
BULLETIN

Considerations Regarding International Employee Benefits and South Africans Working Abroad Post 2020

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Significant criticism has been levelled at the South African Revenue Services (SARS) and National Treasury given the amendment to the income tax exemption on earnings from certain foreign employment, which commences on 1 March 2020. The main thrust of this criticism has come from South Africans who are ordinarily resident for tax purposes and are i) permanent employees residing in low or no tax jurisdictions or ii) contract workers who spend much of the year working abroad in foreign territories. The inference being that these individuals will move from a position where they enjoy an exemption on their foreign earnings i.e. a no income tax environment to a high tax environment, which could have significant implications for their financial affairs and way of life.

Notwithstanding the obvious implications, much of this criticism hasn't taken into account the recommendations and guidance provided by SARS and National Treasury, which was published in their joint Report¹ to the Standing Committee on Finance in Parliament.

The Report was a result of a detailed consultation process and sought to balance the needs of the affected individuals and the needs of the fiscus. This is demonstrated by the recommendations to delay implementation of the revised legislation to 1 March 2020 to give individuals more time to prepare. The introduction of 1 million Rand annual exemption on foreign remuneration provides a high degree of relief to high earners with mid to low earners continuing to enjoy tax-free foreign remuneration.

However, the report went further with additional recommendations being made including the option for individuals to adjust their contractual arrangements and to consider contributions to pension schemes. In the next part of this bulletin, we consider what is meant by "adjustment" of a contract and how this and contractual pension obligations, by an employer, can assist in normalising one's affairs and subsequent impact of the pending legislative change.

Current Remuneration

For a large majority of South African expatriates or contract workers with foreign employment earnings is the fact that they live in a zero tax or tax-exempt environment. As such, there has been little or no incentive to opt for anything but a cash-based remuneration package. However, the wisdom of such packages becomes questionable when brought into the auspices of taxation post 1 March 2020, as packages that maximise earned income takes no account of routinely used mediums for providing relief and as such attract the highest levels of taxation.

¹ Draft Response Document on Taxation Laws Amendment Bill, 2017 and Tax Administration Laws Amendment Bill, 2017, 14 September 2017

Rebalancing of Employment Benefits

The official response to Comment 3 of Point 2 of the Report specifically refers to the option of 'adjusting contracts' as a mechanism to assist in addressing the pending tax burden higher earners are going to face.

Given the context of the report and the concern raised through the consultation process, the point being made, in the report, is that by adopting a different approach towards employment benefits, such as membership to a non-contributory occupational pension, as opposed to cash only packages, the employer may assist in normalising the employees tax position.

However, in order to achieve a more balanced approach to employment benefits, employees will have to forgo the current practice of 'cash only salaries' and make certain sacrifices to their remuneration, in order to partake in more traditional arrangements and brings equilibrium to their employment contracts.

Considerations In respect of Employee Benefits

The structuring of employment contracts to provide a degree of tax efficiency is not uncommon. Under South African law, the best authority was provided via two specific cases that appeared before the Tax Court^{2&3} where the courts confirmed it was lawful to enter into agreements which assisted in balancing tax, income and benefits as explained in one of the judgments:

"...is not uncommon in commercial practice. Employers and employees are entitled to structure salary packages as it suits them, and they are entitled to do so to achieve maximum tax acceptance... It is accordingly quite lawful for an employee to sacrifice salary in return for some quid pro quo from the employer which has the effect of reducing the employees tax liability"

This doctrine was further confirmed in the Supreme Court of Appeal, the highest court in South Africa, on 30 November 2015. The judgement was delivered by a full bench of five judges with no judges dissenting the final judgement and thus provides confirmation on the principles of structuring salary packages⁴.

The Application of Salary Structuring

Whilst the concept of salary structuring provides a mechanism to address some of the imbalance of 'cash only salaries' post 1 March 2020, it requires the employer to be willing to enter negotiations with the employee. Furthermore, such negotiations and subsequent agreement must rigorously observe the appropriate procedures and requirements under South African Law and the resulting arrangement must be robust, not only in terms of its form and substance, but also the implementation and operation of such arrangements.

It's fair to say that, where salary structuring arrangements have not provided the expected benefits, it has been as a direct result of inadequate documentation, lack of agreement between the employer and employee and the failure to follow formalities, and not as a result of the concept of salary structuring.

Pensions as an Option

Of the different benefits which may be provided by way of salary structuring, one of the most common is a contractual obligation on the employer to make provision for retirement in respect of services rendered by the employee. Apart from the obvious benefit of future financial security that pensions provide the employee, South Africans working abroad also stand to benefit from an income tax exemption on foreign pension income⁵. Such exemption applies to the payment of pension benefits where their source was from contributions made outside of the Republic as consideration for past employment outside of South Africa.

² ITC 1663 61 SATC 363

³ ITC 1682 62 SATC 380

⁴ Anglo Platinum Management Services v C:SARS (20725/2014) [2015] ZASCA 180

⁵ (INCOME TAX) 25 (Issue 2) DATE: 16 March 2017 ACT : INCOME TAX ACT 58 OF 1962 SECTION : SECTION 10(1)(gC)(ii) SUBJECT: EXEMPTION - FOREIGN PENSIONS)

As such, the provision of a pension could have a meaningful bearing on South Africans who derive their remuneration from outside of South Africa as it means that in retirement, their foreign pension will be exempt from tax, based on current tax legislation, provided the contractual obligations were structured appropriately and other tax considerations were met.

This highlights the importance that governments place on pension provision and their role in reducing the financial burden on the state by providing incentives for individuals to build retirement provision either directly or indirectly.

Conclusion

A lot of emphasis has been placed on the potential tax burden that South Africans working abroad will face with effect from 1 March 2020, without paying real attention to the detail in the output from government consultation. The new foreign remuneration exemption regime, potential to adjust foreign employment contracts to provide a better balance of benefits, and exemption on income from foreign pensions provides a means of normalising earnings and easing the burden of the amended legislation.

However, unlike tax exemptions where the outcome is clear, salary structuring requires specialist attention in order to meet the requirements as set out in South African case law and anyone who wishes to consider 'adjusting their contracts' as noted in the Government consultation, should only do so with specialist independent advice from practitioners who have experience in such matters.

A South African Expatriate's world will change with effect from 1 March 2020. However, for many the exemptions and options available to them will mean the transition to a post 1 March 2020 environment will not be as onerous as perhaps first envisaged, but South African Expatriates need to start to finalise their affairs, as time is running out.

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**EXTRACT FROM THE REPORT,
COMMENT 3 AND RESPONSE.**

COMMENT: INDIVIDUALS AND HOUSEHOLDS MADE THE DECISION TO WORK AND LIVE ABROAD BASED ON THE CURRENT TAX TREATMENT, WHICH HAD BEEN IN PLACE SINCE THE INTRODUCTION OF THE RESIDENCE BASED SYSTEM OF TAXATION IN 2001. IT SEEMS UNFAIR THAT THERE WILL BE SUCH A SUDDEN AND LARGE CHANGE IN TAX LIABILITIES IN ONE YEAR, ESPECIALLY IF TAXPAYERS MADE PLANS ACCORDING TO A THREE TO FIVE-YEAR CONTRACT.

RESPONSE: PARTIALLY ACCEPTED. TO ALLOW GREATER TIME FOR INDIVIDUALS TO EITHER *ADJUST THEIR CONTRACTS* OR THEIR CIRCUMSTANCES AND TO FINALISE OR FORMALISE THEIR TAX STATUS, IT IS PROPOSED THAT THE EFFECTIVE DATE FOR THIS PROPOSAL IS EXTENDED TO 1 MARCH 2020.

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