

# **A comparative analysis of the tax treatment of employer-provided bursaries and scholarships**

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## ABSTRACT

Section 10(1)(q) of the Act provides a tax exemption on employer-provided *bona fide* bursaries and scholarships provided that certain conditions are met. The overarching requirement is that the bursary and scholarship must not form part of a salary sacrifice arrangement between the employer and the employee for the purpose of granting the bursary or scholarship. As a tax incentive, section 10(1)(q) of the Act contributes towards the country's skills development strategy; however salary sacrifice arrangements create a blockage to the effectiveness of the tax incentive. The purpose of the study was to discuss the effectiveness of section 10(1)(q) of the Act as a tax incentive and, in comparison with OECD countries, the study attempted to determine where South Africa is from an international perspective in terms of the *bona fide* bursary and scholarship tax incentives.

The study followed the qualitative research methodology due to its theoretical nature. In addition, the legal research design method was adopted for this study with a focus on the reform-oriented method. The arrangement of the study was a discussion of section 10(1)(q) of the Act including its evolution from 1962 to date, and this was followed by a detailed discussion of salary sacrifice arrangements as a major contributing factor to the effectiveness of section 10(1)(q) of the Act as a tax incentive. The discussion was followed by a theoretical discussion of tax incentives including a detailed discussion of the characteristics of a meaningful and effective tax incentive. The characteristics were then measured against section 10(1)(q) of the Act to determine its meaningfulness and effectiveness as a tax incentive. Thereafter, the tax policy of employer-provided scholarships by a number of OECD countries was discussed and compared to South Africa's provisions in an attempt to determine the effectiveness of the tax incentive on an international scale.

The study found that section 10(1)(q) of the Act may not fully realise its meaningfulness and effectiveness in the South African context due to limitations created by salary sacrifice arrangements. However, on an international scale, section 10(1)(q) of the Act was found to be lenient since it was discovered that the provisions appear to provide more relief than those of the majority of the OECD countries discussed in the study.

## **KEYWORDS**

Section 10(1)(q) of the Act, employer-provided *bona fide* bursaries and scholarships, skills development, salary sacrifice arrangements, tax incentives, OECD countries

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## **ABBREVIATIONS**

FDI	Foreign Direct Investment
GEAR	Growth, Employment and Redistribution
HMRC	His Majesty's Revenue and Customs
NQF	National Qualifications Framework
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay-As-You-Earn
PIT	Personal Income Tax
R&D	Research and development
SARS	South African Revenue Services
SSC	Social Security Contributions
the Act	Income Tax Act 58 of 1962, as amended

# CHAPTER 1: RESEARCH BACKGROUND

## 1.1. Introduction

Personal income taxes are one of the major contributors to the fiscus in South Africa. According to Steenekamp (2012:40), personal income tax serves the purpose of raising revenue for the state. South Africa uses personal income tax, the single largest contributor to tax revenue, intensively resulting in a high total tax burden (Steenekamp, 2012:44; Kemp, 2017:418). Throughout history, several committees have been appointed to enquire into the South African tax system for improvement purposes; in 1970, the Franzen Commission pointed out the negative impact of increased tax burdens (Koch *et al.*, 2005:194) and later in 1987, the Margo Commission, which operated during a time of rampant inflation and foreign disinvestments due to international pressure against apartheid, was appointed to investigate the tax system given the fiscal challenges at the time (Koch *et al.*, 2005:194; Ndofula, 2013:2). The recommendations by these committees focused on shifting the tax focus from direct to indirect taxation (Jones & Inggs, 1994:17) to lessen the personal income tax burden.

In 1994, the Katz Commission recognized that the high fiscal burden on individuals had to be addressed resulting in the reduction of the number of tax brackets from ten to six and an annual increase of the primary rebate to compensate for inflation (Steenekamp, 2012:41,43). Personal income tax is defined as the normal tax that is paid on an individual's taxable income which includes employment income, investment income, for example interest and dividends, rental income, etc. Of the total personal income taxes, the bulk is made up of employment taxes, commonly referred to as Pay-As-You-Earn ("PAYE"). According to a report by the National Treasury and South African Revenue Services ("SARS") (2020:6), in 2019/20, 39% of total tax revenue consisted of personal income taxes, and 68% of this consisted of PAYE (2020:14).

Olivier (2000:178) contends that it is often salaried taxpayers who feel that they carry the bulk of the personal tax burden. To ease this burden, it has become common for employers and employees to structure their remuneration such that they reduce their taxable income. In these structures, the employee sacrifices a portion of their cash salary in exchange for a non-cash employer benefit thereby reducing the employees' taxable income and ultimately, the tax liability. According to Olivier (2000:179), in the late seventies, high tax rates resulted in employees and employers structuring remuneration packages to pay the minimum tax permissible. In response to these structures and to curb the subsequent loss to the fiscus, Government puts measures in place such as the insertion of the Seventh Schedule, which lists and provides guidance on the qualification of several fringe benefits, in 1985 (McCready, 2020).

Apart from putting into place measures aimed at addressing losses to the fiscus due to taxpayer behaviour, Government provides relief for taxpayers aimed at lifting the personal tax burden, addressing matters that are deemed lacking to the country or a combination thereof. One of these issues is the skills shortage crisis in South Africa. In response, Government provides a tax incentive on employer-provided *bona fide* scholarships or bursaries outlined in section 10(1)(q) of the Income Tax Act 58 of 1962, as amended (“the Act”). In this regard, a *bona fide* scholarship or bursary granted to an employee or their relative is exempt from tax if certain conditions are met, in addition, employers can claim a subsequent tax deduction for costs incurred on the scholarship or bursary.

Section 10(1)(q) of the Act has been amended several times responding to employer structuring, commonly known as salary sacrifice arrangements which are built into the grant of the scholarship or bursary. The term ‘salary sacrifice’ means an employer would grant an employee a non-cash benefit and the cash salary is then reduced by the cost of such benefit, therefore reducing the taxable income of the employee (Braauw, 2009). In 2006, the restrictions to section 10(1)(q) exemption linked to salary sacrifice arrangements were lifted with National Treasury (2006) stating, “while [salary sacrifice arrangements are] justifiable as a matter of legal theory, this distinction makes little economic sense in the light of the skills shortage within South Africa”. However, the restriction on salary sacrifice arrangements has been re-introduced in the 2020/21 Draft Taxation Law Amendment Bill.

Salary sacrifice arrangements aim to reduce the employee's tax liability by receiving a tax-free or minimal tax fringe benefit, ultimately reducing their taxable cash/income. In these set-ups, according to Lockem (2007:14), the structure includes cash and non-cash benefits such as employer-provided medical aid contributions, the use of a company car, meals in cafeterias, and education. To that end, an employer-provided *bona fide* scholarship or bursary is a typical benefit that is offered in a salary sacrifice arrangement. In this regard, where there is a salary sacrifice arrangement, an employee’s tax burden is lessened by the portion of cash allocated for the scholarship or bursary and the individual or their relatives are upskilled. Considering the reduction of the personal income tax burden and the promotion of education and upskilling; salary sacrifice arrangements could, in the context of section 10(1)(q) of the Act, be used as a tool to address the skills shortage crisis as intended when the provision was introduced to legislation.

## **1.2. Literature review**

### **1.2.1. Employer provided *bona fide* scholarships or bursaries**

Current legislation provides that an employer-provided *bona fide* bursary and scholarship granted to the employee or a relative of the employee will be exempt in the hands of the employee unless

the employee agrees to reimburse the employer for any *bona fide* bursary and scholarship granted to that employee if that employee fails to complete his or her studies for reasons other than death, ill-health or injury. Section 10(1)(q)(a)(ii) of the Act relates to the case of a *bona fide* bursary and scholarship granted to relatives of an employee. In this regard, monetary limits have been placed on the employee's remuneration as well as the value of the *bona fide* bursary and scholarship that will be subject to the exemption.

As mentioned, section 10(1)(q) of the Act has been subject to amendments. In 1962, the exemption related to a gratuity of costs incurred by an employee if he/she completes a diploma, degree, or passes an exam and that the gratuity is not derived from remuneration. In 1984, the exemption would apply for *bona fide* scholarships or bursaries provided to employees' relatives subject to meeting admin-related qualifying requirements such as acknowledgement of scheme by the Commissioner, the bursary is awarded based on merit, it is available to all employees' relatives, etc. In 1991, section 10(1)(q) and (qA) of the Act was deleted in its entirety and revised in 1992. The revised section 10(1)(q) inserted in the Income Tax Act 141 of 1992 specifically restricted the exemption if the remuneration was subject to a salary sacrifice arrangement and section 23(j) of the Act, which disallowed employers to claim a deduction on costs incurred, was inserted.

This was a response to years of salary sacrifice structuring between employers and employees. As Olivier (2000:179) explained that from the 1980s, the practice of structuring remuneration by granting fringe benefits was in full force and as a result, 'Government had to take action as it was losing significant amounts of revenue'. In 2006, the qualifying criteria for section 10(1)(q) of the Act were changed. The restriction that the exemption will not apply under salary sacrifice arrangements, was lifted and instead, the exemption was amended to apply if the employee agrees to reimburse the employer the value of the scholarship or bursary should they fail to complete the course by reasons other than death, ill-health, and injury. Furthermore, section 23(j) of the Act was removed to encourage the employers to grant scholarships or bursaries (National Treasury, 2006). National Treasury (2006) explained that, although admitting that the previous clause was justifiable as a matter of legal theory, this distinction made little economic sense considering the skills shortage within South Africa.

In 2020, the Draft Tax Law Amendment Bill proposed a reversal of the 2006 provisions proposing that the exemption should not apply where there is an element of a salary sacrifice and that section 23(j) of the Act be reinstated. This was met with a backlash from industry highlighting that it is majority low-income households that benefit from this exemption given that they would not have otherwise afforded the quality of education had it not been for salary sacrifice arrangements and amending this will severely impact these families' ability to access quality education which will be especially significant in a post-Covid-19 economy (Business Tech, 2020). Despite public

comments to not proceed with these changes, the proposals were implemented and re-enacted into legislation. As a result, employer-provided *bona fide* scholarships and bursaries remains tax-free; however, where there is no salary sacrifice arrangement present.

### **1.2.2. Salary sacrifice arrangements**

A salary sacrifice is a reduction or substitution of an employee's cash salary in exchange for other non-cash benefits in place (Snyders & de Kock, 2016:1). A salary sacrifice arrangement aims to arrange a remuneration package such that the employee enjoys a fringe benefit provided by their employer while paying the minimum tax payable. According to Pieter van der Zwan and Associates (2016:4), the tax issue arising from a salary sacrifice or restructuring scheme is whether the remuneration falls into paragraph (c) of the definition of gross income which deems amounts received by virtue of employment as fully taxable or under the provisions of paragraph (i) of the definition of gross income which deems the cash equivalent of a fringe benefit as subject to tax. Salary sacrifice arrangements benefit the employee to the extent that the reduction of the employee's private/domestic expenses from the provision of the fringe benefit is much higher than the reduced after-tax income (Swart, 1985:289).

Due to the lack of a formal set of rules on salary sacrifice arrangements, case law is utilised in a South African context in defining, arranging, and applying salary sacrifice arrangements. In *Apollo Tyres SA (Pty) Ltd v Commissioner of Conciliation, Mediation & Arbitration & Others (2013)*, Judge Musi stated provided that non-cash benefits are essential in practically all contemporary employment contracts and are given to employees as a quid pro quo for services rendered and is not different from wages given as a quid pro quo for services rendered. As much as salary sacrifice arrangements are designed to receive a tax benefit, the Courts have gone further to say that other requirements must be met. For example, *Income Tax Case 1663* held in 1999 and *Anglo Platinum Management Services Pty (Ltd) v Commissioner for South African Revenue Service* held in 2015 focused on the validity of salary sacrifice arrangements based on failure to meet the administrative requirements and obtaining the necessary approvals and a mixture of administrative requirements and legislative application respectively.

The outcome of these court cases highlighted that a salary sacrifice arrangement does not have to focus on the tax implications alone but relevant criteria such as due process, approvals, etc. are equally as important in the set-up of a valid salary sacrifice arrangement. Salary sacrifice arrangements will be discussed in more detail in the following chapters.

### 1.3. Motivation of topic actuality

The level of skills shortages in South Africa has been a national concern for decades. Langeni (2020:838) explains that skills shortages have been included in the post-Apartheid South African government agenda for some time, and even so, the country continues to face skills shortages. In a Parliamentary session, Mputing (2020) explained that it has been highlighted that the link between skills and education is a critical contributing factor to economic growth. Twalo (2010:838) believes that the inappropriateness and inadequacy of skills has an impact on South Africa's success in the global economy. Salary sacrifice arrangements on section 10(1)(q) of the Act could, within its parameters, work as a tool to address the skills shortage agenda. Concerned about the need to focus on education, Bower (2020), reflects on how implementing scholarships and bursaries in a salary sacrifice basis has provided some breathing space for many middle- and low-income households that struggle to afford quality education for their relatives.

There is a general appreciation for tax incentives introduced into legislation, Government could, if possible, have an opportunity to use tax incentives to advance the skills development in the country. Langeni (2020:60) provides that government's involvement is a critical motivator in the stimulation of the conditions to get momentum going in the development of a knowledge economy. Business Tech (2020) believes that the availability of the education tax incentive is an important one among all current tax incentives available as it allows low-income earners to provide a quality education to South Africa's next generation.

In addition, high levels of personal income taxes have been a concern in South Africa for decades resulting in several tax reforms being introduced into legislation taking recommendations from the Franzen, Margo, Katz, etc. commissions. At present, South Africa's highest individual tax rate sits at 45%, which, according to Trading Economics (2021), places South Africa as the second country in Africa, and in the top 20 countries with the highest tax chargeable in the world as of December 2020. This has an adverse impact on an individual's finances which was worsened in 2020 when the world was faced with the Covid-19 pandemic. Business Tech (2020) reported that Covid-19 has devastated the economy; that dual-income households have become 'single' income' or 'no income' households, thus, emphasising the point of reducing the financial burden on taxpayers.

### 1.4. Problem statement

Tax incentives are a common tool utilized by many countries around the world for various reasons such as the stimulation of economic growth, addressing social objectives, tax competitiveness and as a bid to attract and enhance FDI (Brodzka, 2013:26; Calitz *et al.*, 2013:2; Klemm, 2010:316). As a tax incentive, *bona fide* bursaries and scholarships can be a tool utilized for the advancement of skills development in South Africa and as such, placing limitations such as

limiting the tax incentive on non-salary sacrifice arrangements, could render it ineffective. Salary sacrifice arrangements are sometimes regarded as a tax avoidance mechanism based on several tax cases in which the legitimacy of a salary sacrifice arrangement was scrutinised by SARS requiring intervention by the courts. According to De Koker and Williams (2020), tax avoidance implies stratagems that are prima facie lawful unless prescribed by the Act. In the infamous case of *Duke of Westminster v IRC* (1936), Lord Tomlin set the precedence that tax avoidance schemes are allowed if arranged in accordance with the provisions of the law.

The focus is on whether *bona fide* bursaries and scholarships, in its capacity as a tax incentive is effective in promoting skills development as intended by the Government or if the provisions of salary sacrifice arrangements limit the effectiveness of the tax incentive. By allowing salary sacrifice arrangements on *bona fide* bursaries and scholarships, the tax incentive could be utilised for legitimate purposes such as skills shortages and reducing the personal tax burden on employees. In this manner, the benefits to the economy that is realised by the successful application of the tax incentive with the absence of salary sacrifice arrangement limitations could, if measured against the perceived tax avoidance, result in a more effective and meaningful tax incentive and as such, warrant the removal of salary sacrifice arrangements from section 10(1)(q) of the Act. That is, with the effective application of section 10(1)(q) of the Act, Government's objectives could be met effectively. As such, Government needs to strike a balance between the perceived tax avoidance or abuse of the provisions to the benefits of an effective tax incentive.

Based on the approach by OECD countries on their tax policy on skills development through employer-granted scholarships, is the South African *bona fide* bursary and scholarship tax incentive meaningful and effective?

### **1.5. Main objective**

The main objective is to analyse the manner in which section 10(1)(q) of the Act relating to employer-provided *bona fide* bursaries and scholarships, as a tool to address skills shortages, is provided as a tax incentive and to understand how this compares with similar incentives as provided in foreign jurisdictions from a tax perspective. In comparing the OECD countries' tax policies, the study intends on comparing these approaches.

### **1.6. Secondary objectives**

- a) To discuss section 10(1)(q) of the Act provisions on *bona fide* bursaries and scholarships and its evolution since 1962 to date including detailed discussion on the principles of salary sacrifice arrangements.

- b) To discuss the theoretical principles of tax incentives including characteristics of a meaningful and effective tax incentive.
- c) To conduct a comparative study between South Africa and a selection of OECD countries on how the employer-provided scholarships are designed.

## **1.7. Research methodology**

"Subjectivity in academic research can be fundamental to a research [project], if the research is focused on a phenomenon which can be interpreted in numerous ways. This subjectivity must be addressed in some way to ensure that research is conducted with rigour and fairness (Burke, 2007:477)." A research methodology works as a tool to guide the researcher in conducting an objective, unbiased and fair research. It is therefore important to describe what methodology will be utilized for this study and the accompanying approaches. First, one must determine the research paradigm, that is, the researcher's belief system. Rehman and Alharthi (2016:51) provide that the very nature of a research paradigm is our understanding, studying and interpretation of the reality of the world. Ohei (2015:45) explains that a paradigm is a theory that stipulates an overall set of theoretical assumptions considering three common research paradigms; positivist, interpretivism, and critical theory.

### **1.7.1 Study context and paradigmatic assumptions**

The first paradigm, positivism, assumes that reality exists independently of humans. In this regard, Rehman and Alharthi (2016:53) provide that in positivism, reality is not facilitated by our senses/views/thoughts and is an unchangeable law. The positivist paradigm utilizes objective data commonly made up of mathematical components. In a positivist paradigm, according to Alharahsheh and Pius (2020:41), the researcher aims to find causal relationships between the data gathered in order to formulate a law-like generalization. The second paradigm, interpretivism, focuses on individual understanding, meaning and interpretation (Alharahsheh & Pius, 2020:42). Saunders *et al.* (2012:593) define an interpretive paradigm as a philosophical position that is concerned with understanding the way humans make sense of the world. According to Kivunja and Kuyini (2017:33) in interpretivism, theory follows research so that it is grounded on the data gathered from the research act. Flinspach (2001:14) provides that instead of generalizing knowledge, as a basis for problem-solving, interpretivists researchers aim to educate themselves and their audiences about meaning in a particular empirical or disciplinary framework.

This research does not rely on systematic, mathematical equations or calculations to meet the objectives. Given the various interpretations and application to tax legislation, the researcher intends to obtain an understanding of the OECD countries' interpretation to determine whether this can be applied to South Africa. As a result, this research study will adopt the interpretivist

paradigm. Interpretivism assumes a subjective epistemology, a relativist ontology, a naturalist methodology, and balanced axiology (Kivunja & Kuyini, 2017:33). Methodology is qualitative in nature adopting a legal reform-oriented research project achieved through applying the content analysis and comparative legal research method to achieve the desired objectives.

#### 1.7.1.1. Epistemological assumptions

Epistemology is the study of knowledge. The epistemological approach to an interpretive paradigm, according to Saunders *et al.* (2008:119), assumes subjective meanings and social phenomena and focuses on the details of the situation, the reality behind these details, and subjective meanings motivating the subsequent actions. The subjectivism view is that social phenomena are created from the perspective and consequent actions of social actors (Saunders *et al.*, 2008:111). Kivunja and Kuyini (2017:27) advise that four components of epistemological assumptions exist: *intuitive knowledge* which is belief/faith-based knowledge, *authoritative knowledge* assumes that knowledge is obtained from known data sources such as books, leaders, and reputable people. The third component, *logical knowledge/rationalist epistemology*, is based on seeing rationale or reasoning and *empirical epistemology* is best described as an approach that emphasises the understanding that knowledge is best derived from experiences and demonstrable objective facts.

Legislation is subject to interpretation across its disciplines based on environmental, circumstantial, or social beliefs of the interpreter. Much of the data/information for this research is authoritative in nature where the empirical position, logic, and rationale of the relevant parties involved, i.e., legislators, taxpayers, and employees will be a major contributing factor.

#### 1.7.1.2. Ontological assumptions

While epistemology is concerned with knowledge, ontology is concerned with how we can understand this knowledge. Alharahsheh and Pius (2020:40) provide that ontology is mainly concerned with the phenomenon in terms of its nature of existence, that it is seeking an answer or reality to a research question through referring to existing types of knowledge that can be found. It is the ontological assumption that will enable an understanding regarding the approach by Government on meeting its objectives and the corresponding views or beliefs regarding tax incentives through salary sacrifice arrangements.

#### 1.7.1.3 Methodological assumptions

Methodology refers to the research mechanisms adopted in answering the research question. Van Gestel *et al.* (2012:1) defined a methodology in a legal context as more concerned with making implicit assumptions explicit. A methodology provides guidance and direction on how the research will be conducted, what type of data will be gathered, and how these will be analysed

and applied to the research question. Data gathering, participants, instruments used, and data analysis, are all parts of the broad field of methodology (Kivunja & Kuyini, 2017:28).

The common methodologies in academic research are qualitative (non-mathematical, explanatory, commentary-based), quantitative (mostly scientific and mathematical), or mixed methods. Staller (2010:1158) explains that qualitative research is an umbrella term used to cover a wide variety of research methods and methodologies that provide holistic, in-depth accounts and attempt to reflect the complicated interpretive nature of our social world. Qualitative researchers are interested in understanding how knowledge is historically, politically, and culturally situated (Staller, 2010:1159). One of the positive attributes of qualitative research is the ability of the researchers in obtaining a new way of seeing/interpreting existing data. The methodology adopted for this study is qualitative in nature.

#### 1.7.1.4. Theoretical framework and assumptions

The scope of the research data will adopt a few assumptions to ensure that the research data aligns with the research question; that is, to determine whether South African tax practice or legislation could adopt foreign approaches to *bona fide* scholarships or bursaries to ensure effectiveness of the tax incentive. Therefore, the research will investigate the below factors.

- a) Several employers who fund scholarships or bursaries do so through salary sacrifice arrangements (or the employees' relatives) leading to skills development.
- b) References to public sector participation regarding skills development include employer-provided *bona fide* scholarships or bursaries, unless stated otherwise.
- c) The structure of the salary sacrifice arrangement results in the participating employees' taxable cash portion being reduced, thus having to pay lesser tax and receiving a higher net salary.
- d) Given the current financial realities for many South African homes, due to the pandemic, the value of tax savings to employees is assumed to have a significant impact.

### 1.8. Research design

Research design is a fundamentally important factor in any research project (Webley, 2010:5). A research design is a strategic framework for action that serves as a bridge between research questions and the execution of the implementation of the research (Dürrhein, 2006:34). A research design should provide a plan that specifies how the research is going to be executed (Dürrhein, 2006:34). This study will adopt the legal research method. According to Hutchinson (2008:1068), legal research has been categorized into four broad headings, first established by the Arthurs Report, 1983 and the Pearce Report, 1987: the *doctrinal research*, *reform-oriented research*, *theoretical research*, and the *fundamental research*.

This study aims to determine whether *bona fide* bursaries and scholarships tax incentives are effective in line with international standards by looking into the approaches by the OECD countries to the same. Should the results indicate that the tax incentive is ineffective compared to international standards, recommendations will be made for consideration by the South African tax system, therefore, the legal research method adopted for this study is the reform-oriented method. According to Hutchinson (2008:1068), the reform-oriented research evaluates the adequacy of existing rules and recommends changes to any rules found wanting.

The major portion of legal research for the purposes of law reform is of three categories, analytical, historical, and comparative. The first is concerned with what the law is [critical analysis of section 10(1)(q) of the Act in legislation]; the second with the law's history and evolution [the evolution of section 10(1)(q) of the Act in a salary sacrifice arrangement context]; and the third with the comparable position in other countries [comparison between South Africa and 30 OECD countries regarding the tax policy on scholarships] (Bakshi, 1982:381).

### **1.8.1. Content analysis**

Content analysis identifies patterns in text and the themes in bodies of documents (Hutchinson & Duncan, 2012:118). Content analysis includes the process of reading judgements, legislation, and policy documents as text rather than reading for the substance of the 'law' and legal reasoning (Hutchinson & Duncan, 2012:118). Webley (2010:13) explains that content analysis is reliant on relatively large data sets, which allows the researcher to interrogate the content of a range of documents to draw conclusions. Guided by Webley (2010:13); the researcher intends using a coding method. The coding method is applied by reading the text to pull out emerging themes to make them specific, reduce texts to codes by counting occurrences to allow interpretations to be drawn from the documents, develop an index of descriptors with codes to allow categorization and lastly, organise these into themes identified in the research objectives.

### **1.8.2. Comparative study**

Scholarly legal research often requires comparing one's own legal system to another one (Van Hoecke, 2015:3). Due to increasing globalisation and regionalisation, no legal problem is purely or exclusively national in nature or character (Fombad, 2018:988). To this point, a single legal problem could be solved by applying legal rules or practices adopted by another jurisdiction. Comparative legal research provides useful means for filling gaps and addressing the ambiguities arising from the notion that no national legal system is complete, and is the key to any research aimed at drafting harmonized laws, international conventions, and agreements (Fombad, 2018:988). To achieve the research question, a comparison between South Africa and the OECD countries is vital. These countries were selected based on several factors outlined below.

While South Africa does not fall under the OECD countries, its policies are closely aligned and inspired by OECD principles and as such, the policy-making in South Africa is influenced by OECD principles. In 2007, South Africa became a key partner of the OECD through a resolution adopted by the OECD Council at Ministerial level (OECD, 2018). Key partners comprehensively contribute to the OECD's work in a sustained manner and essential to the collaboration is the promotion of direct and active participation to the OECD by the countries. South Africa is also a primer over of the OECD activities on taxation, investment, policy and governance. As such, the laws of South Africa closely resemble the principles laid out by the OECD and it is a big contributor toward the growth of the South African economy. As such, in its official position, South Africa is an associate in six OECD bodies and participates in 15 OECD bodies and projects (OECD, 2018).

Due to the above, using OECD countries as a comparison to South African principles will impact the manner in which South African tax policy is shaped. This is due to the influence that the OECD has on South African legislation. Therefore, gaining an understanding on how the OECD countries treat employer-provided scholarships will provide the needed guidance on whether South Africa is in line with international standards. The OECD countries discussed in this study are Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Iceland, Ireland, Israel, Italy, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom as well as the United States. These countries consist of first and second world, developed and developing countries which provides the needed balance for the purpose of this study. As a result, using the OECD countries' tax policy on scholarships will prove valuable to the outcome of the research study.

### **1.9. Data collection**

Regarding data collection, adopting the qualitative methodology, Staller (2010:1160) infers that the empirical evidence used in qualitative inquiry is non-numerical and is collected through documents and artifacts. This study will collect the required data through documentation and commentaries which includes, Legislation, i.e. the Acts, corresponding manuals, rulings, commentary from the respective Government's websites. In addition, academic articles, dissertations, thesis, publicly available legal opinions, and academic references will be utilized in this regard.

It should be noted that, qualitative research projects are more fitting to require of the researcher to make his or her position, role, and influence clear and the researcher is expected to examine and disclose their position (Staller, 2010:1160). Axiology refers to the ethical issues that need to be considered when planning a research proposal, put simply, it addresses the question of, what

the nature of the ethical position or ethical behaviour is? (Kivunja & Kuyini, 2017:28). Sources and data gathered for this study will be largely academic, legal, theoretical, written, and be publicly available. The views, opinions, and position of the researcher will be substantiated and backed up by reliable resources.

### **1.10. Chapter overview**

**Chapter One** will introduce the research study, events leading to the research question, the background, outline the research objectives, and briefly discuss the methodologies adopted.

**Chapter Two** discusses the South African Government's objectives in addressing the skills shortage crisis particularly focused educational assistance provided by employers. In this regard, the evolution section 10(1)(q) of the Act since its inception of the current Act in South Africa will be discussed in detail as well as an analysis of salary sacrifice arrangements in their capacity as the contributing factor to the limitation of *bona fide* bursaries and scholarships.

**Chapter Three** discusses tax incentives in theoretical terms applying the principles to section 10(1)(q) of the Act to determine whether section 10(1)(q) of the Act, in its capacity as a tax incentive as defined, is a meaningful and effective tax incentive.

The types of structures that exist in 30 OECD countries on scholarships from a tax perspective will be discussed in **Chapter Four** focusing on the tax provisions where the scholarship is granted by an employer to an employee or their relatives. The findings from the foreign tax policy will be compared to South African provisions to determine whether South Africa is in line with international standards from an OECD perspective or whether the provisions could be improved taking guidance from OECD countries' tax policy.

**Chapter Five** rounds off the study outlining the purpose of the research, discussing the findings from each chapter and concluding on whether the research objectives have been met. This chapter concludes the study.

## **CHAPTER 2: SOUTH AFRICAN TAX TREATMENT OF EMPLOYER-PROVIDED EDUCATION BENEFITS**

In this chapter, the first secondary objective, discussing Government's objectives on curbing skills shortages by using tax incentives through a discussion of the evolution of section 10(1)(q) of the Act from 1962 to date, will be discussed in detail. This will be achieved by a discussion of the evolution of employer-provided educational assistance and grants from a tax perspective through section 10(1)(q) of the Act and related provisions and followed by a theoretical discussion on salary sacrifice arrangements. Furthermore, findings from the previous chapter on tax incentives will be utilized to evaluate and analyse the principles outlined in this chapter accordingly.

### **2.1. Employer-provided scholarships and bursaries**

Employers have always encouraged employees obtaining an education and in so doing, contributed to promoting skills development by compensating them upon successful completion of their studies. Similarly, Government provides benefits through legislation in an effort to promote education for the private sector as it recognises the importance of education and skills development. These benefits include provisions outlined throughout legislation such as section 10(1)(q) exemption on employer-provided scholarships or bursaries, section 11D which relates to the tax incentive on research and development, section 12H of the Act relating to the learnership tax incentive, the Employment Tax Incentive Act, however, for purposes of this study, only the provisions surrounding scholarships or bursaries will be discussed.

Section 10(1)(q) of the Act provides an exemption for employer-provided *bona fide* scholarships and bursaries which are granted to employees or their relatives to enable them to study provided that certain conditions are met. Currently, section 10(1)(q) of the Act reads:

*There shall be exempt from normal tax any bona fide scholarship or bursary, other than any scholarship or bursary contemplated in paragraph (qA), granted to enable or assist any person to study at a recognized educational or research institution: Provided that if any such scholarship or bursary has been so granted by an employer or an associated institution (as respectively defined in paragraph 1 of the Seventh Schedule) to an employee (as defined in the said paragraph) or to a relative of such employee, the exemption under this paragraph shall not apply:*

- i) in the case of a scholarship or bursary granted to so enable or assist any such employee, unless the employee agrees to reimburse the employer for any scholarship or bursary granted to that employee if that employee fails to complete his or her studies for reasons other than death, ill-health or injury.*
- ii) in the case of a scholarship or bursary granted to enable or assist any such relative of an employee so to study\_*

- aa) *if the remuneration proxy derived by the employee in relation to a year of assessment exceeded R600 000; and*
- bb) *to so much of any scholarship or bursary contemplated in this sub-paragraph as in the case of any such relative, during the year of assessment exceeds –*
  - (A) *R20 000 in respect of grade R to grade twelve as contemplated in the definition of “school” in section 1 of the South African Schools Act, 1996 or (BB) a qualification to which a National Qualifications Framework (“NQF”) level from 1 up to and including 4 has been allocated in accordance with Chapter 2 of the National Qualification Framework Act, 2008; and*
  - (B) *R60 000 in respect of a qualification to which an NQF level from 5 up to and including 10 has been allocated in accordance with Chapter 2 of the National Qualification Framework Act, 2008; and*
- cc) *if any remuneration to which the employee was entitled or might in the future have become entitled was in any manner whatsoever reduced or forfeited as a result of the grant of such scholarship or bursary.*

In this regard, when section 10(1)(q) is applied, an employee receiving an employer-provided scholarship or bursary enjoys an education grant that enables them to further their studies at no cost to the employee from a tax perspective. The employer, on the other hand, can claim a deduction against the amounts granted as a scholarship or bursary therefore also receiving a tax benefit. As a result, the amounts allocated to enable employees to study are maximised. However, if the employer’s scholarship or bursary is incorporated in the employees’ remuneration in the form of a salary reduction/sacrifice arrangement, the tax exemption ceases being applicable and the monies expended for bursary or scholarship purposes become taxable in the hands of the employee.

The scholarship or bursary exemption has not always had the present restrictive requirements. Dating as far back as 1962, provisions relating to employee education grants have been reworded, removed from legislation, reinserted into legislation and amended mostly centred around the design and implementation grant by employers.

### **2.1.1 Inception, introduction and first amendments to *bona fide* bursaries (1962 – 1990)**

In 1962, the benefit was in the form of a gratuity payment for completion of studies. Section 10(1)(q) read:

*q) there shall be exempt from income tax so much of any gratuity received by or accrued to any person from his employer as the Commissioner deems to be a grant made because such person had obtained a university degree or diploma or had been successful in some examination, and not remuneration or any portion of remuneration for services rendered or to be rendered.*

In this regard, the exemption applied to a reward provided to an employee for an achievement, that is, the completion of a degree/diploma or passing an exam. Built into the provisions was a limitation that the exemption would only apply to the extent that the gratuity did not form part of

the employee's remuneration in respect of services rendered. That is to say, if the gratuity forms part of the employee's package, it will be fully taxable in their hands thus ensuring that the employer does not compensate the employee for completing their studies from the employees' pockets and deem that portion tax free.

In 1966, section 10(1)(qA) of the Act was inserted into legislation. Section 10(1)(qA) allowed an exemption for *bona fide* bursaries granted to employees or their relatives to enable them to study at recognised educational and research institutions. Law (2009) defines *bona fide* as meaning "in good faith, genuine, without collusion or fraud". SARS' Interpretation note 66 provides that an institution is recognised, for purposes of the tax-free scholarship or bursary, if that institution is established by or registered under the South African education laws such as the Higher Education Act 1997, the Skills Development Act 1998 or the National Research Foundation Act 1998. In this regard, only a *bona fide* bursary agreement, in which the bursary holder studies at an educational institution recognised under South African legislation, would qualify for a tax exemption.

The inserted section did not replace section 10(1)(q) of the Act but was inserted in addition to the existing clause dealing with gratuity payments. Furthermore, section 10(1)(qA) of the Act did not contain restrictions or limitations with regards to the design of the bursary scheme, only that the bursary must be to study at a recognised institution. As such, if the bursary was granted under a remuneration structure, the exemption would remain. In addition, section 10(1)(qA) of the Act dealt with bursaries to the employees' relatives.

In 1984, a number of changes were made to legislation pertaining to employee educational assistance. Three major amendments were made in this regard; the insertion of section 10(1)(nC), the introduction of additional requirements to be met in order for section 10(1)(qA) to be deemed non-taxable and the insertion of provisions relating to study loans in the Seventh Schedule to the Act. The first amendment, section 10(1)(nC) of the Act dealt with spontaneous grants by employers to children of employees. The exemption applied where the grant did not exceed R750 and employee remuneration did not exceed R8 000 per annum. National treasury advised that the exemption was proposed mainly with a view to cost-effectiveness therefore to maximise monies made available for education to employees' children without tax limitations.

Secondly, section 10(1)(qA) was amended to include "scholarships" and the insertion of an exception clause which prohibited the exemption on a scholarship or bursary granted to employees' relatives if that scholarship or bursary scheme has not been approved by the Commissioner due to failure to not meet the Commissioner's criterion. The Commissioner's qualifying criteria for a scholarship or bursary scheme were outlined in sub-paragraphs (i) to (vii) and read,

- i) *the scheme is governed by properly defined rules;*
- ii) *the rules of the scheme provide that the commissioner shall be notified of all amendments to the rules;*
- iii) *the commissioner is satisfied that the scholarships or bursaries under the scheme are awarded on merit or according to need on the recommendation of a representative body of persons acting impartially;*
- iv) *the scholarships or bursaries under the scheme are awarded to enable pupils to study at educational institutions of a public character, other than primary schools, and to follow courses of study specified by the said body;*
- v) *a scholarship or bursary awarded to a pupil to attend a secondary school does not exceed an amount of R750 per annum;*
- i) *the children of all employees of the employer may, depending on any objective criterion, qualify for any of the scholarships or bursaries that may be available in terms of the scheme; and*
- ii) *no bursary awarded under the scheme may be terminated, cancelled, or withdrawn merely by reason of the fact that the services of an employee to whom the scholarship-holder or bursar is related, have for any reason, terminated.*

When the Seventh Schedule was introduced, the wording deemed a bursary granted in terms of section 10(1)(qA) to a relative of an employee as taxable. However, clause 10(1)(g) of the Income Tax Act 121 of 1984 proposed that these grants be treated as non-taxable as long as they were approved bursary schemes since, according to National Treasury (1984:5), it was never the intention to tax *bona fide* bursaries. In this regard, as long as the bursary scheme met the above criteria and had been approved, it would remain non-taxable.

Thirdly, an additional proviso was inserted into section 10(1)(qA) of the Act which provided that a study loan and the subsequent 'interest' on the loan repayments, included in the employee's gross income, would be deemed to be a bursary and therefore exempt in terms of section 10(1)(qA) (National Treasury, 1984:5). The provisions relating to employer-to-employee loans and the interest thereon were outlined in paragraph 2(f) read with paragraph 11 of the Seventh Schedule, which was inserted into legislation in the same Act, i.e. Income Tax Act 121 of 1984.

Up to this point, section 10(1)(q) was provided as a benefit in the form of an exemption to employees for completion of studies and granted as a gratuity. This benefit was deemed non-taxable as long as it did not form part of the employee's remuneration package. Section 10(1)(qA) of the Act was introduced to deal with bursary schemes that are ran by employers for employees' relatives and was never intended to be taxed by design. In addition, section 10(1)(nC), introduced in 1984, covered occasional educational assistance specifically for employees' children. This was intended for cost effectiveness specifically to maximise the education funding by removing the potential tax burden. There were little restrictions and limitation to the benefits and the intent appeared to be focused on promoting education and skills development for employees and their relatives.

### 2.1.2. Introduction of salary sacrifice prohibitions (1991 – 2000)

In 1991, all provisions relating to education assistance, that is, section 10(1)(q), section 10(1)(qA) and section 10(1)(nC) were deleted from legislation. Government pointed out that this was done in the light of the abuse of the exemption by employers through remuneration restructuring schemes and to align with the recently introduced Seventh Schedule, the current provisions would be removed (National Treasury, 1991:5).

A new section 10(1)(q) was then inserted in 1992 which covered all the employer educational assistance for employees and their relatives under one single provision. The new provisions read:

*(q) there shall be exempt from income tax, any bona fide scholarship or bursary granted to enable or assist;*

*any person to study at a recognized educational or research institution: Provided that if any such scholarship or bursary has been so granted by an employer or an associated institution to the employer (as defined in paragraph 1 of the Seventh Schedule) to an employee (as defined in the said paragraph) or to a relative of such employee in circumstances indicating that the scholarship or bursary concerned would not have been granted had that employee not been an employee of that employer, the exemption under this paragraph shall not apply-*

- (i) if any remuneration to which the employee was entitled or might in the future have become entitled was in any manner whatsoever reduced or forfeited as a result of the grant of such scholarship or bursary.*
- (ii) in the case of a scholarship or bursary granted to enable or assist any such relative of an employee so to study, if the remuneration derived by the employee during the year of assessment exceeded R36 000; and*
- (iii) to so much of any scholarship or bursary contemplated in paragraph (ii) as in the case of any such relative exceeds R 1 200 during the year of assessment.*

The new provisions were centred around salary sacrifice arrangements. In this regard, the exemption would apply if certain conditions were met; however, would be disqualified should the grant be under a salary sacrifice arrangement where the bursary was granted to employees. For the employees' relatives, the exemption would apply subject to the monetary threshold, i.e. the employee's remuneration must not exceed R36 000 per annum and the value of the bursary must not exceed R1200. Any amounts over this would be deemed taxable. In addition, section 23(j) which allowed an employer deduction on *bona fide* bursaries was amended to only apply if the bursary does not form part of a salary sacrifice arrangement. Therefore, if a bursary agreement falls under a salary sacrifice arrangement, the exemption would not apply in the hands of the employees and they would subsequently be taxed on the bursary amount and the employer would be denied a tax deduction.

National Treasury provided that the rationale behind the change was due to an abuse of the bursary clause in that employees' children would be granted the bursaries without regard to merits of the bursar (Erasmus, 1992:29; National Treasury 1992:17). Olivier (2000:179) explained that

from the 1980s, the practice of structuring remuneration by granting fringe benefits was in full force and as a result, Government was forced to take action as the fiscus was losing significant amounts of revenue. Furthermore, Government was concerned with the bursary arrangements between the employer and employee, who were mostly in senior positions, in which the employee would accept a reduction on salary or forfeit a future salary increase or allowance in return of the tax-free bursary for their children. This was deemed to be tax avoidance and unjust since only a certain class of taxpayers benefited from the exemption and to the detriment of majority taxpayers (Erasmus, 1992:29). In 1997 the bursary limits for relatives were increased from remuneration proxy of R36000 to R50 000 and bursary amount increased from R1200 to R1600.

In summary, during this period, the exemption was coupled in a single provision under section 10(1)(q) of the Act and included restrictions in terms of how the exemption may be applied. In this regard, the exemption would only apply where there was no salary sacrifice arrangement between the employer and their employees. Government implemented this change to try and curb the perceived tax avoidance by employers who would offer scholarships or bursaries to employees' relatives, mostly children, under salary sacrifice arrangements however only high earning employees would afford to have such arrangements. As such, all the employer-provided educational assistance tax incentives were deleted from legislation and re-introduced as a single provision.

### **2.1.3 Lifting of salary sacrifice requirement (2000 – 2019)**

In 2002, the monetary threshold was again increased from R50 000 to R60 000 in terms of the remuneration proxy while the bursary value went up to R2000 from R1600.

In 2006, section 10(1)(q) of the Act took a complete turn from a qualifying criteria perspective. In this regard, the restriction that the scholarship or bursary falling under salary sacrifice arrangements will be taxable, was removed. Furthermore, section 23(j) of the Income Tax Act which denied employers a tax deduction for the costs incurred on the scholarship or bursary if the scholarship or bursary fell under a salary sacrifice arrangement, was removed. The National Treasury (2006b) provided reasons for the change by quoting "unnecessary difficulties in application" regarding the set-up of the salary sacrifice arrangements on the employers' systems. Admitting that while disqualifying the exemption, if under a salary sacrifice arrangement, was justifiable as a matter of legal theory, the distinction made little economic sense considering the skills shortage within South Africa, thus placing the focus on the ongoing development of skills by extending the incentive to arrangements which fall under salary sacrifice schemes. Therefore, to address these concerns the below amendments were proposed:

- The exemption would apply if the employee agreed to reimburse the employer the value of the scholarship or bursary should the employee fail to complete the course for reasons other than death, ill-health and injury.
- The employer's funds had to be paid directly towards tuition and related expenses (National Treasury, 2006b:79);
- Section 23(j) of the Income Tax Act, which denied a tax deduction for employers for scholarship and bursary payments, was deleted.

As a result, scholarships or bursaries awarded to employees would be exempt from tax in terms of section 10(1)(g), amended by section 10(1)(o) of the Revenue Laws Amendment Act 20 of 2006, provided that the employee agrees to reimburse the employer should they fail to complete their course for reasons other than death, disability or critical illness. Essentially, all *bona fide* bursary agreements which met the prescribed requirements would qualify for a tax exemption whether or no they formed part of a salary sacrifice arrangement. In the case of scholarships or bursaries awarded to the employees' relatives, the exemption would apply if the following monetary limits as met:

- The remuneration derived by the employee for the applicable year of assessment did not exceed R60 000; and
- The scholarship or bursary was capped at R3 000 during the applicable year of assessment.

As indicated by National Treasury (2006a) in the national budget, Government's intention was focused on addressing the skills shortage gap within the country. Furthermore, deleting section 23(j) and allowing an employer tax deduction was intended to encourage the employers to grant scholarships and bursaries, thus contributing to curbing the skills shortage crisis (National Treasury, 2006a). By this, the private sector would play a role in addressing Government's objectives on education and skills development.

At this stage, it appeared that Government focused on the social objective that was the promotion of skills development by encouraging private sector participation through the incentive. Furthermore, the educational grant would be utilised to its maximum effectiveness without being reduced by tax. In this regard, any and all scholarship or bursary schemes qualified for a tax exemption in the hands of the receiving employees and employers were allowed a subsequent tax deduction on costs incurred.

In the following years, the monetary threshold relating to education grants to employee relatives were increased to align with inflation and cost of private education amongst other factors. The 2013 amendment rules increased from R100 000 to R250 000 remuneration proxy and split

between R10 000 basic education and R30 000 higher education. In 2016, a dramatic increase on the monetary threshold was introduced. The remuneration proxy increased from R250 000 to R400 000 and bursary amounts increased from R10 000 to R15 000 for basic education, now identified as grade R to 12 and from R30 000 to R40 000 for higher education (Arde, 2016). By 2019, the remuneration proxy was placed at R600 000 per annum and the bursary threshold increased to R20 000 and R60 000 for basic and higher education respectively (the Rep, 2019). These amendments burdened many employers with financial limitations the opportunity to grant scholarships or bursaries to the employer's relatives. The Rep (2019) added that employers were able to offer this benefit at virtually no cost if the scholarships or bursaries are offered in a salary sacrifice setting thus encouraging increased private sector participation.

In 2017, a revised section 10(1)(qA) was inserted into legislation which focused specifically on scholarships and bursaries provided to persons with disabilities. The provisions remain similar to those outlined in section 10(1)(q) of the Act regarding an employee with a disability. However, in the case of employees' relatives who were disabled as per section 6B(1) of the Act; the monetary allowances were higher than those of non-disabled relatives. For purposes of this study, section 10(1)(qA) of the Act, as amended, will not be explored further.

In summary, by the end of 2019, the tax exemption enabled employers to provide employees with scholarships or bursaries to enable them to further their or their relatives' studies regardless of the manner in which the arrangement has been set. In addition, an additional section was re-introduced into legislation under section 10(1)(qA) which dealt exclusively with disabled persons.

#### **2.1.4. Re-introduction of salary sacrifice prohibition (2020 – present)**

In 2020, the Draft Tax Law Amendment Bill proposed a restriction to section 10(1)(q) of the Income Tax Act, providing that the exemption should not apply where there was an element of a salary sacrifice arrangement, thus proposing the reinstatement of the 1992 provision. Furthermore, National Treasury (2020) proposed that the tax deduction on the cost of the scholarship or bursary should be reinstated if a salary sacrifice agreement existed between the parties, therefore reinstating section 23(j) of the Income Tax Act. This was met by a backlash from industry highlighting that it was majority low-income households that benefited from this exemption given that they would not have otherwise afforded the quality of education had it not been for salary sacrifice arrangements and amending this will severely impact these families' ability to access quality education which would be especially significant in a post-Covid-19 economy (Business Tech, 2020).

Government's rationale for the proposed changes focused on the perceived abuse of legislation by employers regarding section 10(1)(q) of the Income Tax Act specifically on scholarships or bursaries granted to employees' relatives. The proposals were intended to address schemes in which a tax-free scholarship or bursary is offered by an external service provider to the employees' relatives under a salary sacrifice arrangement at no cost to the employer (National Treasury & SARS, 2021:24). Responses to industry comments/submissions on the proposed changes further clarified Government's intent. When argued that the reinstatement of the salary sacrifice restriction undermined Government's objectives on the promotion of skills development as intended in 2006, Government's response highlighted that although skills development remained a priority, the abuse of policy by taxpayers had to be acknowledged and addressed accordingly (National Treasury & SARS, 2021:25).

In response, Rudnick *et al.* (2020) believe that the 2006 amendments enabled middle to low income households that, had it not been for the salary sacrifice arrangements, would not have afforded quality education. In addition, stressing that quality education was needed now given the recent events, Government could achieve its objective of protecting the fiscus from tax avoidance while ensuring the development and growth of taxpayers (Rudnick *et al.*, 2020). Parker *et al.* (2021:30) agreed with the above sentiment adding that re-introducing the salary sacrifice arrangement restriction is thereby limiting resident's access to quality education is short-sighted on Government's part given the current state of the country as it pertains to a shortage of skills and education coupled with the high cost of education.

Despite industry submissions against the re-introduction of the salary sacrifice arrangement restriction on scholarships or bursaries granted to employees' relatives, Government went ahead to implement the proposed changes. As a result, section 10(c) of Taxation Law Amendment Bill 27 of 2020 inserted an additional proviso (cc) to section 10(1)(q)(ii) of the Act which provides:

*(q)(ii) an exemption under this paragraph shall not apply in the case of a scholarship or bursary granted to enable or assist any such relative of an employee so to study:*

*(cc) if any remuneration to which the employee was entitled or might in the future have become entitled was in any manner whatsoever reduced or forfeited as a result of the grant of such scholarship or bursary.*

As it currently stands, legislation provides that an employer-provided *bona fide* scholarship or bursary granted to the employee or a relative of the employee will be exempt in the hands of the employee if the below changes, as outlined in section 10(1)(q) of the Act, are met:

*iii) in the case of a scholarship or bursary granted to so enable or assist any such employee, unless the employee agrees to reimburse the employer for any scholarship*

- or bursary granted to that employee if that employee fails to complete his or her studies for reasons other than death, ill-health or injury.*
- iv) *in the case of a scholarship or bursary granted to enable or assist any such relative of an employee so to study\_*
- aa) *if the remuneration proxy derived by the employee in relation to a year of assessment exceeded R600 000; and*
- bb) *to so much of any scholarship or bursary contemplated in this sub-paragraph as in the case of any such relative, during the year of assessment exceeds –*
- (C) *R20 000 in respect of grade R to grade twelve as contemplated in the definition of “school” in section 1 of the South African Schools Act, 1996 or (BB) a qualification to which an NQF level from 1 up to and including 4 has been allocated in accordance with Chapter 2 of the National Qualification Framework Act, 2008; and*
- (D) *R60 000 in respect of a qualification to which an NQF level from 5 up to and including 10 has been allocated in accordance with Chapter 2 of the National Qualification Framework Act, 2008; and*
- cc) *if any remuneration to which the employee was entitled or might in the future have become entitled was in any manner whatsoever reduced or forfeited as a result of the grant of such scholarship or bursary.*

However, section 23(j) was not re-inserted into legislation suggesting that the cost to the employer for the scholarship or bursary remained deductible regardless of whether there was a salary sacrifice arrangement. Therefore, at present, legislation provides that where there is a salary sacrifice arrangement, the section 10(1)(q) of the Act exemption will not be applicable since Government views salary sacrifice arrangements as an avoidance measure utilised by employers.

### **2.1.5. Conclusion**

From the above discussion, it has been observed that over the years, Government cites ‘promotion of education and skills development’, ‘employer abuse of legislation’ and ‘anti-avoidance’ to motivate the legislative changes when placing and removing the salary sacrifice arrangement-based restrictions on the provisions. As such, salary sacrifice arrangements appear to be a contributing factor to the ambiguity of section 10(1)(q) of the Act and it is important to gain an understanding of the principles that make up salary sacrifice arrangements.

## **2.2 Salary sacrifice arrangements**

A salary sacrifice arrangement, also known as remuneration packaging, is an agreement between an employer and their employee in which the employee agrees to forfeit a portion of their cash salary for non-cash benefits, commonly referred to as ‘fringe benefits’. According to FODB (2016), a salary sacrifice arrangement involves a decrease in employees’ cash salaries for an added fringe benefit in place of the sacrificed salary for the purpose of obtaining the benefit. Snyder and De Kock (2016) maintain that a salary sacrifice is a reduction or substitution of an employee’s

cash salary in which that cash portion covers other benefits in its place, for example contributions to benefit funds, medical aid contributions or the granting of travel allowances. Swart (1985:289) describes the process as one in which the participating employees accept a cut, share or reduction in their cash remuneration in return for the provision of a new or an improved fringe benefit. Mahomed (2007:26) adds that a salary sacrifice essentially means configuring amounts payable to employees for services rendered, which, in most cases, results in a reduced PAYE liability in the hands of the employee.

In these arrangements, the employee forfeits a portion of their remuneration in exchange for receiving the fringe benefit in question such as a pension fund facility while the employer manages the amount sacrificed providing the benefit to the employee or on behalf of the employee where there is a third-party provider. It can be argued that the employer acts as an agent on behalf of the employees by managing the sacrificed salary portion to cover the cost of the fringe benefit in question (Swart, 1985:289). Common employee benefits which are subject to salary sacrifice arrangements include contributions to medical aid schemes, pension or provident fund contributions, group life cover, income protection, travel allowances, right of use of employer owned vehicle, provisions of scholarships or bursaries by the employer to employees or their relatives (Du Preez, 2013; Lockem, 2007:14).

From a legal standpoint, salary sacrifice arrangements are constitutional and allowed; this has been indicated by the courts in numerous rulings where it has been pointed out that employers and their employees have the right to structure their remuneration packages in a tax efficient manner (*ITC 1682*, 1999; Lockem, 2007:14; Silke & Stretch, 1999). In *ITC 1663*, president of the Cape Special Court, Judge Selowitz, held that a salary sacrifice scheme was common in commercial practice and employers and employees had the right to structure salary packages and were entitled to do so as to achieve the maximum tax effectiveness. Judge Musa agreed and stated in *Apollo Tyres SA (Pty) Ltd v Commissioner of Conciliation, Mediation & Arbitration & Others* (2013), that non-cash benefits were essential in many employment contracts and were offered to employees as a *quid pro quo* for services rendered and were not any different from wages given as a *quid pro quo* for services rendered.

The aim and benefits of a salary sacrifice arrangements vary and are dependent on the needs and circumstances surrounding the parties involved. These would include the instances outlined below:

- an employee is granted an opportunity to enjoy a non-cash benefit such as medical aid, pension, or provident funds, etc. (Snyder & De Kock, 2016);

- enabling an employee to access a range of benefits or experiences such as the right of use of a company car and accommodation, study benefits through scholarships and bursaries, low cost or free meals, etc. (Swart, 1985:289);
- a reduction in an employee's taxable income through sacrificing the cash portion of their remuneration which results in a lesser PAYE liability (Mahommed, 2007:26); and
- a potential increment in the employee's net salary. In delivering his judgement in *ITC 1663* (1999), Judge Selikowitz states that the straight-forward use of a salary sacrifice scheme is to effectively reduce the employees' tax liability thereby increasing the employees' take-home pay.

It can be argued that salary sacrifice arrangements can play a pivotal role in improving the lives of employees who opt to enter the schemes. This is due to the tax and private benefits provided by the reduction in the employees' tax liability and enjoying benefits which may have cost more to the employee or unaffordable had it not been for the arrangement in place. In summary, a salary sacrifice arrangement provides an employee the opportunity to access a range of benefits which the employee may not have otherwise afforded under normal circumstances thus maximising their salary, as a result of a potential reduced tax liability.

### **2.2.1. Taxation principles**

As stated, the idea of a salary sacrifice arrangement is to structure a remuneration package such that the employee enjoys a fringe benefit provided by their employer, liable for lesser tax payable and maximise after-tax remuneration. Pieter van der Zwan and Associates (2016:4) are of the opinion that the tax issue arising from salary sacrifice or restructuring scheme is whether the remuneration falls into paragraph (c) or paragraph (i) of the definition of gross income.

Paragraph (c) of definition of gross income:

*Any amount, including a voluntary award, received by or accrued to or for the benefit of any person in respect of services rendered or to be rendered (other than an amount referred to in section 8(1), 8B or 8C) received by or accrued in respect of any employment or holding of any office: Provided that the provisions of this paragraph shall not apply in respect of any benefit or advantage in respect of which the provisions of paragraph (i) apply...*

Paragraph (i) of the definition of gross income reads:

*The cash equivalent, as determined under the provisions of the Seventh Schedule, of the value during the year of assessment of any benefit or advantage granted in respect of employment or to the holder of any office, being a taxable benefit as defined in the said Schedule, and any amount required to be included in the taxpayer's income under section 8A.*

In this regard, paragraph (c) of the definition of 'gross income' provides that income received from employment, that is, remuneration, forms part of gross income and must be added and taxed in full in the employees' hands. On the other hand, paragraph (i) provides that the amount that is to be included in gross income must be the cash equivalent of a fringe benefit determined in the Seventh Schedule to the Act and does not fall under the provisions of paragraph (c). Stiglingh (2020) outlines that any benefits that are provided under the Seventh Schedule of the Act and included in gross income under paragraph (i) of that definition are excluded from paragraph (c). Therefore, if a taxable benefit in terms of the Seventh Schedule to the Act arises, paragraph (c) will not apply. Instead, the cash equivalent of a benefit per the Seventh Schedule to the Act, which may be subject to an exemption, reduction or taxable at a nil value will apply and added to gross income under paragraph (i).

Therefore, should an employee's benefit be deemed to be taxable according to paragraph (i); the cash equivalent of that fringe benefit, determined per the Seventh Schedule to the Act which may be at a reduced value, be exempted or have a nil value, will be subject to income tax. This in turn, reduces the amount of cash that equates to the face value of the fringe benefit in question thus reducing the amount of taxable income. Therefore, in a salary sacrifice arrangement, an employee forfeits a salary which would otherwise be subject to tax per paragraph (c) of the definition of 'gross income' in exchange for an employer-provided fringe benefit as provided in paragraph (i) of the definition of gross income. For example, an employee who sacrifices a salary portion in order to receive the use of an employer-provided company car receives a reduction in their taxable income of 80% or 20% of the company car usage as calculated in paragraph 7 of the Seventh Schedule to the Act. That is, the amount calculated as the cash equivalent of the use of an employer-provided company car is subject to tax at either 80% or 20% in the determination of PAYE.

### **2.2.2. Case law**

Salary sacrifice arrangements have been under scrutiny by the tax authorities for decades. The South African courts have heard cases and have had to make judgements regarding the validity of salary sacrifice arrangements. This section will discuss three separate cases brought before the courts pertaining to salary sacrifice arrangements in which the courts had to decide on the validity of the arrangements thus forming a view on factors to consider when implementing a salary sacrifice arrangement.

In 1999, in *ITC 1663*, the court had to decide whether an arrangement in which the employer, a University, contributed to the employees' medical aid scheme from the employees' pre-tax salary, was a valid salary sacrifice scheme. In this regard, the court had to decide whether the

contributions made by the employer constituted a fringe benefit as per paragraph 2(h) of the Seventh Schedule and thus included in the employees' gross income under paragraph (c) or paragraph (i) of the definition of gross income. Paragraph 2(h) of the Seventh Schedule to the Act deemed an amount paid by an employer, whether directly or indirectly, which is owing by the employee without requiring the employee to reimburse the employer for the amount in question as a fringe benefit and therefore subject to tax.

The employer contended that the arrangement formed part of a salary sacrifice system which had been agreed upon by the employees. The employer was a Technicon established under the Technicon Act 40 of 1967 as a corporate body. In October 1990, the employer subsidised the employees' medical aid contributions in exchange for a 40% sacrifice of the medical aid contribution by the employee. Up until 30 September 1990, the employees were fully liable for medical aid contributions in which they paid 40% of the total contribution which was deducted from their after-tax salary and paid to the scheme by the employer together with the balance of the contributions which the employer covered. From a tax perspective, the employees' PAYE was calculated from the gross salary before any medical aid contributions.

The commissioner argued that the contributions were in fact the employees' liability to the medical aid, formed part of the employees' salaries, and the fact that they were contributed by the employer meant that the nature of the contributions constituted a fringe benefit according to paragraph 2(h) of the Seventh Schedule to the Act thus fully taxable under paragraph (c) or (i) of the definition of gross income. As a result, the court had to determine:

- whether the contributions to the medical aid fund formed part of the employees' salaries and thus constituted gross income; and if not
- whether the employees were liable to make contributions to the medical aid funds and the employer made these contributions on their behalf.

During this period, the Act provided that any contributions made to employee medical aid funds by their employers were not taxable as per the Seventh Schedule to the Act. Instead, employers were granted a tax deduction on the contributions made. The employees, on the other hand, did not enjoy this benefit.

To this effect, the employer alleged that they had entered a salary sacrifice system with the employees which was implemented effective 01 October 1990 and as a result, employees were, in fact, no longer liable for the medical aid contributions. The employer provided the below as evidence that the scheme was indeed valid and implemented:

- the staff association bodies had agreed to the scheme on behalf of the employees,

- the rectorate had the authority to agree to the salary sacrifice scheme on behalf of university,
- the staff association bodies had the authority to negotiate and agree to the amendments of employment terms and conditions on behalf of the employees and exercised this authority,
- the bodies made the decision to implement the salary sacrifice scheme; and
- as a result of the scheme and the medical aid rules, the employees were no longer liable for any part of the medical aid contributions.

The commissioner argued that neither of the parties, the rectorate, and the unions, had a legal authority to approve the scheme nor implement it. Furthermore, the commissioner contended that there was no actual salary sacrifice scheme which was implemented but a change in the formula applied to calculate employees' taxes. In this regard, the employer deducted the medical aid contributions from the employees' pre-tax salary reducing the taxable income and subsequent PAYE thus increasing the employees' net salary.

The court held, based on the hearings and proof submitted by the parties, that the principles of a valid salary sacrifice arrangement had not been adhered to. In this regard, the court held that,

- The rectorate was neither legally authorised to approve nor implement the scheme according to the Technicon's Act neither was it given the authority by the Council;
- Therefore, it was beyond the rectorate's power to agree to implementing the scheme as the power vested on the Council or committee of Council this being sufficient evidence to deem the rectorate's approval void;
- There was no sufficient evidence, for example, written agreements, memorandums, to prove the implementation of the scheme;
- There was no proof that the employer and the employees had an enforceable agreement in which the employees agree to a reduction of their salaries;
- There was no proof that the employer and the employees had agreed to enforce the salary sacrifice system.

This resulted in the courts dismissing the employer's appeal and ruling in favour of the commissioner.

In 2000, the Commissioner brought a similar case *ITC 1682*, to the court to determine whether a salary sacrifice arrangement for medical aid and provident fund contributions was valid. The taxpayer, also a University, implemented a salary sacrifice scheme in which the taxpayer would contribute to a provident and a medical aid fund on behalf of the employees which the commission argued to be subject to employee's tax. In addition, a motor car scheme in which senior

employees funded the scheme from pre-tax salary became subject to scrutiny. In this case, while the Commissioner acknowledged that the scheme had been approved by the relevant parties, the employees' terms and conditions of employment had not been amended. As a result, the Commissioner contended that there had been no valid agreement between the taxpayer and its employees for the schemes utilizing *ITC 1663* as a base source and sought to hold the taxpayer liable for employees' tax for the sacrificed salary (Bolter, 2000:858). The commissioner agreed that the scheme was approved, however, the base of its argument lay in the absence of an agreement between the parties where the terms/rules of the scheme were outlined. As a result, the commissioner contended that the employer's contributions to the provident fund and the medical aid as well as the sacrificed portion in relation to the motor car scheme were in fact gross salary.

The taxpayer provided, with sufficient evidence, that the employees who opted in signed an acknowledgement consenting to participating in the schemes. This after the taxpayer launched detailed campaigns to the employees providing information on the arrangements, the rules and implications thereof. As a result, the court rejected the Commissioner's view that there had not been an agreement between the taxpayer and its employees to amend the employment contracts regarding the salary sacrifice arrangements. Bolter (2000:858) elaborates that although the Commissioner agreed on the validity of the salary sacrifice scheme; they contended that the sacrificed portion in relation to the medical aid fund and motor vehicle schemes was a taxable amount in terms of paragraph (c) of the definition of gross income and should therefore be included in the employees' taxable income. The courts rejected this motion providing that the benefit falls under the provisions of the Seventh Schedule and is therefore a fringe benefit and as such, the provision of paragraph (i) applied.

In 2015, in the case of *Anglo Platinum Management Services Pty (Ltd) v Commissioner for South African Revenue Service*, the court had to decide whether salary sacrifice arrangement on the right to use an employer's motor vehicles was valid and binding. In this case, employees were afforded an opportunity to structure their cost to company between cash and other benefits and this included the right to use a motor vehicle set up as below:

- the employee would choose a vehicle which was purchased by the employer from a dealer in cash and included in the employer's asset register;
- the vehicle would be registered in the employee's name but owned by the employer until the employee fully paid off the vehicle; and
- the employer recovered the cost of the vehicle from the employee by a monthly salary deduction which was determined at the time when the employee elected to participate.

A notional account was created where 'interest' on the repayment of the vehicle would be calculated on a reducing balance. In addition, the employer made payments towards the maintenance costs, running expenses, the insurance premiums and licencing fees on the vehicles which were debited in the notional account including the notional interest. The employees' monthly repayments for the vehicle were added to the notional account as a credit and employees could claim a credit in the notional account. The employer calculated and taxed the fringe benefit in accordance with paragraph 7 of the Seventh Schedule to the Act.

What was different in this case was SARS' argument in relation to the scheme. It argued that the 'sacrificed' portion met the requirements of paragraph (c) of the definition of 'gross income' and not the cash equivalent of a fringe benefit in terms of paragraph (i) of the definition of gross income. Furthermore, it argued that the arrangement did not qualify as a valid and binding salary sacrifice agreement. In addition, the rules of the salary sacrifice agreement regarding the right to claim a credit on the notional account and the obligation to pay premiums, tainted the validity of the salary sacrifice agreement. It believed this was an indication that the employees retained their power over their salary packages.

In the case of the nature of the amount sacrificed, the court held that the amount received was in fact an amount provided in paragraph (i) of the definition of gross income as argued by the taxpayer providing that, paragraph (c) of the definition of gross income precluded any benefit as per paragraph (i) of the definition of gross income. Since paragraph (i) of the definition of gross income read with the Seventh Schedule was applied in this case, the courts held that, if the benefits met the requirements of the definition of gross income in paragraph (i) of the definition of gross income, it, and not paragraph (c) of the definition of gross income applied, thus ruling in favour of the taxpayer.

In the case of whether the salary sacrifice arrangement was valid and binding, the court held that the scheme was indeed a valid and binding salary sacrifice agreement given the below:

- The taxpayer purchased the motor vehicles, owned and claimed depreciation on them.
- The recovery of their total cost, including their running expenses was obtained from the salary sacrifice, not from the employees in return for the amount they had foregone; that the employees received a taxable benefit, the use of motor vehicles.
- The employer assumed liability for the payments and contributions to the vehicles that were part of the scheme and in so doing, released the employees from such an obligation.
- The credit claimable arose from a small unpredicted and unanticipated future contingency and the insurance premiums were in fact paid by the employer.

As a result, SARS' argument that the vehicles should have been taxed according to paragraph (c) of the definition of 'gross income' and that the employees' rights and obligations resulted in the salary sacrifice agreement deemed invalid and unbinding, was rejected.

In conclusion, what is evident from the above is that the legitimacy of a salary sacrifice arrangement lies not only in the correct application of the tax principles; requirements outside of tax are equally as important. Bolter (2000:858) believes that although salary sacrifices provide a tax benefit to employees, the scheme must be implemented accordingly to achieve the desired objective. Oberholzer (2020) adds that the debate around the validity of salary sacrifice arrangements relates to the legal requirements that govern the arrangement and this requires parties to the salary sacrifice arrangement to meticulously structure the arrangements. In this regard, valid salary sacrifice arrangements must not only contain the tax legislative requirements; other components outside of tax must be considered. That is to say that for a salary sacrifice arrangement to be valid, it must comply with the applicable requirements such as legal or common law rules, contractual obligations, ethical conduct, and/or practice. For purposes of this study, the governance-related factors of a salary sacrifice arrangement will not be discussed further.

In conclusion, salary sacrifice arrangements are legal and constitutional regardless of whether they have been implemented with the purpose of gaining a tax benefit by reducing the tax payable by the employees. These arrangements benefit employees in many ways and can improve the lives of many by providing benefits which the participating employees would not have afforded had it not been for the arrangement. It is in the tax principles, implementation, and set-up where salary sacrifice arrangements become questionable, potentially withdrawn, or assessed by SARS resulting in penalties and interest. However, due to a lack of legislative and formal governance guidance on how to address salary sacrifice arrangements, these arrangements are often dealt with on a case-by-case basis.

## **2.3 Conclusion**

In summary, section 10(1)(q) of the Act was introduced with the intention to promote skills development and education by lifting the tax burden on taxpayers who invest in education, through cost-effective tax incentives. However, due to the perceived abuse of the provisions by employers who structure the benefit from the employees' salaries, the provision has been amended, deleted, and reintroduced with restrictions in the form of salary sacrifice arrangements. In this regard, where a bursary or scholarship is granted under a salary sacrifice arrangement, the tax exemption will not apply and as such, the tax benefit is forfeited.

When looking at the provision of section 10(1)(q) of the Act in its entirety, there seems to be a lack of clarity on Government's intent for the provision in its nature as a tax incentive. This is evident in the above discussion where government cites 'promotion of education and skills development', 'employer abuse of legislation' and 'anti-avoidance' when inserting, deleting or amending the provisions to legislation through the years. In this regard, the intention of the legislature seems to shift direction and in so doing, raising the question the effectiveness of section 10(1)(q) of the Act as a tax incentive, that is, is the provision a meaningful and effective tax incentive as defined.

The next chapter will discuss tax incentives including characteristics that make up a meaningful and effective tax incentive in an attempt to determine the meaningfulness and effectiveness of section 10(1)(q) of the Act as a tax incentive.

## CHAPTER 3: TAX INCENTIVES

This study is focused on the role that tax incentives play in promoting skills development in South Africa through employer-provided *bona fide* scholarships and bursaries and as a result, an understanding of tax incentives is vital. In this chapter, the second secondary objective, a theoretical discussion on tax incentives including characteristics of a meaningful and effective tax incentive will be elaborated on in order to gain an understanding of tax incentives in their capacity as a tool utilized by governments to achieve certain economic or social objectives. The aim is to determine and obtain an understanding of the principles that make up a tax incentive in order to determine whether section 10(1)(q) of the Act was designed as a tax incentive as defined.

In the previous chapter, section 10(1)(q) of the Act was discussed in full including its historical evolution in an effort to understand the provisions including a discussion of salary sacrifice arrangements as the restrictive component to the effectiveness of section 10(1)(q) of the Act. This chapter further seeks to understand tax incentives in terms of their meaningfulness and effectiveness through a discussion of the characteristics of a meaningful and effective tax incentive and to determine if section 10(1)(q) of the Act, in its current state, is a meaningful and effective tax incentive. As such, the definitions and characteristics of an effective tax incentive will be analysed to the current employer-provided *bona fide* scholarships and bursaries.

In this regard, the first three sections will discuss the definitions, uses, benefits and advantages and disadvantages of tax incentives applying the principles to section 10(1)(q) of the Act. This will be followed by a discussion of the characteristics that make up a meaningful and effective tax incentives applied to the current provisions of section 10(1)(q) of the Act to determine its meaningfulness and effectiveness as a tax incentive.

### 3.1. Introduction

Tax incentives are tools used by countries around the world with the objective of advancing the economy, to address various national objectives as well as to attract Foreign Direct Investment (“FDI”) (Brodzka, 2013:26; Calitz *et al.*, 2013:2; Klemm, 2010:316). Klemm (2010:19) provides that tax incentives can play an important role in assisting government in achieving certain goals by promoting specific projects. Bloch (1995:30) infers that governments introduce tax incentives to achieve objectives such as motivating investment, encourage exports, stimulate savings, advance education and the provision of social services. According to the Growth, Employment and Redistribution (“GEAR”) report, tax incentives are particularly aimed at the country’s international competitiveness, reducing the damaging effects of taxpayer behaviour on the

economy while preserving the growth and effectiveness of the overall tax structure (National Treasury, 1996:6).

A tax incentive is defined as a measure that provides a favourable tax treatment on certain activities or sectors as compared to what is generally available to the same (Klemm 2010:317). Under this definition, a tax incentive provides an additional reduction, relief or saving on taxes which would otherwise have been due from the activities or sectors involved. Tax incentives can also be defined as a fiscal loss from specific provisions of the tax legislation that have been introduced for non-taxing purposes and aimed at a specific class of taxpayers (Heins, 1984:5). Another term used to define tax incentives is “tax expenditure” which means indirect subsidies granted by way of tax revenue forfeiture through provisions such as tax reductions and allowances (Surrey, 1970:711; National Treasury, 1993:25). Rice (1969:795) infers that the basic premise of a tax incentive is to motivate a person to undertake a course of action that they may not have otherwise opted for.

Section 10(1)(q) of the Act provides an exemption in the hands of the employee receiving an employer-provided scholarship or bursary. In addition, the employer is allowed a tax deduction on the expenses incurred relating to the *bona fide* scholarship or bursary. As a result, the employee in receipt of a *bona fide* scholarship or bursary gains a qualification and skills development free of tax. In this regard, the employee receives a favourable tax treatment for studying while the employer receives a tax deduction for costs incurred on the scholarship or bursary and there is an equal loss to the fiscus on potential taxes from the benefit. In this regard, it can be argued that section 10(1)(q) of the Act meets the definition of a tax incentive as prescribed above.

Zee *et al.* (2002:1498) defined tax incentives for business investment purposes in statutory and effective terms; the former is defined as a special tax provision granted to qualified projects which represent a favourable statutory difference from tax provisions on general projects while the latter means a special tax provision provided to qualifying projects with the ultimate effect of reducing the effective tax burden. With this definition, Zee *et al.* (2002:1499) infer that the statutory definition highlights government’s intent when providing the tax incentive and in effective terms, the focus is on the impact and benefit to the taxpayer receiving the tax incentive. In a business setting, the main effect of a tax incentive is to increase the after-tax return on the investment to the investor in order to realise a profit (Pouris, 2003:195).

Government introduced the provisions in order to promote education and skills development meeting the statutory definition of a tax incentive and in effective terms, lifted the tax burden on

employees and employers for the cost of education. Based on this understanding, the section 10(1)(q) of the Act exemption could be deemed as a tax incentive as defined.

### **3.2. Benefits of tax incentives**

It is believed that tax incentives have a positive influence on economic growth as they enhance FDI and as a result, strengthen an economy's development (Brodzka, 2013:26). Tax incentives are mostly used to achieve an economy's developmental medium to long-term objectives and take various forms which includes reduced or preferential personal or corporate tax rates, tax holidays, tax exemptions, tax exclusions, tax deductions, tax credits, allowances, or tax deferrals, all of which can be complete or temporary relief (Calitz *et al.*, 2013:3; Heins 1984:5; Klemm & Van Parys, 2011:394). Tax incentives also serve as a measure for tax competition and enable the maintenance and improvement of a country's natural competitive position when being compared to similar countries (Haasbroek, 2019:51).

The benefits of tax incentives are mostly dependent on government's intent in introducing the tax incentive. These benefits include an improved economy through FDI and, in addition, a boosting of a country's desirability as well as compensation for limited resources or poor location (Haasbroek 2019:51). Given the various reasons for granting tax incentives which range from FDI to achieving local social objectives; assessing the benefits can be challenging. Klemm (2010:323) believes that in the typical case of incentives aimed at boosting investment and economic growth, it will be difficult to know what the growth performance in the absence of incentives would have been. In addition, since tax incentives are often used to achieve medium to long-term development objectives; other factors outside of tax can bring about challenges to arise in assessing the benefits and effectiveness of the tax incentives (Klemm, 2010:323). In this regard, in order to receive the full benefit from the tax incentive, it is imperative to set out measurable outcomes prior to implementation.

### **3.3. Disadvantages of tax incentives**

Surrey (1970:719) discusses the disadvantages or defects of tax incentives as below:

- Tax incentives allow for windfall gains as they are assumed to reward taxpayers for engaging in activities which they would have had to engage with even in the absence of a tax incentive (Surrey, 1970:719).
- Tax incentives are not equitable. In his view, Surrey (1970:720) provides that tax incentives tend to benefit high-income taxpayers more than low-income taxpayers or those who are outside of the tax system due to low income thus below the threshold, they have losses or are exempt from tax.

- Tax incentives distort the marketplace choices which in turn creates a disproportion of and imbalances the allocation of resources to the economy (Surrey, 1970:725).
- Tax incentives reduce tax revenue thereby constricting the tax base, and this is especially true for tax incentives which are focused on increasing and keeping high tax rates (Surrey, 1970:725).

In addition to the above, the disadvantages of tax incentives appear around their costs and the potential for abuse. Often, the direct cost of tax incentives is linked to the loss of tax revenues to the fiscus (Morriset & Pirnia, 2000:20). Nissum and Sorek (2017:34) are of the view that the social costs of incentives are generally due to the foregone tax revenue which is in turn collected using alternative methods to ensure that government keeps within budget. According to Morriset and Pirnia (2000:2), tax incentives negatively impact on fiscal revenue streams and run the risk of creating suspicious behaviour by tax administrators and taxpayers.

To this end, Moolman (2012:25) infers that tax incentives produce opportunities for corruption as officials and administrators tend to engage in corrupt practices due to the lack of close monitoring of the tax incentive programme. This comes down to the way in which the applicable tax incentives are granted, paid, applied, and continuously managed (Bugher, 2004:129). Other costs of tax incentives include revenue costs, resource allocation costs, enforcement and compliance costs as well as transparency costs (Haasbroek, 2019:51). To this end, Morriset and Pirnia (2000:21) believe that incentives must be marginally effective in order to cover costs of implementation as tax incentives can be administratively costly to implement.

It is therefore imperative that a tax incentive is effective in order to realise the intended benefits and manage the costs linked to implementation and a successful tax incentive programme. As a result, the next section will look at the characteristics of a meaningful and effective tax incentive.

### **3.4. Characteristics of a meaningful and effective tax incentive**

In order to be useful, effective and efficient in their application, tax incentives need to conform to certain design elements and characteristics (Haasbroek, 2019:54; Moolman, 2012:27). These enable the legislature to measure the effectiveness of a tax incentive against its intended purpose. Although there is no textbook definition of an effective tax incentive, Barbour (2005:9) describes an incentive through naming a number of characteristics. In this definition, a tax incentive will stimulate investment while providing little opportunity for tax planning or avoidance given that it is non-discretionary and expressed in legislation thus providing investors or stakeholders with some level of certainty and longevity. Furthermore, a tax incentive must be developed, implemented, and monitored by a single entity to ensure that the incentive criteria is being met and applied

accordingly resulting in low administrative costs for government and must have a sunset clause, its government expenditure or estimated forgone tax revenue must be capped (Barbour, 2005:9).

Due to the perceived abuse of the section 10(1)(q) of the Act exemption by employers, the current provisions placed an anti-avoidance measure by limiting the exemption to only apply where there is no salary sacrifice arrangement between the employer and their employees. The rationale advised by National Treasury was to limit abuse by employers when granting the *bona fide* scholarship or bursary. While the restriction addresses the potential for tax avoidance to exist, it results in less participation by the private sector in the promotion of skills development as initially intended by government. This is evident in discussions where salary sacrifice arrangements are often subject to scrutiny by tax authorities due to the complex nature of their design and implementation. This potentially impacts the effectiveness of section 10(1)(q) of the Act exemption in its capacity as a tax incentive.

To simplify, Moolman and Van Der Zwan (2016:229) outline five characteristics that make up a meaningful and effective tax incentive providing that a tax incentive must have an objective, be effective, be flexible yet stable, its effectiveness should be regularly monitored, and must be transparent. These characteristics will be discussed below and measured to section 10(1)(q) of the Act as a tax incentive to determine whether section 10(1)(q) of the Act is a meaningful and effective tax incentive. Due to the rationale provided by Government when first introducing and re-introducing the salary sacrifice restrictions to section 10(1)(q) of the Act, perceived abuse of legislation, this study will introduce and discuss a sixth characteristic for a meaningful and effective tax incentive: the tax incentive must safeguard against the potential for abuse or misuse.

#### **3.4.1. Tax incentives must have an objective**

According to Pouris (2003:197), it is important to obtain a clear definition of a tax incentive and ensure that the intended outcome is understood from the onset. Zee *et al.* (2002:1499) provide that common tax incentive objectives includes stimulating investment into the host country, reducing unemployment, promoting specific economic sectors, promoting specific economic activities and addressing regional development needs. The objective needs to be clearly defined as part of the motivation to introducing a tax incentive. The Organisation for Economic Co-operation and Development (“OECD”) (2015:3) provides that governments should provide a justification for tax incentives (e.g., regional/territorial development, employment creation) with the expected costs and intended benefits before implementation. Furthermore, tax incentives must be designed and introduced with a specific policy goal (Barbour, 2005:9). By having a clear definition and outline of the tax incentive, the objectives become clearer which contributes to the success of the tax incentive.

A tax incentive should intend to serve and address defined outcomes that the country needs or wishes to meet and achieve which the country intends to and is willing to sponsor financially (Surrey, 1970:713). According to Haasbroek (2019:54), a tax incentive should serve a purpose to promote the government's intended objectives and must be in line with the budgeted resources set aside to finance the incentive. The intended outcome such as FDI, addressing social objectives such as skills development or for direct tax competitiveness, must be clear and precise when a tax incentive is introduced. To achieve this, the goal, purposes and intended outcome of the tax incentive must be clarified before implementation.

Zee *et al.* (2002:1499) suggest four factors that must be considered in examining the conceptual validity of the objectives of tax incentives due to their potential to impede an investor's decision to take on an investment opportunity in a country.

- a) Tax-related considerations refer to the country's overall tax system that could have an impact on the effective tax burden on investment projects. The presence of any limitation in the tax system could be detrimental to the investment. Zee *et al.* (2002:1499) suggest first correcting the limitations directly or through tax reforms if a gap does exist instead of compensating for the limitations by granting tax incentives.
- b) Non-tax-related economic considerations are those that impact either the general macroeconomic or the microeconomic/structural environment, or both. Should there be any concerns or deficiencies in these environments that could have a negative impact on or obstruct the potential investment, the best solution would be to implement comprehensive macroeconomic policies and/or undertake structural reforms to address the issues before implementing a tax incentive in this regard (Zee *et al.*, 2002:1499).
- c) Non-economic considerations relate to the legal, regulatory, and political economy environment. These are equally as important as the tax and other economic considerations in ensuring or maintaining an environment that is conducive to investment (Zee *et al.*, 2002:1500).
- d) Social policy considerations – these arise from equity concerns. Zee *et al.* (2002:1500) are of the view that producers in certain sectors, such as agriculture, may be disadvantaged from an economical perspective as compared to more developed sectors, such as the commercial sector and as such, the provision of tax incentives to the disadvantaged sectors could be an effective way to develop and address the equity objectives.

By addressing any limitations to the above considerations, a country is placed in a better position to effectively define clear objectives for introducing any tax incentive. Furthermore, tax incentives should only be granted in line with a comprehensive policy, which provides the principles and

policy objectives for the introduction or continuation of a tax incentive (OECD, 2015:3). This will direct the management of the tax incentive and the continuous monitoring of the programme and as such, ensuring continued compliance. Poorly targeted incentives are ineffective and expensive (Barbour, 2005:9).

In summary, for a tax incentive to be objective, it must be clearly defined at the onset with its envisioned goal and intended outcome outlined fully understood. This ensures that the framework of the tax incentive is designed with clarity and ease. In order to ensure that the objectives are implementable and effective, factors such as tax, non-tax economic, economic and social policy considerations must be examined, and any identified limitations should be addressed before concluding on the tax incentive objectives. Furthermore, to ensure that the objectives are understood and applied, the tax incentive should be designed in line with a comprehensive policy. This will provide a framework within which the effectiveness of the tax incentive can be measured against.

The National Treasury provides justification for changes in legislation where bursaries or scholarships are concerned. These justifications provide a view of governments goals, objectives, and intent when introducing the bursaries or scholarships tax incentive. In 1984, National Treasury provided that it has never been the intention to tax *bona fide* bursaries but rather maximise funds available for study purposes (National Treasury, 1984:6). Furthermore, when section 10(1)(nC), which focuses on educational assistance for employees' children, was introduced, the focus was on cost effectiveness by removing the tax burden. Government clarifies on its objective for the tax incentive in 2006 when the salary sacrifice arrangement restriction was dropped by highlighting that the intent is to promote skills development which is in line with government social objectives (National Treasury, 2006b).

At present, the current provisions provide that the tax exemption will not apply where there is a salary sacrifice arrangement. As such, the original objectives or intentions when the tax incentive was introduced would appear to have shifted. National Treasury has provided that the rationale for placing the restrictions on bursaries or scholarships granted under a salary sacrifice arrangement is to combat tax avoidance as a result of taxpayer abuse of the tax incentive (National Treasury, 1991:4; National Treasury & SARS, 2021:25). As a result, the objectives seem to have shifted direction from cost maximisation and promotion of skills development to tax avoidance.

### 3.4.2. Tax incentives must be effective

The word “effective” has been defined as meaning “successful in producing a desired or intended result” (Stevenson, 2015). A tax incentive is deemed to be effective if it has fulfilled its intended objectives as outlined in the prior subsection. In order for this to be achieved, the advantages and benefits of a tax incentive should clearly supersede the disadvantages, costs and loss to the fiscus that is linked to the provision of the tax incentive in question (Surrey, 1970:734). As a result, an effective tax incentive should possess a balance between risk and reward for both country and the investor thus creating an effective regulatory environment (Sunley *et al.*, 2002:154).

According to Pouris (2003:195), the effectiveness of a tax incentive is realised, for an investor, when the increased after-tax return on investment for the firm ultimately increases profitability. This is further emphasized by Zelinsky (1986:1033) who provides that a tax incentive is effective in economic terms when it maximizes profitability and achieves customer satisfaction after accounting for barriers to entry. For government, an effective tax incentive enables policy implementation at low transactional costs (Zelinsky 1986:1010). As a result, all parties, the government, the taxpayer and the end-user, i.e., citizens, must realise a benefit from the tax incentive in order for it to be deemed effective. In this regard, Zee *et al.* (2002:1511) infer that a poorly designed tax incentive from a statutory perspective that is unable to lower the effective tax burden for the investor cannot be regarded as an effective tax incentive.

According to Klemm (2010:323), a good tax incentive is incorporated in a tax policy and is transparent, predictable and stable. To this end, an effective tax incentive must be incorporated in tax legislation and must be transparent in its application as this reduces the scope of corruption (Klemm, 2010:323). As such, to be effective, a tax incentive must not only meet its objectives but it must be transparent and provide stability for the investor. To this effect, Klemm (2010:323) provides that tax incentives must be automatic rather than discretionary as this will promote and the concise process of granting tax incentives based on fairness and transparency.

Essentially, a tax incentive is deemed to be effective if it achieves its intended objectives, goals and outcomes. In this regard, the tax incentive provides a favourable result for the relevant stakeholders, commonly the investor or taxpayers and the government. In this regard, the taxpayers realise profitability, customer satisfaction and after-tax returns while the government benefits from a low transaction or running costs of implementing the tax incentive. As such, Moolman and Van Der Zwan (2016:230) provide that the effectiveness of a tax incentive should consider both taxpayers and the fiscus’ standpoints. In addition, an effective tax incentive must be transparent and provide stability for the investor yet remaining flexible to economic changes.

The main objective of the bursary or scholarship tax incentive is based on cost maximisation and the promotion of skills development. As a result, the tax incentive will be deemed to be effective if the objective has been met. This assessment can be challenging given a number of factors which are outside of tax are involved, such as government's social objective to upskill South Africans. As Klemm (2010:323) indicated, assessing the effectiveness of a tax incentive can be challenging given that tax incentives are often used to achieve medium to long term development objectives and as such, factors outside of tax can become a contributing factor to the effectiveness of a tax incentive. The effectiveness of the tax incentive looking at flexibility, stability and transparency will be discussed in the following subsections.

### **3.4.3. Tax incentives must be flexible yet stable**

Given the continuous evolution of an economy, it is important that tax incentives remain flexible and still maintain a level of stability. According to Moolman and Van Der Zwan (2016:231), a tax incentive's flexibility in the context of an investor makes provisions for changes in the environment, technology and policies that change during the period of the tax incentive. This is to say that, when a change in circumstances arises, parties to the tax incentives should not be locked into the previous regime or placed at a disadvantage. The same is true from the perspective of the government, flexibility implies that a tax incentive regime should allow the government room for possible adjustment to the tax legislation in case of unpredictable future events (Moolman & Van Der Zwan, 2016:231).

While the flexibility of a tax incentive is key, stability is equally as important. Klemm (2010:323) provides that investors rely on the stability of tax incentives granted before making a decision to invest. It is therefore important that a tax incentive provides a level of stability as this ensures security to the beneficiaries of the tax incentive. To this effect, Klemm (2010:324) suggests that a tax incentive be incorporated to a country's tax legislation. The historical background of section 10(1)(q) of the Act provides a clear indication of the level or lack of flexibility and stability of the tax incentive. In this regard, the exemption on *bona fide* bursaries or scholarships was introduced in 1966 under section 10(1)(qA) of the Act with a single qualifying criterion that the studies must be at a recognised educational institution.

In 1984, the qualifying criterion was later amended to commissioner approval, that is, the bursary or scholarship scheme must be approved by the commissioner provided it meets the requirements set out by the commissioner. This was later deleted from legislation due to the perceived abuse by employers. The deletion of the educational assistance tax incentives in 1991 following abuse by taxpayers was an indication of a lack of stability of the tax incentive; however, this was quickly amended by the re-insertion of a combined clause in 1991 under section 10(1)(q) of the Act. Since

1991, the clause has been subject to a number of changes in response to the growing economy, for example, the monetary exemption thresholds for bursaries or scholarships for employees' relatives were regularly increased throughout the years to align with inflation and the economic conditions which ensured that employees were not placed in a worse off position should their income change.

Notwithstanding the above, the major changes to the bursaries or scholarship tax incentives have been an indication of flexibility in that the incentive can be adjusted; however, it lacks stability. These changes include the introduction of the salary sacrifice arrangement restriction in 1991 which was later removed in 2006 affording many employers the opportunity to grant *bona fide* bursaries or scholarships to employees while enjoying the tax relief and then re-introduced the restrictions in 2020 thus reducing the number of private sector participation given the economic condition of the country in light of the Covid-19 pandemic (National Treasury 1992:17; National Treasury 2006a; Business Tech, 2020). These changes indicate that government is flexible about changing the provisions given reasonable grounds such as anti-avoidance and the promotion of skills development and in the same breath, the changes prove a lack of stability in keeping the objective that the tax incentive is meant to achieve.

#### **3.4.4 Tax incentives must be transparent**

Moolman and Van Der Zwan (2016:232) provide that transparency in the context of tax incentives refer to transparency in the qualifying criteria for the incentive, transparency in determining investor benefits as well as transparency in the application of the incentive for all taxpayers. To be clear, to increase transparency and empower effective tax administration, all tax incentives should be written and outlined, including the eligibility criteria, in the main context of the tax law (OECD, 2015:3). In this regard, incorporating tax incentives into legislation reduces the risks of abuse in its application as well as reduces the potential for corruption (Klemm, 2010:324).

The OECD (2015:3) infers that incorporating the tax incentive into legislation ensures that the tax incentives are claimed by meeting the eligibility criteria as prescribed in the law in fairness and without exceptions or negotiating with the granting authority. Tax incentives should therefore be structured in such a way that they will not produce an advantage for one out of two persons with similarities (Rice, 1969:788).

Zee *et al.* (2002:1502) provide that transparency has three dimensions to consider with regard to the granting of tax incentives;

- a) The legal and regulatory dimension: in this regard, all tax incentives should be rooted from a relevant tax law and any changes to these laws should be formalized amendments in

the law. As such, changes to the relevant laws must not be reliant on the discretion of any government entity or official. As a result, tax incentives should be granted on merit, having used a fair specified qualifying criteria and without exception (Zee *et al.*, 2002:1502).

- b) Economic dimension: this involves outlining a clear and obvious rationale for granting tax incentives based on well-thought-out economic arguments which include the impact of the tax incentive on the economy and any revenue costs of granting the tax incentive having used clear assumptions and methodologies which is also made available to the public for scrutiny and commentary (Zee *et al.*, 2002:1502).
- c) The final dimension is the administrative dimension of transparency: this is centred around the management of the tax incentive and involves designing the qualifying criteria for the tax incentives that are simple, specific, and objective and as such, does not leave room for additional intervention such as interpretation and application by the administering officials of the incentive program. This also ensures the smooth monitoring and enforcement of the tax incentive on the part of the tax administrators (Zee *et al.*, 2002:1502).

Zee *et al.* (2002:1502) conclude that the above dimensions, if applied accurately and effectively, would allow for an automatic qualifying process in granting a tax incentive with any additional invention necessary for only ensuring that the qualifying criteria was met. This way, the discretionary powers are removed from the tax authorities which ultimately reduces the potential for corruption or unfairness in granting tax incentives. Finally, to ensure continued transparency, periodic audits must be conducted on tax incentives which have been claimed to identify the amount of revenue loss attributed to the tax incentives and to identify any cases of misuse (OECD, 2015:3).

The bursaries or scholarships tax incentive has always been incorporated into legislation. In 1962, the incentive took the form of a gratuitous payment when an employee completed their studies under section 10(1)(q) of the Act. In 1966, an additional clause was introduced which covered *bona fide* bursaries under section 10(1)(qA) of the Act. In 1984, a new clause was inserted under section 10(1)(nC) of the Act which covered educational assistance to employees' children. These clauses were later deleted from legislation and reintroduced in 1991 under a single clause, section 10(1)(q) of the Act. At present, *bona fide* bursaries or scholarships are covered in section 10(1)(q) of the Act and section 10(1)(qA) of the Act which deals with provisions for disabled persons.

In addition, the qualifying criteria are clearly set out in the Act, that is, the tax exemption will be granted to employees who study at a recognised educational institution, and the employee must agree to reimburse the employer for the cost incurred should they fail to complete their studies for reasons other than death, disability or critical illness. The clause includes provisions where

the tax incentive will not apply, i.e. in the event that the *bona fide* bursary is granted under a salary sacrifice arrangement.

### **3.4.5. The effectiveness of a tax incentive must be regularly monitored**

Kurtz (1968:21) provides that when a tax system is used to provide incentives within the economy, it is vital that these provisions be reviewed through careful scrutiny and that the review must be done periodically. Rumina *et al.* (2015:158) provide that the need to assess the effectiveness of a tax incentive arises as a result of the lack of theoretical soundness and a low effectiveness of the benefits of tax incentives. Therefore, to ensure the continued effectiveness of a tax incentive, the OECD (2015:4) provides that there is a need for the periodic collection and analysis of taxpayer data on an on-going basis by revenue authorities. When referring to Research and Development (“R&D”) tax incentives, Pouris (2003:197) provides that the monitoring of a policy’s effectiveness is across a few dimensions and includes an understanding and controlling of the net cost of the policy. This includes conducting a cost-benefit study of the tax incentive which Klemm (2010:323) provides is difficult to do as they count the financial cost of tax revenue given up by the fiscus and compare them to the increased activities, such as employment. However, the process of reviewing tax incentives is important as providing estimates of forgone revenue from tax incentives provides policy makers with the required data and input to impact tax policy decisions (OECD, 2015:4).

Rumina *et al.* (2015:158) list and summarise the main challenges of assessing tax incentive effectiveness including thoughts on what to consider to achieve this effectively:

- a) The first problem concerns defining the concept of tax relief in order to measure the effectiveness thereof. In this regard, it is vital to distinguish between the legislative concept of “tax relief” and its related concepts including preferences, exceptions and exemptions (Rumina *et al.*, 2015:158). In this regard, the definitions and explanations of these concepts must be established as it will ensure that there are clear guidelines and direction as to how the tax incentive should be assessed.
- b) Second is the challenge of setting goals when introducing tax incentives and classifying these goals according to their purpose. In this regard, Rumina *et al.* (2015:159) provide that when introducing a tax incentive, it is important to set its purpose in detail which takes into account the economic and social efficiency of the benefit.
- c) The third challenge involves developing a system which details the evaluation criteria of assessing the effectiveness of the tax incentive. In this regard, Rumina *et al.* (2015:159) provide that the criteria and method used in evaluating the effectiveness of a tax incentive must include factors such as budgets, economic and social efficiency.

The incentive performance reviews must be conducted once every few years and must reflect the costs and benefits of the tax incentives to determine if the tax incentive has met its objectives and this must be accessible to the public (OECD, 2015:4). Rumina *et al.* (2015:158) are of the view that without a continuous review of the effectiveness of tax incentives, there is often an unsystematic withdrawal of the benefits derived from tax incentives.

There is currently no evidence of reviews conducted on the *bona fide* bursaries or scholarships tax exemption as a tax incentive. However, given the changes to the provision through the years, it is evident that there is a level of review that is conducted on the effectiveness of the provision which subsequently results in changes in legislation. An example would be the removal of the salary sacrifice arrangement restriction in 2006 which was motivated by government's intent to redirect its focus to skills development. In this regard, government indicated that although salary sacrifice arrangements were legally justifiable, the restriction made little sense given its focus on skills development (National Treasury, 2006b).

Another indication where tax incentive assessment is evident is found from the 2020 changes to legislation in which the salary sacrifice arrangement restriction was re-introduced into legislation. This followed research conducted by National Treasury where it was determined that employers were abusing the provisions by entering into arrangements with third parties who would administer bursary or scholarship agreements for employees' relatives through a salary sacrifice arrangement between the employer and the employees (National Treasury & SARS, 2021:24). Evidently, a review was conducted which resulted in these changes.

#### **3.4.6. Tax incentives must safeguard against the potential for abuse or misuse**

An unfortunate and yet commonly discussed disadvantage of tax incentive is the potential for abuse by taxpayers. Zee *et al.* (2002:1498) list three undesirable consequences from the use of tax incentives in which the last was the social costs and behaviour linked to the abuse of tax incentive provisions. Padilla *et al.* (2020:6) maintain that tax incentives can create opportunities for tax abuse due to their complexity. Zelekha and Sharabi (2012:140) suggest that in theory, tax incentives can lead to corruption through rent seeking behaviour by tax administrators and taxpayers alike. With this in mind, for a tax incentive to be meaningful and effective, it must be designed such that it is not open to abuse nor does it create an opportunity for corruption by all stakeholders. In order to achieve this, Padilla *et al.* (2020:11) suggest that effective tax incentives need to be properly designed, and be underpinned by transparency and good governance to ensure that they achieve their intended goals and as a way to curb abuse and misuse. Therefore, to ensure that the tax incentive safeguards against potential abuse and misuse, Padilla *et al.* (2020:26) suggest the below actions:

- The regimen must be underpinned by transparent and legitimate legal, technical, and political processes in order to mitigate abuse or rent seeking activities.
- The tax incentives must be clearly justifiable and the justification, backed by technically sound evidence-based assessments, must be linked to the country's national development strategy, and positively contribute towards the economy and social policy needs.
- The social costs and benefits of the tax incentive must be comprehensively evaluated such that they cover any externalities, potential and anticipated consequences and remain consistent with the country's social policy.
- The tax incentives must be specifically outlined in the laws with clear guidelines on the qualification criteria and sunset clauses. This will ensure that little room is left for discretion.
- The tax incentive must clearly indicate the potential tax expenditure as a result of its introduction. That is, the foregone revenue must be determined, outlined, and publicly reported at all levels of governance.
- The tax incentives must be reviewed and monitored on an ongoing basis with public participation, and this must be made public. The review must highlight any gaps that exist where a tax incentive is found to no longer serve its purposes thus leading to its termination.

In essence, to ensure that a tax incentive does not fall victim to potential abuse or misuse, the aforementioned characteristics of a meaningful tax incentive must be present in addition to good governance. It is evident from the background of section 10(1)(q) of the Act that the tax incentive became occasionally subjected to abuse by taxpayers. Although the rules were outlined in legislation, the actions by Government in introducing significant changes to legislation were simply motivated by the perceived abuse of the tax incentive.

This is evident in the complete deletion of section 10(1)(q) and (qA) of the Act in 1991 and insertion of the single provision in 1992 which placed limitation on salary sacrifice arrangements and the reintroduction of these provisions in 2020 leading to the provision as it currently stands. In these changes, the rationale is based on taxpayer abuse and the perceived tax avoidance schemes. However, given the recent changes, that is, the reintroduction of the salary sacrifice arrangement limitations to section 10(1)(q) of the Act can be viewed as a mechanism to safeguard the tax incentive against abuse and misuse. In this regard, the perceived abuse or misuse by taxpayers in applying the tax incentive is mitigated.

### 3.5. Conclusion

Tax incentives are, sometimes, necessary for the advancement of an economy and for many developing countries, tax incentives have been known to improve the economic conditions and attract foreign investment. Notwithstanding their benefits which include, attracting foreign investment, promoting social objectives and economic development, tax incentives have certain disadvantages as they usually come at a cost and often result in a loss to the fiscus. As such, it is important that a tax incentive is effective in order to realise its intended goal and purpose. The above discussion elaborated on six characteristics which make up a meaningful and effective tax incentive. In this regard, a meaningful and effective tax incentive must have an objective, be effective, it must be flexible yet stable, transparent, its effectiveness must be regularly monitored and it must safeguard against the potential for abuse or misuse. This study was focused on *bona fide* bursaries or scholarships in their capacity as a tax incentive and as such, their meaningfulness and effectiveness.

Section 10(1)(q) of the Act was designed with the intention to promote education and skills development since inception and has taken many forms through the years. The initial intention was not to tax the benefit but rather to maximise the educational grants to employees through the private sector. However, due to taxpayer behaviour, particularly pertaining to salary sacrifice arrangements entered into between the employer and their employees, the provisions have since been amended, removed, reinserted and at present, tightened. When applying the characteristics of a meaningful and effective tax incentive to section 10(1)(q) of the Act, it was determined that the tax incentive is objective although the objective changed over the years, its effectiveness could not be determined, it is flexible but not stable, it is transparent, gets monitored on a case-by-case basis and does safeguard against abuse or misuse.

As a result, from a meaningfulness and effectiveness perspective, the current provisions set out in section 10(1)(q) of the Act cannot be determined holistically. This is due to the fact that, looking at the characteristics of a meaningful and effective tax incentive, section 10(1)(q) of the Act did not meet all the characteristics but only three of the six characteristics. In this regard, the South African legislative authorities cannot be said to have succeeded in balancing the effective running of the tax incentive and mitigating tax avoidance. As a result, the findings from this chapter point towards the inconclusiveness of section 10(1)(q) of the Act as a meaningful and effective tax incentive. As a result, guidance must be sought from foreign jurisdictions in an attempt to determine the effectiveness of section 10(1)(q) of the Act by comparing South African practices to foreign countries' tax policies on employer-provided scholarships on an international scale. The next chapter will discuss how foreign jurisdictions treat employer-provided education assistance

benefits from a tax perspective. This will then be compared to the current section 10(1)(g) of the Act exemption from a design perspective.

## **CHAPTER 4: COMPARISON OF INTERNATIONAL TAX POLICY ON EMPLOYER-PROVIDED SCHOLARSHIPS TO SOUTH AFRICA**

In the previous chapters, section 10(1)(q) of the Act on employer-provided *bona fide* bursaries and scholarships was discussed in detail to identify the principles and the design of the provisions from a South African perspective. This was followed by an analysis to determine whether the current provisions are deemed to be a tax incentive as defined (chapter 3) including a further analysis on whether the tax incentive is meaningful and effective. Up to this point, a *bona fide* bursary and scholarship is deemed to be a tax incentive as defined; however, the meaningfulness and effectiveness of the tax incentive remains unclear due to failure to meet the requirements of the characteristics of a meaningful and effective tax incentive discussed in the prior chapter. As a result, guidance from the treatment by other countries, of employer-provided bursaries and scholarships will be sought in an effort to address these challenges.

In this chapter, the third and final secondary objective, to conduct a comparative study between South Africa and the OECD countries on how the employer-provided education benefit is designed, will be discussed. This will be through a discussion of the international treatment of bursaries and scholarships incentive, particularly employer-provided, in comparison with South African provisions outlined in section 10(1)(q) of the Act. In these discussions, the OECD countries will be compared to South Africa in an effort to determine whether the current provisions are effective as a tax incentive and, if applicable, to identify any potential gaps in the current provisions by analysing whether the tax incentive is in line with international standards. A detailed summary of the tax policy on skills particularly focused on employer-provided scholarships is outlined in **Annexure A**. The first section conducts a comparative study of the OECD countries' policies with the South African provisions. Section three will conclude the chapter through a discussion of where South Africa is in terms of its current legislation and whether the current provisions are in line with international standards.

### **4.1. OECD Country's skills policy on scholarships**

The OECD conducted a review of the tax policy on skills for 30 participating countries. In the review, the OECD looked at tax incentives provided to citizens for the promotion of skills and education. The study was conducted with the goal to examine how tax policy can be used to encourage skills development in the OECD countries by building indicators that are used to examine incentives which individuals and governments can use to invest in skills development and education (OECD, 2017). The study was conducted mainly for policymakers and governments to utilize for skills development in their respective countries and highlighted the

importance of having a comprehensible policy mix to encourage investment in skills and sent a clear message to governments on the risk, costs, and consequences of failure to invest in skills in the years ahead. While the OECD study looked at the overall incentives provided by the countries such as scholarships, allowances, tax credits, tax deductions, and much more, this study focuses only on the scholarship incentives with a particular focus on employer-provided scholarships.

**4.2. Comparative Analysis**

**Annexure A** provides a detailed summary of the tax policy on scholarships with a focus on the countries tax rules for employer-provided scholarships. Based on the findings which will be discussed herein, it is the view that the countries have adopted similar approaches on their tax policy on scholarships with certain themes recurring on how the exemption will apply. A summary of the findings is provided in the table below. Since the focus of this study is on employer-provided bursaries and scholarships, the below summary highlights circumstances where a scholarship has been granted and there is an employer-employee relationship.

<b>Country</b>	<b>Scholarship Exempt?</b>	<b>Employer-Provided Scholarships exempt?</b>	<b>Comments</b>
Australia	Yes	No	
Austria	Yes	No	
Belgium	Yes	No	
Canada	Yes	Conditional	Exemption is limited to training for the benefit of employer and if scholarship is granted at arm’s length.
Chile	Yes	Conditional	Exemption is capped at monetary threshold.
Czech Republic	Yes	No	
Denmark	No	No	
Estonia	Yes	No	
Finland	Yes	No	
Greece	Yes	Unspecified	Employer-provided scholarships exemption laws not found in country’s legislation.
Hungary	Yes	Conditional	Exemption is capped at equivalent of minimum wage.

<b>Country</b>	<b>Scholarship Exempt?</b>	<b>Employer-Provided Scholarships exempt?</b>	<b>Comments</b>
Iceland	No	No	
Ireland	Yes	Conditional	Employer provided scholarship must be awarded from trust fund in which 75% of the fund is awarded to the general public.
Israel	Yes	Conditional	Exemption is capped at monetary threshold
Italy	Yes	No	
Luxembourg	Yes	Unspecified	Employer-provided scholarships exemption laws not found in country's legislation.
Mexico	Yes	Conditional	Exemption capped at a monetary threshold.
Netherlands	Yes	No	
New Zealand	Yes	Unspecified	Employer-provided scholarships exemption laws not found in country's legislation.
Norway	Yes	No	
Poland	Yes	Unspecified	Employer-provided scholarships exemption laws not found in country's legislation.
Portugal	Yes	Unspecified	Employer-provided scholarship exemption laws not found in country's legislation.
Slovak Republic	Yes	No	
Slovenia	Yes	No	
Spain	Yes	No	
Sweden	Yes	No	
Switzerland	Yes	Conditional	The training must be granted for the employee's professional training or continued education to be exempt.
Turkiye	Yes	Conditional	Employer provided scholarships to employees' relatives must not have a current or potential employment relationship between the employer/sponsor and the recipient, i.e., the relative.
United Kingdom	Yes	Conditional	Employer provided scholarship capped at monetary threshold for employees and for

Country	Scholarship Exempt?	Employer-Provided Scholarships exempt?	Comments
			relatives, the employer’s scholarship fund by the employer must allocate up to 25% of funds to employees’ relatives and the rest must be allocated to the general public.
United State	Yes	Conditional	Employer provided scholarships must be granted on merit and approval must be obtained from the IRS to allow an exemption to be applied.

Based on the above tabled findings, in most of the 30 countries under review, there is some form of tax relief for scholarships income which comes in the form of an exemption from Personal Income Tax (“PIT”) and Social Security Contributions (“SSC”). Out of the countries discussed above, 28 countries grant an exemption from scholarship income, with only Denmark and Iceland treating scholarships as fully taxable (OECD, 2017:43). Where the scholarships have been granted by an employer, the exemption will not apply in 14 countries; these countries include Australia, Austria, Belgium, the Czech Republic, Denmark, Estonia, Finland, Italy, Netherlands, Norway, the Slovak Republic, Slovenia, Spain and Sweden while in five countries, Greece, Luxembourg, New Zealand, Poland and Portugal, the tax treatment for employer-provided scholarships could not be determined due to a lack of guidance on the respective countries’ legislation. In respect of employer-provided scholarships, ten of the countries in the OECD study, Canada, Chile, Hungary, Ireland, Israel, Mexico, Switzerland, Turkiye, the United Kingdom, and the United States, allow a tax exemption provided that certain conditions are met.

At present, South Africa allows a tax exemption for bursaries and scholarships thus aligning with the majority of the countries in the OECD study. In addition, employer-provided bursaries or scholarships will be allowed an exemption provided that certain conditions are met which is in line with the ten OECD countries discussed above.

#### **4.2.1. Conditions for tax exemption**

For the counties which grant an exemption on scholarships, the conditions which must be met before an exemption is allowed will be discussed below.

#### 4.2.1.1. Qualifying sponsors

The scholarship must be funded or granted by the state, public authorities or bodies in order to qualify for an exemption. This is the case in the following countries:

- In the Czech Republic, the scholarship that is awarded from the state, municipal and regional budget, universities, public research institutions or legal entities which carry out secondary school or higher vocational education activities, will qualify for the tax exemption.
- In Estonia, the scholarship must be granted by the Education and Youth Authority, public authorities or schools to qualify for the exemption.
- In Finland, scholarships which have been granted by a public entity or from the Nordic Council will qualify for a tax exemption without a cap while the exemption for privately awarded scholarships have a monetary limit provided that it is not employment related.
- Greece allows an exemption if the scholarship is granted by the Greek State, public entities or specific private charitable funds.
- In Hungary, scholarships which have been granted from a public benefit foundation, or through a foundation founded by the President, or have been awarded on the basis of the National Higher Education will receive an automatic tax exemption.
- In Poland, scholarships received from the local government and public benefit organisations are automatically subject to an exemption from income tax.
- In the Slovak Republic, scholarships awarded from the state budget as well as corporate scholarships granted to university students, scholarships granted by foundations and civil associations, non-profit organisations and non-investment funds will be tax exempt.
- Spain will allow an exemption if the scholarship is a public grant or scholarship.

From a South African context, the bursaries and scholarship exemption will apply where they have been granted by any sponsor, whether or not the sponsor is a government entity, public institution or if it is awarded by an private entity to the general public or to employees and their relatives. To this extent, the nature of the sponsor will not impact the tax exemption of the bursary and scholarship granted.

#### 4.2.1.2. Monetary thresholds

The exemption will apply for scholarships received however the amount that is allowed as an exemption is limited. A number of countries have placed a monetary limit on the tax exemption for scholarships, these have been detailed below:

- Canada limits the exempt amount to the cost of tuition fees if the studies are undertaken part-time.
- In Chile, scholarships granted to employees' children will be exempt and capped at the equivalent of one and a half annual tax units for early education or five and a half annual tax units for higher education as agreed in a contract. Tax units are monthly monetary indicators determined by the Chilean tax authority
- Finland caps the exemption to EUR 24 475, which is the equivalent of the annual artist grant amount.
- In Hungary, the scholarship is capped at the equivalent of the minimum wage amount for employer-provided scholarships.
- Israel provides that the exemption will apply up to a ceiling amount of ILS 92 000.
- In Mexico, a scholarship exemption is capped at the equivalent of seven times the minimum wage amount. If the total of the scholarship income and wages is higher than the capped amount, the exemption will be limited to one annual minimum wage however, the amount cannot be lower than seven minimum wages.
- In Poland, the tax exemption on scholarships provided to Polish citizens living outside of Poland, scholarships received for the purpose of science, art, doctoral degrees, scholarships received from the local government and public benefit organisations is capped at PLN3800.
- Slovenia has a cap the equivalent of the minimum wage amount, in 2017, this amount was EUR 8 977 (OECD, 2017:43).
- In Spain the exemption is capped at EUR 3000 for undergraduate education and EUR 15 000 for graduate education.
- The United Kingdom has placed a cap of GBP 15 480 on additional costs which have been incurred by the employee such as accommodation, subsistence allowances, travelling allowances excluding tuition fees (HMRC, 2022; OECD, 2017:43).

For the remaining countries, no monetary thresholds apply for the exemption on the scholarships granted. In South Africa, the tax exemption currently has no limit for bursaries and scholarships granted to the general public and employees. However, for employer-provided bursaries and scholarships granted to employees' relatives, the exemption is capped at specified amounts. At present, a bursary and scholarship granted to an employee's relative is capped at R20 000 for primary and high school education and NQF levels 1 to 4 qualifications and R60 000 for NQF levels 5 – 10 (Parker *et al.*, 2021:29). In this regard, South Africa follows a similar approach by the above-mentioned OECD countries in that certain bursary and scholarships have monetary limits.

#### 4.2.1.3 Employment relationship

Another condition for the scholarship exemption to apply relates to where there is an employer-employee relationship between the sponsor and the recipient of the scholarship. In this regard, the scholarship cannot be linked to employment, employment income and/or there must be no potential or current employer-employee relationship between the parties. Of the 28 countries which allow an exemption on scholarships, 14 countries automatically deem the scholarship as taxable if there is some form of employer-employee relationship. These countries include Australia, Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, Italy, the Netherlands, Norway, the Slovak Republic, Slovenia, Spain and Sweden. In South Africa, legislation does provide for an exemption where there is an employer-employee relationship between the sponsor and the recipient or their relatives subject to meeting certain conditions.

The tax treatment of scholarships where there is an employer-employee relationship in South Africa is similar to that of ten countries in the OECD study. These countries, Canada, Chile, Hungary, Ireland, Israel, Mexico, Switzerland, Turkiye, the United Kingdom, and the United States, allow a tax exemption on employer-provided scholarships if certain conditions are met. The conditions have been summarised below:

- The exemption is allowed for employer-provided scholarships up to a certain amount. This is the case in Chile which caps the exemption at the equivalent of one and a half annual tax units for early education or five and a half annual tax units for higher education for employees' children; Hungary limits the exemption to the equivalent of the minimum wage amount, Israel caps the exemption at a ceiling amount of ILS92 000 and the United Kingdom which limits the tax exemption at GBP 15 480 for additional educational costs incurred by the employee. Similar to these countries, in South Africa, the exemption will apply for employer-provided bursaries and scholarships granted to relatives provided that it falls within the monetary threshold, which is, R20 000 for primary school, high school and NQF levels 1 to 4 qualification and R60 000 for NQF levels 5 to 10 qualifications.
- The scholarship must be granted under non-preferential terms and must be granted under a scholarship fund which is largely available to the general public. The United States provides that the qualifying criteria should be based on merit when selecting candidates who will receive the scholarship. In Ireland and the United Kingdom, it has been provided that 75% of the scholarship fund must be made available for the general public and only 25% of the fund be made available to employees or their relatives in order for an employer-provided scholarship to be exempt. In South Africa, SARS provides that one of the conditions for the exemption to apply is that the bursary and scholarship must be granted on merit. In this regard, the SARS' Interpretation Note 66 provides that the basis of selecting the candidates must be

based on merit therefore aligning to non-preferential treatment in selecting the qualifying candidates. However, South African laws do not require the employer to make the bursary or scholarship available to the general public in order to qualify for an exemption.

- The scholarship must be granted in an arms-length transaction and should not be funded or partially funded from the employee's salary, therefore, no salary sacrifice arrangements should be present. This is the requirement in Canada. In South Africa, this is the overarching principle which, if met, automatically disqualifies the tax exemption and deems an employer-provided bursary and scholarship as taxable. In this regard, the presence of a salary sacrifice arrangement automatically excludes the exemption from applying.
- Another requirement is that the study that the employee undertakes must be for the ultimate benefit of the employer. In Canada and Switzerland, in order for the exemption to apply, the study must be for the benefit of the employer and the sponsorship must be covered for professional training or continued education by an employee respectively. South Africa does not require the education or training to be for the benefit of the employer or professional training to qualify for an exemption. As discussed in chapter two, South Africa's focus in providing an education tax incentive is for the ultimate skills development of South Africans and as such, does not place a limitation on the nature of the courses undertaken. As such, this requirement does not apply in South Africa.

In conclusion, South Africa provides certain requirements to be met in order for the exemption for employer-provided bursaries and scholarships to apply which is similar to the countries discussed above. Though the nature of some of the conditions differs, the principle that certain conditions must be met to qualify for a tax exemption on employer-provided scholarships is similar to that of the countries discussed above. In this regard, the South African tax incentive appears to be in line with that of the ten countries which allow an exemption provided that conditions are met.

#### **4.3. Conclusion**

South Africa currently provides a tax exemption on bursaries and scholarships, provided that the bursary or scholarship which have been granted by both public and private entities including employer-provided scholarships meet certain conditions. In this regard, scholarships which are linked to employment are exempt from tax if they are not subject to salary sacrifice arrangement between the sponsor and the employee. In comparing these provisions with the OECD countries under review, it would appear that in South Africa, the tax provisions for skills and education as outlined in section 10(1)(g) of the Act are similar to some of the international provisions. This is due to the below observations.

- South Africa, like 28 countries under the OECD study, grants an exemption for scholarship income as provided in section 10(1)(q) of the Act.
- The exemption is granted both for employment and non-employment related scholarships and whether it is state funded and privately funded.
- The bursary and scholarship exemption currently has no cap on post-graduate education for employees. This is similar to 20 countries, which include Australia, Austria, Belgium, Chile, the Czech Republic, Estonia, Greece, Hungary, Ireland, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Sweden, Switzerland and Turkey (OECD, 2017:43).
- Like Canada, Chile, Hungary, Ireland, Israel, Mexico, Switzerland, Turkiye, the United Kingdom, and the United States, employer-provided scholarships will be exempt if certain conditions are met. In South Africa, the overarching condition which must be fulfilled is the requirement that there should not be a salary sacrifice arrangement.

In conclusion, this chapter finds that, regardless of the current restrictions on salary sacrifice arrangements discussed in chapter 2, South Africa provides more relief than that of most of the OECD countries for employer-provided scholarships since most of the countries exclude employer-provided scholarships from qualifying for a tax exemption altogether. In addition, in comparing South African tax policy on *bona fide* bursaries and scholarships as a tax incentive, with most of the countries discussed above, the tax incentive may be argued, to a certain extent, to be effective and meaningful in providing some relief for employees and their relatives. This is since a tax incentive, as defined by Klemm (2010:317), provides a favourable tax treatment on certain activities or sectors as compared to what is generally available to the same. And as such, section 10(1)(q) of the Act provides a favourable tax treatment for employees and their relatives in that scholarships received from their employers would be exempt from tax, if conditions are met, as opposed to 14 of the countries discussed above.

Therefore, based on the above findings, it is the view that the South African tax incentives with regards to *bona fide* bursaries and scholarships is, to a certain extent, effective and meaningful on an international scale given that the provisions appear to be more lenient than that of most of the countries discussed. In addition, South Africa's tax incentive has been designed applying similar principles and rules to that of ten countries which allow the exemption based on meeting certain conditions, in that regard, the South African provisions are in line with these countries.

## **CHAPTER 5: CONCLUSION AND STUDY FINDINGS**

### **5.1 Introduction**

The focus of this study, as outlined in chapter one, was to discuss section 10(1)(q) of the Act including its current limitations in its capacity as a tax incentive and to determine whether the tax incentive is meaningful and effective in its current state. Based on the findings in chapter three regarding whether the tax incentive is meaningful and effective, the study went further to compare the South African provisions to selected OECD countries in an effort to determine whether the tax incentive is in line with international standards as far as employer-provided bursaries and scholarships are concerned. This chapter looks at the overall findings of the study to align with the research objectives and to discuss any limitations to the study and possible areas of further research on the research topic.

### **5.2. Research objectives**

Chapter one of this study discusses the background of the study, describes the problem statement and its corresponding research objectives. This study contained one main objective which was to analyse how section 10(1)(q) of the Act which relates to employer-provided *bona fide* bursaries and scholarships currently used as a tool to address skills shortages, is provided as a tax incentive and to understand the effectiveness of the tax incentive by comparing it with similar incentives provided in foreign jurisdictions from a tax perspective. In order to address the main objective, three secondary objectives were included in the study; the secondary objectives will be discussed in detail below including concluding remarks on whether the objectives were met.

#### **5.2.1. Secondary objective one: discussion and analysis of section 10(1)(q) of the Act**

The first secondary objective was to discuss section 10(1)(q) of the Act's provisions on *bona fide* bursaries and scholarships and its evolution since 1962 to date including detailed discussion on the principles of salary sacrifice arrangements. Chapter two elaborated on this research objective through a thorough discussion of section 10(1)(q) of the Act including the evolution of the tax provisions from 1962 to date and an analysis of salary sacrifice arrangements in its capacity as a limitation to the effectiveness of section 10(1)(q) of the Act and to that effect, the first research objective was met. Chapter two found that section 10(1)(q) of the Act was introduced with the intention to promote skills development and education by lifting the tax burden on taxpayers who invest in education through an exemption on bursaries or scholarships received for the recipient as well as a tax deduction for the payer.

However, the effectiveness of the provisions has been largely limited by salary sacrifice arrangements due to the perceived abuse of the tax provisions by employers. This resulted in the amendment, deletion, and reintroduction of restrictions in the form of salary sacrifice arrangements with major events in 1991 when the salary sacrifice arrangement was introduced, 2006 when it was lifted and the reintroduction in 2021. The chapter concluded that looking at the provisions of section 10(1)(q) of the Act in its entirety, there is a lack of clarity on Government's intent for the tax incentive. This is because of the contradicting statements that Government provided over the years when making changes to legislation on section 10(1)(q) of the Act such as 'promotion of education and skills development', 'employer abuse of legislation' and 'anti-avoidance'. This provides a picture of the legislature's intentions shifting direction and in so doing, raising the question the effectiveness of section 10(1)(q) of the Act as a tax incentive.

### **5.2.2. Secondary objective two: tax incentives**

The second secondary objective was to discuss the theoretical principles of tax incentives including characteristics of a meaningful and effective tax incentive. In chapter three, tax incentives were discussed in detail including definitions, benefits, and disadvantages of tax incentives. In 3.4, the characteristics of a meaningful and effective tax incentive were discussed in theory and applied to section 10(1)(q) of the Act. The aim was to understand what makes a meaningful and effective tax incentive and in understanding this, apply the findings to section 10(1)(q) of the Act to determine whether it meets the characteristics and can therefore be deemed effective as a result. As such, it was determined that a meaningful and effective tax incentive must have an objective, be effective, be flexible yet stable, transparent, its effectiveness must be regularly monitored and it must safeguard against the potential for abuse or misuse. As a result, the research objective was successfully met.

Chapter three found that in determining whether section 10(1)(q) of the Act is a meaningful and effective tax incentive, it was concluded that the findings were inconclusive in 3.5. This was due to the fact that section 10(1)(q) of the Act met three of the six characteristics of a meaningful tax incentive. In this regard, it was determined that as a tax incentive, the tax incentive is objective (although the objectives seem to have changed over the years), its effectiveness could not be determined, it not flexible but is stable, it is transparent, does get monitored on a case-by-case basis and safeguards against abuse or misuse. As a result, the chapter concluded that due to the inconclusive nature of the effectiveness of the tax incentive, a comparison with foreign countries is necessary to determine if the tax incentive is effective from an international perspective.

### **5.2.3. Secondary objective three: comparative analysis with OECD countries**

The third secondary objective was to conduct a comparative study between South Africa and a selection of OECD countries on how the employer-provided scholarships are designed. In chapter four, the third and final secondary objective was addressed. In this regard, the tax policy on employer-provided scholarships by 30 OECD countries was outlined and compared to South Africa's section 10(1)(q) of the Act. Chapter four determined that of the 30 countries under review, 28 allowed an exemption of scholarships and of these 28 countries, 14 countries automatically excluded the exemption from applying of the scholarship is provided by an employer to an employee or their relative. Of the remaining countries, five were assumed to allow an exemption on employer-provided scholarships since there were no provisions within legislation to prove otherwise.

The rest of the countries allowed an exemption on employer-provided scholarships provided that certain conditions were met. These conditions include monetary limits, the scholarship fund must be largely made available to the general public, the parties must be dealing at arm's length without salary sacrifice components, and the scholarships must be granted on merit and approved by the relevant tax authorities. After analysing these and in comparison with South African legislation, it was determined that South Africa is in line with ten of the countries under the OECD study which allow an exemption provided that certain conditions are met and a further discovery that the South African provisions provide more relief than many of the countries under review. To that extent, chapter 4 met the third secondary objectives and concluded that section 10(1)(q) of the Act is aligned with some countries on an international scale regardless of the salary sacrifice arrangement limitations.

### **5.3. Conclusion**

The research question attempted to answer the question of whether section 10(1)(q) of the Act including its current limitations in the form of salary sacrifice arrangements, is a meaningful and effective tax incentive through applying the characteristics of a meaningful and effective tax incentive as outlined in section 3.4 and further comparing the tax incentive on an international scale with the tax policy on employer-provided scholarships by OECD countries in 4.2. The overall finding is that section 10(1)(q) of the Act may not realise its full effectiveness in the South African context due to salary sacrifice limitations; however, on an international scale, the provisions appear to provide more relief than those of 16 countries under the OECD study, thus placing them in a more favourable position.

In chapters two and three, it is evident that section 10(1)(q) of the Act is not fully effective in achieving its intended goal due to limiting the exemption to arrangements that do not have a salary sacrifice element. This is evident when considering industry responses when the reintroduction of salary sacrifice arrangements was first suggested in 2020. Industry argued against the proposal by considering the state of the economy given the Covid-19 pandemic and the limitations by employers who do not have the financial means to grant a bursary or scholarship unless if under a salary sacrifice arrangement as well as concerns that placing salary sacrifice arrangement limitations will have an impact on the country's skills development strategy. In addition, when applying the characteristics of an effective tax incentive to section 10(1)(q) of the Act, the tax incentive met half of the requirements thus concluding that it is not fully effective as defined.

However, as discovered in chapter four, on an international scale, section 10(1)(q) of the Act was determined as more meaningful and effective, to a certain extent, given that it is in line with some of the OECD countries. In this regard, section 10(1)(q) of the Act provides more relief in that it allows a tax exemption on employer-provided scholarships as opposed to 16 countries in the study. Furthermore, similar to the countries which allow a tax exemption on employer-provided scholarships, the conditions which must be met for the exemption to apply are reasonable and on the same spectrum with compared countries. These conditions include awarding the bursary and scholarship on merit, opening the bursary and scholarship to the general public, imposing monetary thresholds on the exempt amount and limiting the exemption to arrangements where there is no salary sacrifice arrangement. As such, on an international scale, South Africa seems to be more effective given its leniency in terms of the provisions.

The research study was intended to determine whether the *bona fide* bursary and scholarship tax incentive is effective and meaningful, that is, to determine if there is a balance between the anti-avoidance measures of section 10(1)(q) of the Act and the effectiveness of the tax incentive when comparing with the approach by OECD countries. The anti-avoidance measures in the form of salary sacrifice arrangements meet the sixth characteristic of a meaningful and effective tax incentive in that it ensures that the tax incentive safeguards against abuse and misuse. However, based on the financial status of many employers due to the pandemic, the salary sacrifice arrangements limitation result in many employers being unable to grant bursaries and scholarships thus unable to participate in the development of skills. This is since salary sacrifice arrangements were a means to enable employers to contribute towards skills development by offering bursaries and scholarships to employees and their relatives.

As such, while the anti-avoidance measures ensure effectiveness from an abuse perspective, in practical terms, these measures have an adverse impact on the skills development strategy due

to a lack of participation by the private sector thus affecting the meaningfulness of the tax incentive. On an international scale, the tax incentive was determined to be aligned with some of the countries' tax policies which provide a tax exemption on employer-provided scholarships provided that certain conditions are met and some of these conditions appear to take the form of anti-avoidance measures. In addition, due to their leniency, the South African provisions appear to be more effective on the international spectrum than locally given that many of the countries automatically disqualify the exemption where there is an employment relationship. In this regard, this study finds that there may be a level of balance between the anti-avoidance measures and the effectiveness of section 10(1)(q) of the Act when comparing the tax incentive to OECD countries.

#### **5.4. Limitations to research study**

The purpose of this research was to determine whether section 10(1)(q) of the Act is a meaningful and effective tax incentive through a discussion of the characteristics of a tax incentive and applying these to section 10(1)(q) of the Act as well as a comparative analysis of similar provisions by foreign jurisdictions to the South African tax incentive. This study did not look at section 10(1)(qA) of the Act which focuses on bursaries and scholarships granted to persons with disabilities, or focus on section 23(j) which discusses the tax deduction that is made available to employers for the costs of the bursaries and scholarships.

In chapter two, the research study did not look at provisions of the Act prior to 1962 as the focus was on the current tax Act, Income Tax Act no 58 of 1962, which was introduced in 1962. Furthermore, there was a lack of resources on industry comments on the changes to legislation from 1962 to 2020 as discussed in section 2.1.1 to 2.1.3. In section 2.2, there is a lack of official guidance from National Treasury and SARS on salary sacrifice arrangements and as such, guidance was sought from case law and industry comments. Furthermore, the discussion of salary sacrifice arrangements only focused on the tax principles through legislative provisions and court rulings and not the validity of a salary sacrifice arrangements considering factors outside of tax such as governance and administrative requirements.

Chapter three focused on tax incentives in general and due to a lack of clear definitions in the tax Act, guidance was sought from industry-based commentary and academic authors. In chapter four, challenges with translating foreign legislation were a contributing factor to the lack of findings on the tax treatment of employer-provided scholarships for some of the countries. Furthermore, outside of the individual countries' legislative provisions and the OECD study on scholarships, there was a lack of industry comments and academic authors from the participating countries

regarding the tax treatment of employer-provided scholarships to refer to and as such, the study interpreted legislation in its raw form for many of the countries.

### **5.5. Areas for future research**

Opportunities for further research could be the exploration of section 23(j) of the Act which allows a tax deduction for employers provided *bona fide* bursaries and scholarships to employees as mentioned in 2.1.5 are complied with; however the deduction is not allowed for bursaries and scholarships granted to the employees' relatives. Another area of possible research is expanding on 3.4.6 regarding the sixth characteristic of a meaningful and effective tax incentive, 'a tax incentive must safeguard against abuse or misuse' linking it to the anti-avoidance mechanisms. In addition, the OECD countries' tax policies outlined in 4.1 could be further explored in conjunction with 2.1.5 on allowable tax deductions by conducting a comparative study.

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## **ANNEXURE A**

### **1. Australia**

Scholarships granted to students for full time studying is exempt from income tax in Australia; however, the exemption will not apply where there is an employer-employee or potential employer-employee relationship between the payer and the student (OECD, 2017:227).

In this regard, the scholarship, which includes scholarship, bursary, educational allowance, or educational assistance, will be exempt from tax if:

- the recipient is a full-time student at a school, college or university;
- the scholarship is provided mainly and principally for educational purposes;
- the scholarship must be a government payment
- the scholarship must not come with a requirement for the recipient to work, meaning the scholarship must not be granted with a condition that the recipient will continue to work or is expected to work for the organisation funding the scholarship. If this is the case, then the scholarship will be fully taxable (ATO, 2022).

In this regard, where the sponsor is an employer, the scholarship is fully taxable in the hands of the student.

### **2. Austria**

In Austria, scholarships are tax exempt if they are not related to employment; in this regard, if the scholarship is granted by an employer to an employee, the scholarship will be taxable in the hands of the employee. Similar to Australia, Austria allows a tax deduction on training costs related to professional activity, therefore linked to employment. If the training costs are not linked to employment, the payer cannot claim a tax deduction (OECD, 2017:227).

### **3. Belgium**

In Belgium, scholarship income is subject to a tax exemption. The exemption will apply whether or not the training is job related (OECD, 2017:228). However, Articles 30 and 31 of the 1992 Income Tax Code provide that whether the scholarship is paid as a result of compensation for services rendered or under a subordinate relationship constituting an employment contract, the exemption will not apply and as such, the scholarship will be subject to tax (Brussels Commissioner, 2022).

#### **4. Canada**

In Canada, scholarships granted to individuals for non-research degrees in which the student earns a degree or diploma will be exempt from tax provided the studies are full-time. Limitations apply where the scholarship is granted for part-time enrolment; in this case, the exemption is limited to actual costs of tuition plus programme related material. Where the scholarship received is pertaining to education that is part-time, the scholarship exemption is limited to the value of tuition costs plus the costs of program-related materials (OECD, 2017:228).

However, the treatment in terms of employer-related scholarships varies based on the arrangement between the employer and employees. In this regard, the below is applied:

- Scholarships granted by employers are generally deemed to be taxable in the hands of the student unless the course or training is primarily for the benefit of the employer. In addition, the student must commit to repaying the employer for the cost of the scholarship if they do not meet the terms of their employment agreement.
- With regards to scholarships granted to employees' relatives and the parties are dealing at arm's length, the scholarship will be exempt from tax provided that the employer's salary was not reduced or used to partially fund the scholarship.
- Where a scholarship has been granted to a relative of an employee and the parties are not dealing at arm's length, the treatment will be as follows:
  - If the employee is not a shareholder of the employer, the scholarship will be deemed to be income in the hands of the employee and therefore taxable
  - If the employee is a shareholder of the employer, the scholarship will be deemed to be income in the hands of the employee-shareholder and thus taxable in their hands and the employer will not be eligible to claim the scholarship as a tax deduction (Canada Revenue Agency, 2020).

#### **5. Chile**

In Chile, only a tax exemption of scholarship income is available. In this regard, a scholarship will be exempt from income whether or not it is linked to employment (OECD, 2017:229). With regards to employment related scholarships, section 6bis in Article 31 of the Income Tax Law provides that scholarships granted by an employer to the children of employees will be exempt if the below requirements are met:

- The grant is in relation to family responsibilities and general company rules.
- The scholarship is available to all company workers.

- The amount if the scholarship does not exceed the equivalent of one and a half annual tax units (tax units are monthly monetary indicators determined by the Chilean tax authority), for early education or five and a half annual tax units for higher education as agreed in a contract.

In this regard, employment-related scholarships will be exempt if they are available for all workers, granted in relation to the general rules applicable to the workers and do not exceed the monetary threshold outlined above.

## **6. Czech Republic**

For the Czech Republic, the first benefit relates to a tax exemption on scholarships. In this regard, a scholarship that is awarded from the state, municipal and regional budgets, universities, public research institutions or legal entities which carry out secondary school or higher vocational education activities, will be exempt from tax. The exemption will apply even where the scholarship is job-related or not (OECD, 2017:229). However, section 4(k) of Act of the Czech National Council of Income Taxes no 586/1992 highlights that where the recipient of the scholarship is a member or employee of the above-mentioned legal entities, the exemption will not apply.

## **7. Denmark**

In Denmark, scholarships are treated as normal income and therefore taxable, and as such there is no tax benefit for the provision of scholarships. However, Denmark does allow a tax deduction on the interest charged on student debt (OECD, 2017:229).

## **8. Estonia**

In Estonia, there is an exemption on scholarship income from taxation. In this regard, scholarships which are granted by public authorities are exempt from tax. As such, where the scholarship is linked to employment, it is treated as normal income and thus taxable (OECD, 2017:229). The scholarship exemption will apply in the below circumstances:

- Where a school is funding the scholarship, the recipient must be a pupil or the student and enrolled in the school paying the scholarship or grant;
- If the scholarship is paid by the Education and Youth Authority;
- Where the entity funding the scholarship is a public institution, the scholarship must be granted to the winner of a public competition.

The exemption will not apply where the scholarship or grant is paid to a person who is related to the association.

In regard to employment related scholarship, the exemption does not apply if the scholarships and grants includes payments, which remunerate any work-related activities or if the person who received the scholarship receives the rights to work for the funding institution (ETCB, 2022). As such, if the person is related to the funder, including an employer-employee relationship, the exemption will not apply.

## **9. Finland**

In Finland, student grants are generally subject to taxation; however, there are exceptions to the rule. Scholarships which have been awarded by a public entity or from the Nordic Council will qualify for a tax exemption as long as it has been awarded for studies, academic or artistic activities. Scholarships which have been awarded by private entities will be exempt from tax but the amount will be limited to the total annual artist grant amount, currently to the amount of EUR 24 475. However, any scholarships which have been paid as compensation for work performed or linked to wages will be taxable in the hands of the recipient. As such, the scholarship cannot be a payment made as remuneration or in exchange for rendering a service (OECD, 2017:229; FTA, 2022).

## **10. Greece**

Scholarships are subject to a tax exemption in Greece. The exemption is applied where the scholarship awarded by the Greek State. The exemption is available whether the education is job-related or not. The law in Greece according to Article 6 of Law no 2238/1994 provides that scholarships are exempt from taxation if they are legally awarded by the Greek State, public entities or specific private charitable funds. The exemption is allowed provided that the scholarship is proven to be awarded for pursuing objectives which are beneficial to the Nation, or they are religious, artistic, philanthropic objectives. Scholarships which are funded by foreign States and organisations will also be subject to an exemption in Greece (European Commission, 2013; OECD, 2017:230).

The legislation does not contain provisions where the scholarship is granted by an employer, nor does it address scholarships granted to employees or the allowed institutions.

## **11. Hungary**

In Hungary, scholarship income is exempt from tax, the exemption applies whether the training is job-related or not (OECD, 2017:230). The Hungarian CXVII of 1995 Law on Personal Income Tax provides circumstances in which scholarships are exempt from tax. In this regard, sections 3 (tax-free public benefits) and 4 (tax free based on certain activities) provides that scholarships will be

exempt from tax if they are granted from a public benefit foundation, through a foundation founded by the President, awarded on the basis of the National Higher Education, if the studies are related to certain fundamental research, sports education etc. With regards to employer-employee related scholarships, section 4.15 provides that the exemption is limited to the equivalent of the minimum wage amount where a stipend is paid to a scholarship employee.

## **12. Iceland**

In Iceland, educational tax benefits are only available in the form of a tax deduction for educational expenses. The tax deduction applies for job-related education and training only (OECD, 2017:230).

## **13. Ireland**

Ireland grants an exemption for scholarship income. The exemption is applicable whether or not the training is job-related (OECD, 2017:230). However, the scholarship cannot be linked to employment with the sponsor. However, if the scholarship is awarded from a trust fund created by the employer for the sole purpose of awarding scholarships, the scholarship will be exempt provided that not more than 25% of the total payments made through the trust fund were “relevant scholarships”. Section 193 of the Taxes Consolidation Act (TCA) 1997 defines a relevant scholarship as a scholarship that has been granted to an employee or to a family member, dependent or household member of the employee by the employer. Therefore, if 75% of the scholarships awarded from the trust fund were awarded to individuals who are not connected to the sponsor, scholarships awarded to employees or their relatives will be exempt from tax (ITC, 2021).

## **14. Israel**

Scholarship income is exempt from taxation. Legislation provides that a scholarship which has been granted to a student or researchers during a course of study at an educational or research institution will be exempt up to a certain amount. The ceiling amount is currently capped at ILS 92 000 per academic year (OECD, 2017:231). With regards to employment related scholarships, section 29 of the Income Tax Ordinance, 1961 provides that compensation received as part of a sponsorship relationship which includes an obligation of the recipient to provide a service or fulfil a role will not be considered compensation for tax purposes. As such, if there is an employer-employee relationship between the parties, the scholarship remains exempt provided that it is within the ceiling amount.

## **15. Italy**

In Italy, scholarships are exempted from Personal Income Tax (“PIT”) but are subject to special schedule for Social Security Contributions (“SSC”). In this regard, SSC is levied against scholarship income at 17% for employee contributions if the employee has other income or 26.72% if the employee has no other income in which SSC is contributable (OECD, 2017:231). However, section 1(c) of Article 50 of the Consolidated Law on Income Tax no. 917 provides that income paid as scholarships for the purpose of studying or professional training if the recipient is bound by an employment relation with the funder will be treated as employees’ income and thus taxable.

## **16. Luxembourg**

Luxembourg provides an exemption on scholarship income in which the scholarships are exempt from PIT and SSC (OECD, 2017:231). Section 3 of Article 112 of the Amended Law of December 4, 1967, concerning Income Tax deemed payments made to scholarship foundation as special expenses provided that there was no kinship, that is, parent-child relation, clause. There are currently no provisions in legislation which address employer provided scholarships.

## **17. Mexico**

In Mexico, a scholarship is subject to a partial tax exemption limited to a monetary threshold. In this regard, the scholarship income and other taxable wages should not exceed 7 times the minimum wage amount. If the sum of the scholarship income and wages is higher than the capped amount, the exemption will be limited to one annual minimum wage but cannot be lower than 7 minimum wages (OECD, 2017:231). Furthermore, section VIII in Article 93 of the Income Tax Law, 2013 provides that no income tax will be paid for educational scholarships granted to workers or their children which have been granted in a general manner as per legislation or employment contract. As such, employment related scholarships are exempt from tax subject to the above monetary threshold.

## **18. Netherlands**

The Netherlands grants an exemption for scholarship income. In the Netherlands, scholarships are granted in the form of a conditional loan subject to the student completing a course of study or degree within a specified period. Therefore, if the university education studies are completed, the loan does not need to be repaid. It is further provided that the scholarship income is exempt to the extent that the training is not job related. Therefore, if the training is job-related, then the scholarship is taxable (OECD, 2017:232). This is further confirmed in Article 6.28 of Income Tax Act 2001 which provides that the exemption will not apply where the funding is linked to the person’s employment.

## **19. New Zealand**

In New Zealand, it is provided that a scholarship received by students who are enrolled in a four-year degree is exempt from tax. This specifically relating to the Course Participation Allowance as well as scholarships made under the Education Act 1989 (OECD, 2017:232). However, CW 36 of the Income Tax Act specifically provides an exception to the exemption where the student receives a student allowance in accordance with Section 645 of the Education and Training Act 2020. In this regard, the student allowance will be taxable however the rest of the scholarship and other scholarships remain exempt from tax.

## **20. Norway**

Norway allows an exemption of scholarship income if the income is not related to employment. Therefore, if the scholarship is related to employment, the tax exemption will not apply (OECD, 2017:232). In this regard, a scholarship will not be exempt from tax if the scholarship is:

- closely related to services or work that has been performed or rendered and the benefit that has been achieved or gained to the extent that it would be deemed that the scholarship was a benefit gained through work, or
- if the scholarship is paid as personal support that the recipient is entitled to according to the law or an agreement (NTA, 2019).

In this regard, the taxability of the scholarship is linked to the benefit or service that the recipient would render to the funder in exchange for the scholarship or purely on entitlement.

## **21. Poland**

In Poland, income earned by student is subject to tax; however, scholarship income is exempt from tax. The exempt will apply even where the training is job-related (OECD 2017:232). Article 21 of the Act of 26 July 1991 on the Income Tax on natural persons provides circumstances where scholarships will be subject to an exemption. In this regard, scholarships provided to Polish citizens living outside of Poland, scholarships received for the purpose of science, art, doctoral degrees, scholarships received from the local government and public benefit organisations up to PLN3800 will be exempt from income tax. The Act does not provide circumstances where the scholarship is granted an employer to an employee.

## **22. Portugal**

Portugal subjects normal income received by students to tax; however, scholarship income is tax exempted where or not the training is job-related (OECD 2017:233). Section 5 of Article 12 of the

Personal Income Tax Code provides that a scholarship granted to sports practitioners by the Olympic committee will not be subject to tax. Currently, there are no provisions which address circumstances where the scholarship is granted by an employer to an employee.

### **23. Slovak Republic**

The Slovak Republic provides that public grants and scholarships awarded from the state budget, granted according to a special regulation, corporate scholarships granted to university students, and scholarships granted by foundations and civil associations, non-profit organisations and non-investment funds will be tax exempt (OECD, 2017:233). The exemption will apply whether or not the training is job-related. Section 9(2)(j) of the Law on Income Tax 595/2003 provides that the above scholarships will not be exempt if they have been granted as compensation for loss of income or if it relates to performance of employment activities or derived from self-employment income. Therefore, if the scholarship forms part of employment, it will not be exempt from tax.

### **24. Slovenia**

Slovenia provides a tax exemption for scholarships provided that they meet certain requirements. Furthermore, the amount of the scholarship that is exempt from tax is the equivalent of the minimum wage amount (OECD 2017:234). Article 25 of the Personal Income Tax Act ZDoh-2 provides regulations pertaining to the scholarship exemption. In this regard, a scholarship will be exempt if:

- it has been provided to an enrolled pupil or student for full time study and training purposes if the scholarship is financed from a fund budget or received from a foreign country; and
- the scholarship is paid to cover education costs such as tuition fees, accommodation, and transportation costs to the person who is studying.

However, the above-mentioned scholarship must not be a staff scholarship or granted to a person in connection with the performance of work or services rendered by the recipient to the sponsor. In this regard, the parties must not have a former, current, or prospective employment relationship. If this is the case, the exemption will not apply.

### **25. Spain**

In Spain, scholarships are partially exempt subject to monetary thresholds. In this regard, a scholarship that is deemed as a public grant or scholarship will be exempt if it has been granted to pursue education and capped at EUR 3000 per year to a maximum of EUR 15 000 for four-year university degrees. The exemption is available even where the training is job related (OECD

2017:234). Paragraph (j) in Article 7 of the Law 40/1998 on Personal Income Tax and other Tax Regulations, provides those public scholarships which have been received for the purpose of pursuing studies at all grade levels up to and including a bachelor's degree or equivalent will be exempt from tax.

However, paragraph (h) of Article 16 deems scholarships which have been granted in relation to personal work or labour or statutory relationship as taxable income and therefore subject to tax. In this regard, Spain allows an exemption of scholarships from tax provided they fall under public grants and are not paid in relation to employment.

## **26. Sweden**

The Swedish law provides that scholarships will be exempt from income tax if they have been granted for study purposes. However, the exemption will not apply where the scholarship is paid as part of the recipient's remuneration (OECD 2017:234). According to the Swedish Tax Agency (2022), scholarships which have been granted for education and for reasons other than education purposes are tax free; however, if the scholarship is paid by an employer or client or require a form of compensation for work performed by the recipient, it will be fully taxable and therefore no exempt.

## **27. Switzerland**

Switzerland provides a tax exemption for scholarships granted for furtherance of education and professional training. The scholarship exemption will apply even where the training is job-related (OECD, 2017:234). Paragraph (a) in Article 83 of the Federal Direct Tax Law of 1990 specifically excludes from taxable benefits, income which is linked to education and training for professional purposes which has been paid for an employee by their employer. As such, if the sponsorship is covered for professional training or continued education by an employee, the sponsorship is not deemed to be taxable and therefore exempt from tax.

## **28. Turkiye**

Turkish tax law provides an exemption on scholarships granted to students to enable them to study at an educational institution except where the scholarship is granted to apprentices (OECD, 2017:235). Article 28 of the Income Tax Law no. 193 provides that the exemption will apply where the scholarship covers accommodation, subsistence, and collection expenses for enrolment in public and private educational institutions. Where the scholarship is granted by an employer to children of employees, the exemption will apply if the below requirements are met.

- The students are studying in Turkiye,

- the expenses cover food, accommodation, and collection expenses,
- the payment is made to the student exclusively; and
- there is no employer-employee or potential employer-employee relationship between the sponsor and the student (ATO, 2010).

As a result, where there is an employer-employee relationship between the paying sponsor and the student, the exemption will not apply.

## **29. The United Kingdom**

In the United Kingdom, scholarships awarded for educational purposes are not subject to tax unless there is an employer-employee relationship between the parties (OECD, 2017:235). However, the United Kingdom does allow an exemption to scholarships granted by employers provided certain conditions are met. Section 776 of the Income Tax (Trading and Other Income) Act 2005 sets out circumstances where scholarships made by an employer for an employee's studies will not be subject to tax. In this regard, the below requirements must be met:

- The employee must be enrolled for a full-time course, including sandwich courses.
- The employee must be enrolled at the educational institution for at least one academic year and is required to attend at least 20 weeks during that academic year.
- The educational institution must be recognized university, college or similar educational establishments and must be open for members of the public to enrol and the institution must offer more than one course of study.
- Commencing on or after 1 September 2007, the payments for the courses such as accommodation, subsistence allowances, travelling allowances, etc., but excluding tuition fees, payable by the employee must not exceed GBP 15 480 for the academic year (HMRC, 2022).

If the above requirements are met and the scholarship is covered by the employer, the scholarship will be exempt from tax.

Furthermore, scholarships which are granted to relatives of employees by the employer will be subject to tax and thus do not qualify for a tax exemption. This is the case based on the "by reason of employment" principle. In this regard, the employee will be taxed on the amount of the scholarship granted to their relative whether the scholarship was a direct grant or by arrangement with a third party in association with the employer. However, an exception to the rule applies where the scholarship remains exempt. In this case, section 776 the Income Tax (Trading and Other Income) Act 2005 provides that the tax exemption will apply if the scholarship is funded from the employer's trust fund or separate scheme for full-time education and:

- during the relevant tax year, up to 25% of the scholarship awards is paid to employees' relatives to study; and
- the scholarship is not provided by reason of the employee's employment, that is to say, the scholarship would have been awarded to the person had they not been related to the employee, therefore, based on merit (HMRC, 2019).

From the above, it appears that the United Kingdom bases the exemption of scholarships to relatives on merit and accessibility of the funds to the general public.

### **30. United States**

The United States provides that scholarships be treated in two different ways: for US citizens studying abroad and for studying in the United States. If the student is studying outside of the United States, the scholarship exemption does not apply and as such is taxable. Where the student is studying in the United States, the scholarship will be exempt from costs which cover direct educational expenses such as tuition fees, books, supplies and the relevant equipment. Any costs paid to cover expenses outside of the allowed educational expenses will be taxable (OECD, 2017:235).

However, where the scholarship is granted and represents compensation for services rendered to the sponsor, the scholarship, fellowship, or grant will not be exempt from tax and thus fully taxable (IRS, 2022b). Therefore, the presence of an employer-employee relationship disqualifies the scholarship from the exemption. However, there are circumstances in which employer-provided scholarships will be exempt if they are granted to employees and their relatives. In this regard, a ruling can be requested from the Internal Revenue Service ("IRS") to exempt the scholarship provided that the below requirements are met.

- The employment related benefit and preference must apply only for the initial qualifying criteria;
- the selection of candidates must be based on criteria outside of employment related factors and the process must be controlled; and
- the probability that employees or their relatives will receive the scholarship grant must be limited (IRS, 2022a).

Therefore, if the selection process is transparent, unbiased, and limited to factors outside of employment, the employer can apply for a ruling from the IRS to allow the scholarship to remain exempt even if it has been granted to employees or their relatives.