

# Tax and the ethics of paying back the money

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Companies can't just pretty up their board of directors with figure heads, appointed for their reputation and the contacts that they will bring to the particular organisation. Certainly a company director may have been a revered academic or a sporting celebrity, but they need to upskill in what is expected of them as directors before they take up the position.



Image source: Getty/Gallo

The Companies Act 71 of 2008 sets out a broad range of duties for company directors. Specifically, section 76(3), which provides the following with respect to the standards of care that company directors must follow in the execution of their duties.

A director of a company, when acting in that capacity, must exercise the powers and perform the functions of director:

- In good faith and for a proper purpose;
- In the best interests of the company; and
- With the degree of care, skill and diligence that may reasonably be expected of a person:
  - Carrying out the same functions in relation to the company as those carried out by that director; and
  - Having the general knowledge, skill and experience of that director.

In other words, a director needs to act in the best interests of the company but, very importantly, it is vital that one acts with the requisite knowledge and skill that a company director is presumed to have. With this imperative placed on company directors to be scrupulous, the following question arises.

*If a director is paid a bonus based on the expectation that he or she will render a certain level of performance, but the required performance is not rendered, should not the bonus be repaid to the company if the director has not delivered?*

It is clear if the required performance demanded by the company and/or shareholders, said director must repay the bonus. This should not even be something which the remuneration committee should be requesting or demanding from the director. An ethical director would do the right thing without being asked.

What makes the question more interesting and the predicament so much more difficult is where large bonuses have been paid to top executives and company directors in well-known public, private and state-owned entities and through various disclosure the evidence coming to light that the basis for paying these were incorrect.

The decision to do the right thing in these circumstances goes to the core of being a responsible director, not just ethically, but also from a Companies Act perspective.

Incentives and bonuses approved by a board on incorrect, incomplete or, even worst, fraudulent information, must be recouped.

## **There is no tax disadvantage to reimbursing bonuses**

If one were to put forward the notion that company directors and executives needed to reimburse performance-related bonuses that should never have been paid in the first instance, the following question would be asked: “I’ve already paid a sizeable sum of tax on this bonus. Will I get this back if I repay it?”

In 2009, Section 11 (nA) was introduced into the Income Tax 58 of 1962 to allow a taxpayer to take a deduction of any amount into account - which is refunded by the taxpayer— when calculating taxable income in the year of assessment that the amount is refunded.

This only applies if that amount had been previously included in his or her taxable income.

This means that should a company director be required to pay back a bonus, he or she will be able to claim back the tax paid on this bonus – or a portion thereof – in the fiscal year when the repayment has been done.

This has always been one of the principles of our tax system, that a taxpayer should not be taxed where there is no net enrichment, and we have never encountered a problem with SARS to allow this deduction where done on a first-time accurate basis.

Thus, from a governance and tax perspective there appears to be no reason why directors should not be required to pay back bonuses where the simple fact is later established that it was improperly paid in the first instance.

Despite this, there are very few (if any) company directors who do, in fact, repay these monies.