

WHEN DOES AN ADVANCE BECOME TAXABLE? By Jonathan Hore

I know quite well that Tax is not one of the easiest subjects or professions that one can come across. That I can tell you. As tax is brought into effect through legislation, this leaves a lot of room for various divergent interpretations. At times, different opinions just crop up simply because there is no guidance from the tax authority regarding that matter. One of the issues that keeps cropping up is when employers should start taxing advances. In other words, when does an advance become a loan, which as you may know, has tax implications? That's the issue I will analyse in today's article. In this article, words importing the masculine shall be deemed to include the feminine.

WHAT IS AN ADVANCE?

In an employer-employee relationship, an advance refers to a payment made to an employee before the amount has been earned by them. This usually applies in cases where an employee has an emergency and then requests the employer to give them an advance of their future salary. Let's say an employee has a wedding in July 2018, they may request for an advance of their August 2018 salary in July 2018. The employer will basically be lending the employee money and such money should be paid back. Let me be clear and state that a salary advance is not taxable in the month in which it is paid over. The employer will tax it in the month in which it is earned.

An advance is technically a mere short-term loan.

In other scenarios, advances are granted for a specific reason such as to allow an employee to travel to further the employer's business. Such advances may be granted to cover travelling, accommodation and communication costs whilst the employee is on business. After the business trip, the employee is usually required to account for the advance and pay back any excess not used for business. The concept of an advance is therefore similar whether it is a salary advance or an advance to cover expenses.

HOW LONG IS AN ADVANCE?

This is the big question that is usually asked regarding advances. The reason why the question crops up that often is that the advances' policies differ per each employer. Some employers' policies require that advances be repaid in 3 months whilst some prescribe repayment periods of 12months. The main reason why professionals such as tax and human resources consultants want to know how long an advance should be is because the longer the period, the advance may end up being a loan, which has tax consequences.

I will be upfront with you and state that the matter is further complicated by the fact that the Income Tax Act does not have a definition of what constitutes an advance. To be honest, I don't think I have ever seen that word in the said Act. So, employers find themselves with no legal backing to distinguish an advance from a loan. On the other hand, tax authorities usually provide guidance when something is not specifically covered in the applicable law. BURS has not issued any public notice through what they call Divisional Guidance Notes or rulings on advances. Some taxpayers whom I have met have told me that they got rulings from the tax authority stating that an advance runs for not more than 12months but I have not seen such letters, so don't bank on that.

WHAT IF IT'S A LOAN?

Well, if an employer grants a loan to an employee, they should consider whether tax should be determined on such a loan. The determining criterion is whether the interest that the employer charges the employee would be less than the rate set by BURS per each tax year.

For the 2018 tax year, we are advised that BURS' rate is 5.5%, meaning that an employee who pays 0% interest on a loan is supposed to be taxed as he enjoys a benefit of 5.5% less 0%, which is 5.5%. In such cases, assuming that the employee accessed a loan of P1m, he will be taxed on P 55 000, being P 1m x (5.5%-0%). The P 55 000 will constitute part of the employee's annual taxable income.

However, if an employee pays higher interest to the employer than the BURS' rate, then no benefit is taxed in his hands. This would happen in instances where the employee is charged interest of say 8% on the loan. In conclusion, based on the absence of a legal definition or guidance on advances, I would advise anyone who has an issue regarding how long an advance should be to seek a ruling from BURS. I am however of the view that a public ruling by BURS would help as it will be accessible by all taxpayers.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him.