded that one's ability to determine the manner in which their productive capacity should be used in the relationship, automatically makes them 'independent contractors'.

5.8 Other indicia

In the *SA Broadcasting Corporation* case the court tabulated the differences between an 'employee' and 'independent contractor' and the indicia considered includes the dominant impression test and all other indicia that have been considered above and more that haven't been mentioned before. It is clear that other factors mentioned continue to widen the scope and lent more complicity to this phenomenon.

The court went further and made a distinction between a contract of employment from a contract of work as follows:

“1. The object of the contract of service is the rendering of personal services by the employee to the employer. The services are the object of the contract. The object of the contract of work is the performance of a certain specified work or the production of a certain specified result.
2. According to a contract of service the employee will typically be at the beck and call of the employer to render his personal services at the behest of the employer. The independent contractor, by way of contrast, is not obliged to perform the work himself or to produce the result himself, unless otherwise agreed upon. He may avail himself of the labour of others as assistants or employees to perform the work or to assist him in the performance of the work.
3. Services to be rendered in terms of a contract of service are at the disposal of the employer who may in his own discretion subject, of course, to questions of repudiation decide whether or not he wants to have them rendered. The independent contractor is bound to perform a certain specified work or produce a certain specified result within a time fixed by the contract of work or within a reasonable time where no time has been specified.
4. The employee is subordinate to the will of the employer. He is obliged to obey the lawful commands, orders or instructions of the employer who has the right of supervising and controlling him by prescribing to him what work he has to do as well as the manner in which it has to be done. The independent contractor, however, is notionally on a footing of equality with the employer. He is bound to produce in terms of his contract of work, not by the orders of the employer. He is not under the supervision or control of the employer. Nor is he under any obligation to obey any orders of the employer in regard to the manner in which the work is to be performed. The independent contractor is his own master.
5. A contract of service is terminated by the death of the employee whereas the death of the parties to a contract of work does not necessarily terminate it.
6. A contract of service terminates on expiration of the period of service entered into while a contract of work terminates on completion of the specified work or on production of the specified result. See Smit v Workmen's Compensation Commissioner at 61AH.”

Other authors, commentators, local and international organization have advocated for inclusion of certain other factors or considerations required by laws or other judicial authorities, including provisions of the South African Constitution (1996). Benjamin (2004:787-789), argues that, “the continued application of the traditional common law tests in distinguishing an employee from an independent contractor has resulted, “*in a situation in which boundaries of labour law are poorly defined resulting in* *a number of employees being denied protection*". It is for this reason that he advocates for a purposive and expansive interpretation of the definition which is in the line with the Constitution (Section 23 of the Constitution) and the purpose of the LRA."

National Economic Development and Labour Council established by section 2 of the National Economic, Development and Labour Council Act No. 35 of 1994 ('NEDLAC') issued a Code of Good Practice, which dealt with the rebuttable presumption of who is an employee in terms of the Labour Relations Act 1995. The code requires that when persons or juristic bodies applying or interpreting the Labour Relations Act 1995 (LRA) and/or Basic Conditions of Employment Act 1997 (BCEA) with regards the distinction between an 'employee' and 'independent contractor' considerations should be given to the requirements of this code. The court in the Cheadle AJ in *Kylie v CCMA* (2008) 29 *ILJ* 198 (LC) case held that "the Code cements the modern trend that focus is now on the nature of the employment relationship rather than its contractual form. The language of the Code implores on courts to look at the realities of the relationship between the parties since the contractual relationship may not always reflect the true relationship." In addition, the code in interpreting the presumption of employment articulated in the Labour Relations Act 1995 requires that the courts should do so in compliance with International Labour Standards of the International Labour Organisation ('ILO').

Chapter 6: Statutory law principles

The reality is that on paper, the general understanding of these conceptions is simple, but in everyday life, the nuances and complexities are numerous. Invariably, meaning has been sought in both statutory and common law – but still our courts are struggling to nail a fail-safe solution. In the quest to find general accepted principles related to this conception, the accepted convention is to explore meaning in the statutes and if that fails then common law is explored. SARS in IN 17 avows in this note that, "in practice, the statutory tests are considered first. The common law tests are applied to finally determine whether the person is an independent contractor or an employee only if the statutory tests are not applicable in a particular situation."

6.1 Basic condition of employment Act

The Basic Conditions of Employment Act 75 of 1997's definition of 'employee' is not more different to the Labour Relations Act 1995 definition, in fact, they are both identical safe for a few textual deviations. Section 78 of the Basic Condition of Employment Act 1997, defines an 'employee' as follows:

> "(a) 'employee' means any person who is employed in a workplace, except a senior managerial employee whose contract of employment or status confers the authority to do any of the following in the workplace:
>
> …
>
> (ii) represent the employer in dealings with the workplace forum; or
>
> (iii) determine policy and take decisions on behalf of the employer that may be in conflict with the representation of employees in the workplace; and
>
> (*b*) 'representative trade union' means a registered trade union, or two or more registered trade unions acting jointly, that have as members the majority of the employees employed by an employer in a workplace."

In accordance with the Basic Condition of Employment Act 1997, an employee is any person employed in a workplace, with or without a written contract of employment, not a senior managerial employee, and possibly a registered member of a trade union.

6.2 Labour relations Act

In s 213 of the Labour Relations Act 1995, employees are defined within the meaning of the term as follows:

> "(a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and
>
> (a) any other person who in any manner assists in carrying on or conducting the business of an employer, and "employed" and "employment" have meanings corresponding to that of "employee"."

The exclusion of an 'independent contract' from s 213 (a) of the Labour Relations Act 1995 from any person who is entitled to receive any remuneration' makes sense because it is highly unlikely that they receive remuneration, the problem is that there is no definition of 'independent contractor' in the Labour Relations Act 1995 – how will then this distinction be made in the absence of any statutory tool that can deliver some relief? A more specific definition in s 54 of Labour Relations Act 1995 defines, "[an] employee, as any person who is employed in a workplace, except a senior managerial employee …".

This definition is textually the same with the definition espoused in the Basic Condition of Employment Act 1997. Notably, a senior managerial employee, meets the Roman Law definition of a 'locatio conductio operarum' and their contract is that of service not of work. This principle concurs with Grogan (2011)'s definition and SARS assertion in IN 17 (2019). In addition, de Koker & Williams (2021) illuminate these contradictions further by asserting that, "It is possible that persons may be regarded as employees for tax purposes but not so regarded under the Basic Conditions of Employment Act 1997 or the Labour Relations Act 1995. It is possible, therefore, that as an 'employee', yet the same person may not qualify as an employee under the Basic Conditions of Employment Act 1997 or the Labour Relations Act 1995." The senior management employee is a case in point and embodies the aforementioned characteristic in its entirety.

The Labour Relations Act 1995 in s 200A goes as far as to presume certain workers to be employees and expands the definition in this manner:

> "Until the contrary is proved, a person who works for, or renders services to, any other person is

presumed, regardless of the form of the contract, to be an employee, if any one or more of the following factors are present:

(a) the manner in which the person works is subject to the control or direction of another person;

(b) the person's hours of work are subject to the control or direction of another person;

(c) in the case of a person who works for an organisation, the person forms part of that organisation;

(d) the person has worked for that other person for an average of at least 40 hours per month over the last three months;

(e) the person is economically dependent on the other person for whom he/she works or renders services;

(f) the person is provided with tools of trade or work equipment by the other person; or

(g) the person only works for or renders services to one person."

Section 200A (1) of the Labour Relations Act 1995, introduced a rebuttable presumption as to who is an employee and provides as follows, "Until the contrary is proved, for the purposes of this Act… a person who works for, or renders services to, any other person is presumed, regardless of the form of the contract, to be an employee, if any one or more of the factors mentioned above are present." The presumption builds on existing jurisprudence developed by the courts and does not amend or widen the scope of the definition of employee. Van Niekerk, A., Christianson, M., McGregor, M., Smit, N. & Van Eck, B. P. S., 2015, *Law @ Work,* 5th edn, p. 64, LexisNexis, South Africa, opined that it is an "evidentiary device calculated to switch the onus of proof of employment in circumstances where any one of the seven factors listed is established." If a person alleging to be an employee proves the existence of any one of the factors the presumption is triggered. That person is presumed an employee and the onus shifts to the alleged employer who must now rebut the presumption on a balance of probabilities. (Kasuso 2015).

The phrase "regardless of the form of contract" is not defined in terms of the Labour Relations Act 1995. It is not clear, whether it refers to the existence or non-existence of a contract, or some form of a written existing contract. In any event Van Niekerk *et al (2015:64)*, affirms that "the presumption applies *"regardless of the form of contract."* By use of these words, the legislature confirmed that the statutory definition of employee extends beyond the common law contract of employment."

Kasuso (2015), argues that "the above interpretation came under scrutiny in *Universal Church of the Kingdom of God v Myeni Mxolisi Justice* (Unreported LAC Durban, DA 3/14 delivered on 28th July 2015), ‘the court concluded that “section 200A required that there must be a legally enforceable agreement or some contractual working arrangement in place between the parties for it to apply. By the use of the words *“regardless of the form of contract”,* it simply means that a contract does not have to be formal or in writing. The court then went on to rule that since on the facts the parties never intended to engage in any form of a legally binding agreement, including an employment contract, section 200A was not applicable to Myeni and for that reason, no employer - employee relationship existed.”

A simple reading of the Labour Relations Act 1995 confirms that if any one or more of the afore-mentioned factors in s 200A is present a person is presumed to be an employee, regardless of the form of contract. Consequently, the trigger for the qualification as an employee is one of the seven factors not the existence of a contract. Kasuso (2015) argues that the court in the Universal Church of the Kingdom of God case adopted a restricted interpretation of s 200A of the Labour Relations Act 1995. “Emphasis on the term *“contract”* in section 200A negates earlier assertions that the statutory definition of an employee in labour legislation does not presuppose the existence of a valid and binding contract. Use of the word *“contract”* does not refer to a common law contract but a “*work arrangement”* as envisaged in sections 200A (3) of the LRA and 83A (3) of the BCEA. Applicability of section 200A must be dependent on the existence of an employment relationship or a work arrangement and not existence of a valid and enforceable contract. To hold otherwise would clearly limit the scope of application of the presumption thereby defeating its purpose.”

The definition in the Labour Relations Act 1995 is comprehensive and wide but there is a need to widen the scope beyond a simple statutory law definition or contract of employment and explore the existence of an employment relationship. As a result of exploring the relationship, the court had to inquire on the relationship as opposed to the contract or the label attached by the parties. On this basis, courts have had to look at the realities of the relationship as opposed to the label given to it by the parties. Conradie, B., Giles, G., Godfrey, S., Cooper, C., Cohen, T., Steenkamp, A. & Du Toit, D., *2006, Labour Relations Law: A Comprehensive Guide,* 6th edn, p. 73, LexisNexis Publishers, South Africa “acknowledge that the statutory definition of employee though wide, non-descriptive and rooted in the common law, there is need of formulating a definition premised on the employment relationship rather than the contract of employment.”

On a positive note, while the definition is still rooted in the common law contract, it is capable of an expansive interpretation. The jurisprudential basis for such a purposive interpretation lies in international labour standards adopted by ILO, the Constitution of the Republic of South Africa of 1996 and the primary objects of labour legislation. On the basis of this broad interpretation, it can be concluded that the definition of employee does not presuppose the existence of a valid contract. Emphasis is on the existence of an employment relationship rather than a contract of employment. (Kasuso 2015)

Section 1 of the Compensation for Occupational Injuries and Diseases Act 130 of 1993 defines an employee as "a person who has entered into or works under a contract of service or apprenticeship or learnership, with an employer, whether the contract is express or implied, oral or in writing, and whether the remuneration is calculated by time or by work done, or is in cash or kind, and excludes … (iv) a person who contracts for the carrying out of work and himself engages other persons to perform such work." The common denominator is a contract of service with an employer wherein the employee is remunerated for their performance, safe to say, that persons who contract others to perform work on their behalf are excluded. This proviso could be a reference to an independent contractor or an employer as defined. In addition, the relationship is not limited to a contract of employment that is written – it could be express or implied as well. The Unemployment Insurance Act 30 of 1996, shares the same definition and wording except that the word 'contributor' as opposed to 'employee' is used and there are certain categories of persons excluded.

6.3 Income tax Act

The Income Tax Act 1962, in para 1 of the Fourth Schedule defines an 'employee' as follow:

> "(a) any person (other than a company) who receives any remuneration or to whom any remuneration accrues;
>
> (b) any person who receives any remuneration or to whom any remuneration accrues by reason of any services rendered by such person to or on behalf of a labour broker;
>
> (c) any labour broker;
>
> (d) any person or class or category of person whom the Minister of Finance by notice in the Gazette declares to be an employee for the purpose of this definition;
>
> (e) any personal service provider."

The central theme in all the statutes mentioned above regarding the definition of an 'employee' is that there should at least be two parties agreeing to some contract, that contractually obligates one party to perform a service for the other party, as required by that party, and/or controlled and/or supervised by that party, for an agreed payment, that the recipient of the service should remunerate the other for the services rendered. However, depending on the object or purpose of the particular statute, each will have a number of variations that will not be commonly shared.

The earning of remuneration by the party providing services in terms of the definition of 'employee' in the Income Tax Act 1962 deserve further enquiries. Accordingly, 'remuneration' is central to the definition of employee and the term is defined in para 1 of the Fourth Schedule of the Income Tax Act 1962 as:

> "…any amount of income which is paid or is payable to any person by way of any… fee... whether in cash or otherwise and whether or not in respect of services rendered, including –
>
> (a) any amount referred to in paragraph (a), (c)… of the definition of "gross income" in section of this Act."

It has been legislatively confirmed above that the definition of remuneration in para 1 of the Fourth Schedule of the Income Tax Act 1962 includes fees and any amount referred to in para (c) of the definition of "gross income" in s 1 of the Income Tax Act 1962. The term 'fees' has not been defined further in the Income Tax Act 1962 and there is nothing in the Income Tax Act 1962 that suggests that fees to non-executive directors of companies are excluded. There is no discernable definition of the term 'fee' in the Income Tax Act 1962. According to the Collins English Dictionary (2000), a fee is defined as follows: "A fee is the amount of money that a person or organization is paid for a particular job or service that they provide, or a payment asked by professional people or public servants for their services."

There is nothing in this definition that suggests that the fee referred to in the definition of 'remuneration' is any different to the ordinary meaning of the term. In addition, it could be argued that directors irrespective of their designation or responsibilities are professional people endowed with certain expertise that they afford to the company for some form of compensation or remuneration.

The definition of 'gross income' in s 1 of the Income Tax Act 1962 reads as follows:

> "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 any employment or the holding of any office…"

The definition confirms that any amount received in respect of 'the holding of any office' is included in gross income and these amounts in terms of para 1 of the definition of remuneration in the Fourth Schedule of the Income Tax Act 1962 are included in the same definition.

It is common knowledge that non-executive directors of companies provide skills and expertise to the boards of such companies and are remunerated in the form of fees for such services. On the other hand, the definition in the Fourth Schedule of the Income Tax Act 1962, is blind to the existence of different categories of directors, and it is therefore safe to assume, that no category of a director is excluded, including non-executive directors. Hence, it is a no-brainer, and it is invariably cast in iron that executive directors of companies whether private or listed who are involved in the day-to-day operations of the company are salaried employees who earn remuneration included in para 1 (a) of the Fourth Schedule. Non-executive directors, by their nature receive fees which are characteristic of "any amount received or accrued in respect of the holding of office", for services rendered and are characterized as holders of office. In addition, any other director who happens to be a director (not involved in the day-to-day operations of the company) and a recipient of fees included in 'gross income' will also be a recipient of 'remuneration' as defined and therefore characterized as an employee as defined in terms of the Fourth Schedule of the Income Tax Act 1962. It can therefore be concluded that both executive and non-executive directors of companies are employees of the company and receive remuneration as defined, for their services, in terms of the Income Tax Act 1962.

In the *Protect A Partner* case, the court ruled that, "The question as to whether a director, albeit a permanent part-time director, is an employee will always be coloured by the context in which the question of the director's work status has arisen and the answers will highlight conflicting factors that may operate in any given situation. The Court has to consider the relevance of all of these factors, decide what weight should be given to each of them and then balance one against the other to arrive at an appropriate conclusion." This conclusion, suggest a wider analysis of the employment relationship in terms of the Labour Relations Act 1995 , which is far different to the narrow interpretation of the Income Tax Act 1962, which seems to suggest that all directors irrespective of their designation or work status, are employees, based solely, on their right to receive fees, which in terms of the Income Tax Act 1962 fall within the definition of ‘gross income’ and ‘remuneration’.

The definition of the term ‘remuneration’ in para 1 of the Fourth Schedule of the Income Tax Act 1962, includes certain exclusions, which nullifies the inclusion of certain amounts. In terms of the exclusionary subpara (ii) of the definition of ‘remuneration’ in s 1 of the Fourth Schedule of the Income Tax Act 1962, “a person shall not be deemed to be an employee if any amount paid or payable in respect of services rendered or to be rendered by any person in the course of any trade carried on by him independently of the person by whom such amount is paid or payable and of the person to whom such services have been or are to be rendered. IN 17 distinctively separates the exclusionary provisions into statutory tests. ‘The exclusionary subparagraph (ii) of the definition of “remuneration” provides a statutory test [Test 1] to conclusively deem that a person will not to be carrying on a trade independently, and consequently will be earning “remuneration”, and a statutory test [Test 2] to conclusively deem a person to be carrying on a trade independently and not to be earning “remuneration”. “ (author’s emphasis).

The phrase “independently of the person” is not accorded any meaning or definition in the Income Tax Act 1962. It could be accorded a purposive interpretation or just an ordinary meaning or read contextually. Or it can be argued that you are only independent from the payer and recipient of the service to the extent that you aren’t operating from their premises and you aren’t controlled or supervised by any person in the performance of such a service. de Koker & Williams (2021) interestingly argued that “in the absence of a statutory definition the determination of this concept is a question of fact.” The Collins English Dictionary (2000), defines independence as “If one thing or person is independent of another, they are separate and not connected, so the first one is not affected or influenced by the second.”

The statutory definition of ‘employee’ appears all inclusive and it covers all persons who receive remuneration in the exception of a company, it also includes labour brokers, personal service providers, directors of private companies and any person so authorized by the Minister of Finance. In contrast, the definition expressly excludes a person who is not a resident, or an employee contemplated in paragraph (b), (c), (d) or (e) of the definition of ‘employee’. In addition, the proviso shall not deem the following persons not to be carrying on a trade independently:

> "(a) a person shall not be deemed to carry on a trade independently as aforesaid if the services are required to be performed mainly at the premises of the person by whom such amount is paid or payable and of the person to whom such services were or are to be rendered - [referred to as the 'premises test' in common law]; and
> (b) the person who rendered or will render the services is subject to the control or supervision of any other person as to the manner in which his or her duties are performed or to be performed or as to his hours of work – [referred to as the 'control test' in common law]."

The conjunction should be present for a person not to be deemed to be carrying on a trade independently. If any one of the conditionalities is present, then the status quo remains and the person is still deemed to be carrying on a trade independently and shall therefore be treated as an 'employee' as defined.

The Income Tax Act 1962 doesn't define the phrase 'mainly at the premises' and it is difficult to determine what percentage or quantitative measure is referred to in this context. In addition, the word 'mainly' hasn't be accorded any meaning in the statute as well, except that the Collins English Dictionary (2000), defines it as, "for the most part; to the greatest extent; principally". The courts have interpreted the word as a quantitative measure of more than fifty percent. In the Lourens Erasmus (Eiendoms) Bpk case, Botha JA held that "the Afrikaans word hoofsaaklik, which is translated to English as 'mainly' meant more than 50%".

The terms 'control' and 'supervision' haven't been defined in the Income Tax Act 1962. In terms of the Collins English Dictionary (2000) the term 'control' means, "the power to make all the important decisions about the way that it is run." Supervision on the other hand is defined by Collins English Dictionary (2000), "as the act or function of supervising; superintendence". With regards to the exclusionary provisions, it means important decisions are made by the person receiving the services or making payment, and in addition the services are executed under supervision. These terms appear unambiguous and simple to understand, but the thorny issue relates to the person responsible to effect control and supervision. In terms of IN 17, "this control-or-supervision part of this test refers to 'any person'. This is wide, and could include the payer of the amount, the recipient of the service or any other person who has a right to control or supervise the person in respect of those specific services." The explanation seems plausible and reasonable under the circumstances, but the provision only mentions 'any other person', and there is no mention of ‘any other person who has a right’. A simple reading refers to just about any person, without any particular distinction or qualification at all.

The exclusionary provision further stipulates that “a person will be deemed to be carrying on a trade independently if he throughout the year of assessment employs three or more employees who are on a full-time basis engaged in the business of such person or rendering any such service, other than any employee who is a connected person in relation to such a person. This provision will still have effect, even if the person operates in the premises of the person paying and recipient of the services rendered – including the person being under the control or supervision of any other person regarding the manner in which duties are performed or hours of work.” de Koker & Williams (2021) confirms that notwithstanding, the existence of any of the requirements (premises, control or supervision) will be rendered null & void and the person will be deemed to be carrying on a trade independently, if throughout the year of assessment he employs three or more employees who are on a full-time basis engaged in his business of rendering such service – and will be treated as an employee or recipient of remuneration as defined.

Chapter 7: The impact of SARS interpretation of NED liability on the provisions of the OECD MTC and/or Treaties

In terms of BGR 41, "The VAT treatment of employees and independent contractors is dealt with in proviso (iii) to the definition of "enterprise" in section 1(1). This is a reference to the services of a so-called "common law employee". The effect is that such services can never qualify as an enterprise activity. As such, the employee cannot register for VAT and will not charge VAT on any salary, wages, commission or similar amount which is paid or payable by the employer in that regard."

Proviso (iii) (aa) to the definition of "enterprise" in s 1(1) of the Value-Added Tax Act 89 of 1991 reads as follows:

> "the rendering of services by an employee to his employer in the course of his employment or the rendering of services by the holder of any office in performing the duties of his office, shall not be deemed to the carrying on of an enterprise to the extent that any amount constituting remuneration as contemplated in the definition of "remuneration" in para 1 of the Fourth Schedule to the Income Tax Act 1962 is paid or payable to such employee or office holder as the case may be."

The proviso applies to both an employee and holder of office. According to de Koker & Williams (2021), "a person who is not an employee will be regarded as a director if he holds an office or performs functions of the type normally performed by the director of a company." In BGR 41, SARS deliberately includes resident non-executive directors into the VAT liability because SARS classifies them as independent contractors in terms of proviso (iii) (bb) of s 1 of the VAT Act 1991. SARS asserts as follows:

> "Proviso (iii)(bb) to the definition of "enterprise" refers to the services rendered by an "independent contractor" to the employer (recipient) under a contract for services in circumstances where such enterprise is carried on independently of the recipient. In other words, the activities of the service provider show the hallmarks of an independent business (enterprise) activity carried on by that person as opposed to the services rendered by an employee under an employment contract. In addition, even if a person is an employee as contemplated in proviso (iii)(aa), that person is not necessarily prevented from conducting enterprise activities outside of the employment contract as contemplated in proviso (iii)(bb). In such a case, that person may be

liable to register and charge VAT in respect of such enterprise activities carried on independently."

Proviso (iii) (bb) of s 1 of the VAT Act 1991 of the definition of 'enterprise' reads as follows:

> "sub-paragraph (aa) of this paragraph shall not apply in relation to any employment or office accepted by any person in carrying on any enterprise carried on by him independently of the <u>employer</u> or <u>concern</u> by whom the amount of remuneration is paid or payable." (Own emphasis)

The sub-paragraph refers to employment or office carried on independently of the employer or concern by whom remuneration is paid or payable. It is clear, that reference is only made to an 'employer' or 'concern that pays remuneration'. An employer in s 1 of the Fourth Schedule of the Income Tax Act 1962 is defined as follows:

> "… any person… who pays or is liable to pay to any person any amount by way of remuneration, and any person responsible for the payment of any amount by way of remuneration to any person under the provisions of any law or out of public funds…"

The definition refers firstly to an 'employer' making payment by way of 'remuneration' only. In fact, the reference to remuneration is absolute and there is no provision for any kind of alternative payment. The term 'concern' is not defined in the VAT Act 1991 or the Income Tax Act 1962 but what is incontrovertible is the fact that this 'concern' pays remuneration.

It is important to note that in terms of para 1 of the Fourth Schedule of the Income Tax Act 1962 an employee is defined as any person (other than a company) who receives any remuneration or to whom any remuneration accrues, including a labour broker, personal service provider, director of a private company, anyone declared by the Minister of Finance to be an employee. In addition, a labour broker, personal service provider, anyone declared by the Minister of Finance to be an employee, are excluded from the exclusionary provision (ii) of the definition of 'remuneration' and it is not recognized that they can carry on trade independently – in terms of the same provision.

The second reference is to a 'concern' that pays remuneration – it is highly unlikely that the 'remuneration' mentioned in this phrase is in any manner, form or shape different to 'remuneration' as defined in para 1 of the Fourth Schedule of the Income Tax Act 1962. If that be the case, then the receipt or accrual of remuneration is the nexus of this exclusionary provision. It is fair and reasonable to conclude that Proviso (iii) (bb) of s 1 of the VAT Act 1991 only refers to an employee in common law and an employee who is an office holder (only based on the fact that this office holder in particular is a recipient of remuneration). The provision only relates to remuneration receiving employee or office holders who carries on any enterprise independently of the employer or concern paying the remuneration.

An employee is defined in a number of statutes, including Labour Relations Act 1995 and the Income Tax Act 1962, but the independent contractor is not defined in our statutes, but he certainly doesn't meet the definition of an employee in terms of statutory or common law. SARS' IN 17 further affirms that, "An independent contractor must be distinguished from its counterpart, the employee. Legally, the two terms (independent contractor and employee) are mutually exclusive and are direct opposites. Our courts have been inundated with dealing with the perennial problem of how to define an independent contractor and how different is the independent contractor from an employee. Conradie et al (2006), distinguishes between an employee and an independent contractor in the following way: An employee… receives regular monthly or weekly remuneration… By contrast the independent contractor usually performs a discrete service for a fee…" If we are to accept this assertion by Conradie et al (2006), then it is highly unlikely that, an independent contract can be a possible recipient of an amount of remuneration nor be an employee as defined – nor is it likely that the legislator meant to conceive or include an independent contractor in this exclusionary provision.

The phrase "Independently of the employer and concern" is not defined in the Vat Act of 1991, nor is the term 'independently' on its own. It is not clear whether we need to look at the exclusionary provisions in the Income Tax Act 1962 for the factors or conditions of what is 'independently' or look to common law. In BGR 41, "It is therefore incorrect to conclude that an independent contractor must be regarded as an employee for VAT purposes merely because that person's income is deemed to be "remuneration" which is subject to employees' tax under the Fourth Schedule to the Act." Is SARS in this instance disregarding statutory law relating to the Income Tax Act 1962, even if the contractor in this instance meets the definition of 'independent' – which definition of 'independent' will the SARS use?

SARS in BGR 41 asserts that "It is concluded in paragraph 3.2 of BGR 40 that an NED is not considered to be a common law employee. This is based on the view that the services must be supplied independently and personally by the NED. Any director's fees paid or payable to an NED for services rendered in that capacity is therefore not regarded as "remuneration". It follows that for VAT purposes an NED is treated as an independent contractor as contemplated in proviso (iii)(bb) to the definition of "enterprise" in section 1(1) in respect of those NED activities." In the previous argument, Conradie et al (2006), asserted that employees received remuneration and independent contractors usually perform discrete services for a fee. The exclusionary provision (iii) (aa) of the definition of 'enterprise' of the VAT Act 1991, refers to an employee of office holder carrying on an enterprise independently of the employer concern by whom the amount of remuneration is paid or payable. There is no mention of an independent contractor nor is there any guidance in the VAT Act 1991 of a definition of independent contractor.

Eversheds (2017), raised further concerns regarding SARS treatment of non-executive directors as independent contractors and asserted that "There are still some questions as to whether SARS correctly interpreted the Value-Added Tax Act, as SARS considers a NED to be an independent contractor as per sub-section (iii)(bb) to the definition of "enterprise" in section 1 of the Value-Added Tax Act.] As sub-section (iii)(bb) only applies to services rendered by employees or office holders (as contemplated by sub-section (iii)(aa)) where the remuneration payable constitutes "remuneration" as defined in the Fourth Schedule to the Income Tax Act… Furthermore, there still remains the question of whether such activities of attending and voting at board meetings comprise the "supply" of "services" as defined in the Value-Added Tax Act or are they merely the fulfilment of the statutory duties of the NED. Also, the NED is elected to that position in his/her personal capacity to serve a fixed term in terms of the Companies Act, which is different from the typical independent contractor who is appointed under a contract to provide specific services, and who can delegate the performance of the services."

The court in the European case *J.A. van der Steen v Inspector van de Belastingdienst Utrecht-Gooi/kantoor Utrech*, Case C-355/06, (18 October 2007), European Court Reports ECR (2007), I-8863, accepted that, even in the absence of a contract of employment, it is considered that the services rendered by a director in his capacity as a director should be considered to be dependent. A director owes fiduciary duties to the company and has a different relationship and responsibilities to a normal contractor. There are numerous differences between an independent contractor and non-executive director as spelled out above - which points to lack of congruence and leads to a conclusion that the two terms are incompatible and SARS's conclusion is difficult to fathom.

BGR 41, specifically excludes non-resident non-executive directors from paying VAT, primarily because the definition of 'enterprise' excludes remuneration receiving employees and office holders for VAT obligations. In terms of the exclusionary provision (iii) (aa) s 1 of the VAT Act 1991, "the rendering of services by an employee to his employer in the course of his employment or rendering of services by the holder of any office in performing the duties of his office, shall not be deemed to be the carrying on of an enterprise to the extent that any amount constituting remuneration as contemplated in the definition of 'remuneration' in paragraph 1 of the Fourth Schedule to the Income Tax Act 1962 is paid or payable to such an employee or office holder…"

The non-resident non-executive directors escaped the inclusion into being referred to as a 'independent contractor' because the exclusionary provisions of the definition of remuneration excluded them from being able to trade independently – they are therefore treated as recipients of remuneration subjected to employee deductions and being an employee as defined. In addition, they fall within the exclusionary provision of the definition of 'enterprise' because of their designation as employees. There is very little difference between a resident and non-resident executive director except location, and they both render services to the employer under a contract of service where such enterprise is carried on independently of the recipient, not under the employers 'control or supervision'.

Elsewhere in this thesis it is argued that 'any amount' received in respect of the holding of any office is included in gross income and these amounts in terms of para 1 of the definition of remuneration in the Fourth Schedule are defined as remuneration. Both resident and non-resident non-executive directors by their nature receive fees which are characteristic of 'any amount' (as mentioned in the definition of 'remuneration), for services rendered and also are holders of office. The exclusionary provision in the Income Tax Act 1962, deems a non-executive director to be conducting his trade independently. It is questionable in some instances that they are independent, especially if they dependent economically from the company and they are dependent on executive management to provide correct reports in order for them to render their services or they could own shares in the company – all these conditions could affect their independence. Therefore, in some cases non-executive directors are employee like any other director of the company and their fees should be subjected to income tax in the same manner as non-resident non-executive directors as well.

South Africa changed its tax system from a source to residence-based system. Accordingly, the country has taxing rights on all income earned by their residents including their worldwide income as well. The country of source is irrelevant, the primary nexus is the taxpayer residence status, however, non-residents are taxed only on their South African income – or only income from a South African source is taxed. Invariably, non-resident non-executive directors serving on the board of company's resident in the country will be liable to taxation in the country. de Graaf, A. & Frank P.G. Pötgens, F.P.G., (2011), '*Worrying Interpretation of 'Liable to Tax': OECD Clarification Would Be Welcome*, 39, Intertax, Issue 4, pp. 169-177, avers that "the tax-residence states of companies have the right to tax directors fees. Whether the companies actually pay directors fees or whether the directors reside in the company's residence state is irrelevant."

Article 16 of the OECD, 2017, *Model Tax Convention on Income and on Capital (*'OECD MTC'), OECD Publishing, Paris, states that "Directors fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State." Hunt, G., (2008), *New Zealand's Evolving Approach to Tax Treaties, 14:2, New Zealand Journal of Taxation Law and Policy,* 131, further avows with regards Article 17 and concurs with de Graaf & Potgens (2011) that directors fees may always be taxed by a company's residence state. The allocation of this taxing right may not be changed even if the services are performed in another state and/or the directors are taxed in their residence state(s).

Article 24 of the OECD MTC (2017), which reads as follows: "Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected." In line with the spirit of our taxing system, BGR 41, has a discriminatory effect on the treatment of local and non-resident non-executive directors. In essence the resident non-executive director is charged VAT in terms of the VAT Act 1991 at a fixed rate of 15% currently, in addition the output tax is subject to certain input taxes, which will reduce the VAT liability.

In the SARS quick reference guide, it is suggested that the following expenses, on which VAT has been incurred, that may qualify as input tax: Utility costs, office rent, travel expenses, Vehicle repairs, admin costs, etc. According to Nair (2020), "Since the global pandemic of COVID-19 has changed the way we all work, it is expected that the costs associated with working remotely (e.g., telecommunication services) will present an opportunity for registered non-executive directors to claim slightly higher input tax claims." This will surely have a positive effect on the tax consequences of a resident non-executive director. In addition, it is only obligated to pay additional taxes based on taxable income, subjected to certain allowable deductions at a progressive rate and will not be subjected to PAYE.

The non-resident non-executive director is subjected to PAYE on total salary earned without the same deduction at higher progressive rate, with estimated rates of 45% at its highest peak. Consequently, the fiscal burden is heavier on the non-resident non-executive director than on the resident non-executive director. Nair (2020) confirms that both non-executive directors are not treated equally, and his view is as follows: “It has been argued that the position of non-resident non-executive directors is punitive in comparison to their resident counterparts as non-resident non-executive director fees remain under the ambit of PAYE and these non-executive directors are, additionally, required to determine whether they have a VAT registration liability in South Africa. If so, they must register and bear the costs of all the ongoing VAT compliance associated with being a vendor in South Africa.” This contention is also shared by Bammens, N., 2012, *The principle of non-discrimination in international & European tax law,* p. 523, Amazon.com, who asserts the following: “It is clear that a tax rule which differentiates on the basis of residence amounts to indirect discrimination, in so far as the rule mainly burdens nationals of other Member States. It is clear, indeed, that a rule targeting non-residents will often fall heavier on foreign nationals.”

The treatment is not in compliance with Article 24 of the OECD MTC (2017), but it is sometimes suggested that where there are differences between the resident and non-resident directors the different treatment could be justified. A look at the text of BGR 41, doesn’t suggest or point to any differences between the two except that one is treated as an ‘employee’ for Income Tax Act 1962 purposes and the other an ‘independent contractor’ for VAT Act 1991 purposes. A difference some commentators argue is not supported by any jurisprudence. *Bammens* (2012), further argues that “not only rules which differentiate on the basis of nationality amount to discrimination; rules which apply other differentiating criteria, but in fact lead to the same result as a directly discriminatory rule, are forbidden as well. The same is true in matters of direct taxation, where distinctions are rarely made on the basis of nationality but often on the basis of residence. As indicated above, the situations of residents and non-residents are, normally, not comparable. However, it is possible that no relevant difference exists between both categories. In such a case, different treatment might amount to discrimination.”

In fact, the assertion above confirms that all forms of differentiation that leads to discrimination are prohibited. In *Klaus Biehl v Administration des contributions du grand-duché de Luxembourg*, Case C-175/88, (8 May 1990), European Court Reports ECR (1990), I-1779), the Court began by repeating the

Sotgiu formula: “the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality but also all covert forms of discrimination which, by the application of other criteria of differentiation, lead to the same result”.

In terms of Commentary for Article 24 of the OECD MTC (2017:C24) it is articulated that, “Likewise, the provisions of the Article cannot be interpreted as to require most-favoured-nation treatment… As tax conventions are based on the principle of reciprocity, a tax treatment that is granted by one Contracting State under a bilateral or multilateral agreement to a resident or national of another Contracting State party to that agreement by reason of the specific economic relationship between those Contracting States…” BGR 41, rules binding only to SARS itself and they are general in nature and not specific to any particular treaty. It can therefore not be argued that they are specific to economic relationships or whether economic relationship specific to certain treaties or countries where considered.

It is submitted that the courts found in the case of W. *Wallentin* v. Riksskatteverket, Case C-169/03, (1 July 2004), European Court Reports ECR (2004), I-6443, paras. 21-22 that, “Advocate General Léger has already had occasion to recall that, in the area of tax, the Court accepted that “discriminatory national rules may be justified for imperative public-interest requirements other than those set out in the Treaty and in particular in the name of the cohesion of the tax system”.” If we are to apply the judgement above, it will be reasonable to conclude in the absence of any evidence to the contrary that the introduction of BGR 41 bears testimony to the assertion above. BGR 41 has resulted in some negative consequences as alluded to by Nair (2020) “It is not clear whether the National Treasury (2016) has considered the punitive impact of the Note on non-resident non-executive directors, in light of its negative impact on the freedom of companies to appoint foreign resources for the objective steering of a board of directors… It is not clear whether SARS has seen an increase in VAT registrations of non-executive directors and whether this has translated to significantly higher net revenue to the fiscus.” However, it could well be, that there was some “imperative public-interest requirement” to deal with directors fees of non-executive directors, but it is doubtful that it was borne from some derogating provision expressly provided for in some of the Treaties.

It can be reasonably concluded that the treatment of non-resident non-executive directors is discriminatory and in addition, it is not consistent with the provisions of Article 16 of the OECD MTC (2017). If we were to take for an example the Convention between the Republic of South Africa and the

United Kingdom for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (2002) ('UK Treaty'), Treaties & Models, IBFD (which is congruent with Article 16 of the OECD MTC (2017), the BGR 41 will be inconsistent with the OECD MTC (2017). International law in its simple definition is a combination of treaties and customs that regulate the conduct of states among themselves – we can safely conclude that our treatment of non-resident non-executive directors leads to an approach that is inconsistent with international law.

Section 231 of the South African Constitution (1996) states as follows:

> "Customary international law is law in the Republic unless it is inconsistent with the Constitution or an Act of Parliament."

Section 233 of the South African Constitution (1996) states as follows:

> "When interpreting any legislation, every court must prefer any reasonable interpretation of the Legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law."

Tladi, D., 2016, 'Interpretation and international law in South African courts: The Supreme Court of Appeal and the Al Bashir saga', *African Human Rights Law Journal*, 16(2), 310-338, affirms that, "According to section 232 of the South African Constitution (1996), customary international law is law in South Africa. This means that, to the extent that the rules of identification and interpretation described above form part of customary international law, South African courts are obliged to apply these rules when identifying or interpreting international law. This is certainly the case with the Vienna rules of interpretation and the rules relevant to the identification of customary international law."

In the *Government of the Republic of South Africa & Others v Grootboom & Others* 2000 (11) BCLR 1169 (CC) (paragraph 26) case, Justice Yacoob of the Constitutional Court said: "The relevant international law can be a guide to interpretation but the weight to be attached to any particular principle or rule of international law will vary. However, where the relevant principle of international law binds South Africa, it may be directly applicable."

The relevance of international customary law to the South African Constitution (1996) certainly falls beyond the scope of this thesis, but there is no legal objection to the fact that the OECD MTC (2017) and the United Kingdom treaties are a representation of international law and therefore recognized as law in the Republic in terms of s 231 of the South African Constitution (1996). Hence, the fact that the SARS ruling on BGR 41 is inconsistent with the laws of the Republic, international law and the South African Constitution (1996).

Chapter 8: The UK's VAT Act and case law pertaining to the treatment of Directors with regards to VAT

In the South African legal environment, particularly in the Companies Act 2008 and the Income Tax Act 1962, there is no mention of a non-executive director as a distinct designation from an executive director. There is no distinction between an Executive and Non-Executive Director in the United Kingdom jurisprudence, the same as in the Republic. Both are treated the same and carry the same fiduciary responsibilities. Gibbon, N., Garston, C. & Salaman, B., (2019), '*Corporate governance and directors duties in the UK (England and Wales): overview'*, emphatically confirmed that, "There is no statutory definition of an executive director or a non-executive director, so under the law there is no distinction between the role and responsibilities of a non-executive director and those of an executive director. Both types of directors are subject to statutory obligations, duties and responsibilities."

The South African courts have endeavoured to distinctively define the difference between an executive and non-executive director in this manner – in the *Protect A Partner case* Gaibie AJ held as follows: "In general, there are essentially two types of directors, more commonly known as non-executive and executive directors. The directors of an organisation are the persons who are the members of its board. An executive director, sometimes also referred to as an "inside director" is a director who is often an employee, officer, significant shareholder, or someone similarly connected to the organization." King III concurred with the distinction above and expanded the conception to split non-executive directors into those that are dependent and those that aren't.

In the United Kingdom, Gibbon et al (2019) went on to assert that, "a non-executive director is generally understood to be a director on the board who does not form part of the executive management team and is not an employee of the company. Non-executive directors are expected to devote part, but not all, of their time to the company and their role is generally to provide an advisory or supervisory element to the board, scrutinising and challenging the company's strategy and management. By contrast, an executive director is typically an employee of the company who holds a senior management and executive role within the business. However, as executive directors have the same statutory duties as non-executive directors as members of a unitary board, these duties extend to the whole of the business, and not just that part of it covered by their individual executive roles." He went to define the character of a non-executive as follows: "non-executive directors are considered to be independent when the board determines that they are independent in character and judgement, and that there are no relationships or circumstances which are likely to affect, or could appear to affect, their judgement."

Companies globally will employ the services of non-resident directors who serve on their boards, for their skills, expertise, etc, either as executive or non-executive. Furthermore, there is no distinction in the law between a resident and non-resident director with regards their roles and responsibilities within the company in either the Republic or the United Kingdom. The directors in the provision of their services are remunerated with fees, salaries and other forms of benefits. The taxing rights regarding the income earned by non-residents directors are determined by the UK Treaty (2002). In terms of Article 15 of the UK Treaty (2002), fees to directors are taxed by each fiscal jurisdiction as follows: "Directors fees and other similar payments derived by a resident of a Contracting State for services rendered in the other Contracting State in his capacity as a member of the board of directors of a company that is a resident of the other Contracting State may be taxed in that other State." According to Knight L., (2019), '*The perils & pitfalls of non-UK resident directors*, "The takeaway is that remuneration paid to a non-resident director working in the Republic/UK will generally be liable to income tax in the Republic/UK. If it is the Republic/UK company paying that remuneration, it will invariably be required to subject that same remuneration to tax under PAYE."

The tax laws of the United Kingdom treat executive, non-executive and non-resident non-executive directors as 'office holders' and fees received for the performance of their duties as directors is treated as remuneration for tax purposes and subject to the Income Tax (Earnings & Pensions) Act of 2003 ('ITEPA') of the United Kingdom. In section 5 of the ITEPA (2003) of the United Kingdom, non-executive directors are treated as follows:

> "(1) The provisions of the employment income Parts that are expressed to apply to employments apply equally to offices, unless otherwise indicated.
> (2) In those provisions as they apply to an office—
> (a) references to being employed are to being the holder of the office;
> (b) "employee" means the office-holder;
> '(c) "employer" means the person under whom the office-holder holds office.
> (3) In the employment income Parts "office" includes in particular any position which has an existence independent of the person who holds it and may be filled by successive holders."

The UK tax legislation states that ‘office holders’ and ‘employees’ should be treated the same for tax purposes. Resident and Non-resident directors of UK companies for an example are defined as office holders, and equally affected by the provisions of the ITEPA (2003), that apply to both employment and office holders. In essence, this fiscal treatment affects all designations of directors including executive and non-executive directors as well. The treatment of non-resident directors in the UK is the same as the Republic, except where the Republic treats a resident non-executive director as an independent contractor subjected to the requirements of the VAT Act 1991.

In the provision of their fiduciary duties, directors in the United Kingdom aren’t subjected to VAT for the fees received in performance of their services. There are instances where the question of VAT should be considered for the supply of directors services. In De Maeijer, S., Vastmans, S., Bidoul, V., Wessels, J. & Dirk Evers, D., 2017, ‘European Union VAT and Directors Fees in the Benelux’, *International VAT Monitor,* 28(3), 1-3, the question of the applicability of VAT in relation to directors was considered and the authors agreed that “One of the many outstanding questions in this area relates to the VAT status of company directors. A key question is whether a company director should be considered to be a taxable person acting independently within the framework of an economic activity… or, by contrast, whether he should be considered an “instrument” of the company, who does not act independently and therefore remains outside the scope of VAT.”

The CFE Fiscal Committee, 2016, Opinion Statement FC 5/2016 on the VAT liability of directors, OECD Publishing, Paris. In its working paper No 786 to the VAT Committee states that, “the European Commission correctly accepts that an employee shareholder may be providing dependent services that are not subject to VAT. However, the paper also suggests that where a professional is already a taxable person then he may be acting as a taxable person when he provides services to a company even if those services are provided under a contract of employment. The United Kingdom as a tax authority in s 94(4) Value Added Taxes Act 1994 (‘VATA’) states that a person is acting as a taxable person when he is appointed to an office in the furtherance of a trade, profession or vocation. This is despite the fact that the directors remuneration is taxable as employment income for direct tax purposes.”

In the Tribunal decision in the *Bray Walker* (LON/00/264) case. Mr. Walker appealed against an assessment on his director’s fees. It is common cause that Mr. Walker held shares and was appointed a director of a company that he owned. He was also appointed, and he accepted a position as a director of another company where he offered his expertise and professional services. He was of the opinion that the fees he received from this appointment should be included in his PAYE and not treated as vatable. The Tribunal dismissed his appeal on the grounds that he had accepted the directorship in the course or furtherance of his profession in terms of s 94(4) of the UK VATA 1994, not as an employee, and the services will be treated as a supply for VAT purposes.

In the event that a director or office holder may be involved in a number of companies providing similar services as a director - In a number of instances one of the companies could aggregate the fees due and pay the director, and later claim from such other companies where the director sits – in essence these are all directors fees. This could be construed as person furthering his/her trade profession or vocation, and in terms of s 94(4) of the UK VATA 1994, services supplied by him as the holder of that office are treated as supplied in the course or furtherance of the trade, profession, or vocation – such directors fees are subjected to VAT. In another example: In the Tribunal decision in the case of *Withies Inn Ltd* (LON/95/1778 No 14257), the trader argued that the services rendered by directors of the parent company, who are also directors of the parent's subsidiary companies constituted a supply of management service by the said directors. The Tribunal, in dismissing the trader's contention, held that "where directors act in a dual capacity an assertion that one company is supplying services to the other must be viewed with circumspection". The Tribunal accepted that it is possible that a parent could render services to its subsidiary, it is possible as a proposition of law that these could be construed as supplies for VAT purposes.

In Jenkins, L. & Majithia, P., (2016), '*Non-Executive Directors & Non-UK Resident Directors: Taxation of Remuneration'*, the authors noted that, "a NED is an 'office holder' which means that their earnings are subject to PAYE and NIC in the same way as executive directors and employees. The exception to this is if they are providing other non-NED consultancy services to the company via their personal service company in which case it may be possible to pay that element of their remuneration gross. Separate contracts are always advisable where this is the case to help bring clarity to the situation." The fees emanating from the director's personal service company, even though, delivered by the director as an employee of the company will not form part of his remuneration subjected to ITEPA (2003) – but will meet the requirements of s 94(4) of the UK VATA 1994, and be liable for VAT. The CFE Fiscal Committee (2016)'s position is congruent to Jenkins & Majithia (2016) assertion above, in that it "accepts that there may be cases where an employee or director may be rendering different services in different capacities. For example, he may be rendering some services as an employee or director and some services in the course of his professional consultancy business. In such cases, the professional services will be independent and therefore taxable."

In certain instances where a company exercises its contractual or legal right to appoint directors to a board of another, this in terms s 94(4) of the UK VATA 1994 will constitute a vatable supply. This happens in group structures where companies normally share specialist knowledge, skills, etc. It is difficult to make a direct comparison with instances in the Republic because of the distinction SARS makes between executive and non-executive directorship in that VAT is charged indiscriminately on all fees received by non-executive directors. In essence the United Kingdom s 94(4) of the UK VATA 1994 is selective and not as encompassing as SARS ruling in BGR 41.

SARS compares less favourably with countries such as the UK, which has no distinction between an executive and non-executive director. In addition, all directors are treated as employees and their fees defined as remuneration for tax purposes. This treatment is simplistic and could quiet down the noise regarding the manner in which resident non-executive directors and non-resident non-executive directors are treated with regards equity and compliance without discrimination in accordance with the Articile 24 of the OECD MTC (2017).

Chapter 9: Conclusion

This research report has critically analysed SARS characterization of independent non-executive and independent contractors in terms of statutory and common law. Including its rationale of applying the exclusionary proviso (iii) (bb) of the VAT Act 1991 to equate independent non-executive directors to independent contractors in order to characterize director's fees as a supply subject to VAT. The report further explored complexities of the difference between employees and independent contractors in both our legislation and common law. The endeavour by our courts to finding a generic solution to this vexing question has been arduous and different courts have offered different indicia to resolve this puzzle. In addition, the report has explored international law to determine the discriminatory effects of SARS ruling and its compliance with the provisions of the South African Constitution (1996).

The question of whether non-executive directors are 'employees' in terms of the Fourth Schedule of the Income Tax Act 1962 remained unresolved for some time, until the Minister of Finance in the 2016 Budget made an announcement and SARS published Binding General Ruling 40. The dilemma has always been the characterization of fees paid to non-executive directors for taxation purposes. The ruling confirmed that a non-executive director is excluded from the definition of 'employee' in terms of the exclusionary subpara (ii) of the definition of 'remuneration' in s 1 of the Fourth Schedule of the Income Tax Act 1962 and should be characterized as a holder of office not a common law employee. In addition, SARS characterized a non-executive director as an independent contractor and treated the services rendered by a non-executive director as a vatable supply by a vendor in terms of the exclusionary proviso (iii) (bb) of the VAT Act 1991.

The rationale underpinning SARS ruling has come under a groundswell of opposition from a number of quarters. The disquiet has continued and others have argued that SARS' assertion of treating a non-executive director as independent contractor is incorrect. The decision is largely based on the assertion that he is a non-executive director and therefore, he naturally carries on trade independently, without exception. This contention is flawed and exacerbated by the fact that there is no definition of 'executive or non-executive director' in the Income Tax Act 1962. In addition, the Companies Act 2008, makes no attempt to distinguish executive from non-executive directors, either. King III, states that in contrast to SARS, that there are two types of Non-Executive Directors, those that are independent and those that aren't. It is therefore a misnomer, according to King III, to suggest that all non-executive directors are independent – the assumption is that others are biased and conflicted because of the interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in their decision-making.

The provisions SARS relies on to define a non-executive director as an independent contractor only refers to a person carrying on an enterprise 'by him independently of the employer and receiving remuneration'. The exclusionary provisions relied upon refer only to services provided independently from the company, not by a contractor but by a person to whom remuneration is paid - in fact, there is no reference to an independent contract at all. Therefore, SARS argument of treating a non-executive director as an independent contractor is not supported by the exclusionary provisions of the definition of 'enterprise' in the VAT Act 1991. The ruling could possibly be supported by common law but, if that be the case, then each case will have to be determined on its own merit, and any general application will be inconsistent with the legislation.

It is posited that the decision to equate a non-executive director to an independent contractor could be flawed because it has been perennially difficult for our jurisprudence to find a generic solution to the definition of an independent contractor. IN 17 states that an independent contractor must be distinguished from its counterpart, the employee. And the two terms are mutually exclusive and are direct opposites. The distinction and its complexities are much more pronounced in both statutory and common law where most practitioners, experts, commentators seek some form of relief. Benjamin (2004) confirmed his observations and has argued that the jurisprudential basis for identifying reality of an employment relationship in our law remains unclear.

Our courts have for a very long time grappled with this question and it can be argued today, that neither statutory nor common law has provided sufficient evidence to put this gnawing dichotomy to bed. A battery of tests from control, supervision, dominant impression, organization, economic, risk and loss, have be used by our courts and subsequently rejected as being ineffective or just another indicum in a basket load of indicia. Up to date the courts still hold that the tests should be broadened to include other elements or factors which could assist the situation. There is very little certainty that there is some generic definition of independent contractor that will without doubt fit the character of a non-executive director.

SARS in Binding General Ruling 40 regards non-resident non-executive directors as employees and treats their fees earned for service rendered as remuneration and therefore, liable for PAYE. In contrast, resident non-executive directors are treated as independent contractors only liable for VAT. It can be reasonably concluded that the treatment of non-resident non-executive directors is discriminatory and in addition, it is not consistent with the provisions of Article 16 of the OECD MTC (2017) and other bilateral Treaties. International law in its simple definition is a combination of treaties and customs that regulate the conduct of states among themselves – we can safely conclude that our treatment of non-resident non-executive directors leads to an approach that is inconsistent with international law. In terms of the South African Constitution (1996) bilateral Treaties are treated as International Law and codified into our laws. It is submitted that it is highly possible that this treatment of non-resident non-executive directors is inconsistent with the South African Constitution (1996).

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